

Testing Your Business Idea

Adapted from "Will It Fly? The Idea Tester" by Carla Langhorst.

Go to www.smallbusinesssolver.com for more information.

What do you do when you have several business ideas and you don't know which one to pick? How do you know if your great idea is going to work? If you don't want to spend weeks researching your idea and developing a full business plan, try this quick test.

- **Outline your Idea:** The important thing here is to make sure your business idea meets a genuine need. If there is no need, you will not have any customers. If the idea doesn't meet a need, stop here.
- **Run the numbers:** The numbers must show a profit. If you can't even show a profit on paper, you definitely won't show a profit in real life.
- **See if it fits in your life:** Can you afford the time and money to start this business? Are you realistically at a place in your life where you can afford to take the risk to start this business, or would you be better off taking a job and saving some money/paying down some debt before you start the business?

Outline Your Idea

What is your basic product/service?

1. What is the need you are fulfilling? Start with a need (pain) – not a product, service, or feature. Ask 10 people if there is a need for your offering.
2. What is your offering? What is your product and/or service? Does it fully meet the need you identified above? Can you provide an additional product or service that will fully meet the need? Is someone else already providing a similar offering?
3. What is your competition? Understand your competition and their strengths and weaknesses. Create an offering that adds value in a way your competition doesn't. Can you ensure that it is difficult for competitors to copy your offering?

What is the supporting business model?

A business model defines how the product or service is delivered: store front, direct marketing, business-to-business, web-based, trade-show based, bait and hook, auction, franchise, low-cost, service quality, multi-level marketing, subscription, etc.

Run the Numbers

If the idea cannot make money, there is no sense moving forward. You will need to do some research and make some estimates.

How much will it cost to start this business? (Cost) If you were going to start this business tomorrow, what would you need? Fixed costs are those business costs that are incurred even if you don't sell a single product or service: business registration, legal and accounting fees, marketing costs, building or office rent, furniture, salaries, equipment, office supplies, utilities, insurance, vehicles, etc. Try to limit your fixed costs. *For a start-up business, every dollar saved in fixed costs increases your chance of profitability.*

Cost of Being in Business (Fixed Costs)

Item	\$ Per month	\$ Per year
Business registration		
Legal/accounting fees		
Marketing		
Office (rent, equipment, furniture, computer, printer, supplies)		
Warehouse (rent, equipment)		
Factory (rent, equipment)		
Research and Development (prototype, testing)		
Salaries		
Utilities		
Insurance		
Interest		
Other		
TOTAL		

How much money will be made on each sale? (Margin)

Profit margin is the difference between what it costs you to deliver your offering and what you can sell it for. How do you figure out what your cost of one sale is?

Cost of Sales (variable costs)

Items required for one sale	\$ Amount
Materials (raw materials, components, or wholesale product)	
Direct labour (labour to make, sell, or distribute your product – don't count salaries because you've already included them in fixed costs)	
Shipping (pick and pack, storage, shipping)	
Sales (commissions, sales tools)	
TOTAL cost to make one sale	

Once you know what your costs are per sale, then you have a better idea of the price you must charge. Then you need to compare that price to the going price in the market place for similar products/services (or ask 10 potential customers if they would pay that price for your offering).

Profit margin per one sale = price per one sale – cost per one sale.

How much must be sold in order to pay off the initial investment? (Break even)

The break even point is equivalent to the number of sales you'll need to pay off all your costs of being in business.

Break Even = cost of being in business/profit margin

Break Even

Description	Calculation	\$
Total cost of being in business (fixed costs)	Your total fixed costs in the table above	
Price per one sale	The price you will charge per sale	
Total cost per one sale above	What it costs you per sale (variable costs) in the table above	
Profit margin per one sale	Your profit margin in \$ above	
Break even yearly target	Total cost of being in business/profit margin	
Break even monthly target	Break even yearly target/12	
Break even weekly target	Break even yearly target /50	
Break even daily target	Break even daily target/250	

These calculations will help you:

- Plan your marketing strategies. If you only need 3 major sales a month to break even, you can target a niche market. If you need 1,000 customers a day, you need to figure out how to reach that many customers.
- Plan your price point. You may need to raise prices in order to make a profit.
- Examine ways to cut fixed or variable costs
- Realistically assess how much financing you'll need for your business

Assess Your Lifestyle

If your business idea has passed the tests on meeting a need and making a profit, then move on to see if it fits your lifestyle. Your business idea must fit:

1. Your values and passion
2. Your strengths and weaknesses in business skills such as sales, marketing, technology, operations, accounting, business law, and human resources. If you don't have these skills, you'll have to buy them.
3. Your salary expectations and financial rewards. The typical small business does not make a profit in its first year. Can you survive without income for a year? Even when your business is making some money, is it enough to pay your bills and debts?
4. Your expectations for work/life balance and the time you have to commit to your business. The average self-employed person in Canada works 50 hours a week – more when starting up a business. Can you take that much time away from your family and personal life?

The Test is Over

Did your business idea pass? If it did, you should develop a complete business plan.