

University of Economics, Prague

# **Master Thesis**

University of Economics, Prague  
Faculty of Business Administration  
Field of Study: International Management



Title of the Master Thesis:

## **Comparison of Business Plan and Business Reality: Design Towels Entering the Czech Market**

Author of Master Thesis:  
Supervisor of Master Thesis:

Bc. Miroslav Tabernaus  
prof. Ing. Jiří Dvořáček, CSc.

## A f f i r m a t i o n

I hereby affirm that I created the Master thesis on topic  
*„Comparison of business plan and business reality: Design Towels entering  
Czech market“*  
alone and with use of literature and information, which I properly cite.

In Prague, October 10th, 2011

Signature

**Title of Master thesis:**

Comparison of business plan and business reality: Design Towels entering Czech market

**Abstract:**

The targets of this Master thesis were to analyse the mistakes that an entrepreneur tends to make when creating a business plan, and make recommendations on how to avoid these mistakes. The method used was empirical learning, i.e. the author has created a business plan, started the new venture, and six months later analysed the deviations of business plans from the business reality. As the main reasons for deviations were named poor market research, no contractual agreements on minimum performance of a business partner, mistakes in an internet research of competition and of legal requirements, and over-optimistic expectations. The recommendations to new entrepreneurs also included creation of an assumption tree, a detailed sales plan, scenarios for normally unexpected situations and finding ways to avoid high fixed costs in the beginning. The overall finding was that business planning is a worthwhile activity.

**Key words:**

business plan, entrepreneur, start-up, mistakes, business reality

**Název diplomové práce:**

Srovnání podnikatelského plánu a podnikatelské reality: vstup Design Towels na český trh

**Abstrakt:**

Cílem této diplomové práce bylo analyzovat chyby, které podnikatelé dělají při vytváření podnikatelského plánu, a doporučit způsoby, jak se tímto chybám vyhnout. Metoda, použitá pro zkoumání, byla empirické učení, kdy autor vytvořil podnikatelský plán, začal nový podnik a po šesti měsících analyzoval odchylky plánu od podnikatelské skutečnosti. Za hlavní příčiny odchylek byly pojmenovány nedostatečný průzkum trhu, neexistence smluvních ujednání o minimálním požadovaném výkonu obchodního partnera, chyby v internetovém průzkumu konkurence a právních náležitostí a příliš optimistické očekávání. Doporučení začínajícím podnikatelům též zahrnovali vytvoření stromu předpokladů, detailního plánu prodeje, scénářů pro jinak neočekávané situace a vyhnutí se fixním nákladům v začátcích. Celkové zjištění práce je, že vytvoření dobrého podnikatelského plánu se vyplatí.

**Klíčová slova:**

podnikatelský plán, podnikatel, začínající podnik, chyby, podnikatelská realita

## List of shortcuts

<b>B2B</b>	Business to Business
<b>BCG</b>	Boston Consulting Group
<b>COGS</b>	Cost of goods sold
<b>CZK</b>	Czech crown (currency)
<b>E-shop</b>	electronic or internet shop
<b>EU-27</b>	27 states of the European Union (as of 2011)
<b>EUR</b>	Euro (currency)
<b>FDI</b>	Foreign Direct Investment
<b>g/m<sup>2</sup></b>	grams per square meter
<b>ICC</b>	International Chamber of Commerce
<b>IKEA</b>	Ingvar Kamprad Elmtaryd Agunnaryd (a retail store)
<b>IT</b>	Information Technology
<b>NPD</b>	New Product Development
<b>R&amp;D</b>	Research and Development
<b>SWOT</b>	Strengths, Weaknesses, Opportunities, Threats
<b>TRIPS</b>	Trade-related Aspects of Intellectual Property Rights
<b>USP</b>	Unique Selling Proposal
<b>WOM</b>	Word of Mouth
<b>WTO</b>	World Trade Organization

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## Introduction

This Master thesis entitled „Comparison of business plan and business reality: Design Towel entering Czech market“ is analyzing the mistakes that starting entrepreneurs make in their business plans. On an empirical example of a real start-up company, the thesis compares the assumptions made by an entrepreneur in the business plan, prior to starting the business activity, with the reality of the new venture six months after it had started. The thesis then offers recommendations to the new entrepreneurs, based on the analysis of both the wrong and the correct assumptions from the business plan. Moreover, it suggests to the entrepreneurs what to prepare for in the first six months of business activity, based on the empirical evidence from the investigated new venture.

According to the statistics, in the European Union, 75 % of new ventures go bankrupt within the first two years of existence, and 95 % within the first five years.<sup>1</sup> The author assumes that there is an insignificant number of „suicidal“ entrepreneurs, in the sense that if their business plan shows that the venture is going to go bankrupt within two years, they will start it anyway. This must mean that 75% of entrepreneurs make a mistake of crafting an inaccurate, over-optimistic or otherwise biased business plan, which is then proven to be wrong within the two-year horizon, by the real circumstances of the entrepreneur's new venture.

The target of this Master thesis is to map the mistakes that an entrepreneur tends to make when crafting a business plan, assuming the events that will happen, sales that will occur, competition that will act, or problems that will be solved. Its target is to help starting entrepreneurs make business plans that will count with various possibilities of action and be closer to the reality. In the Theoretical part, the author provides a review of the literature, on whether the business plan is useful and worth the efforts or not. Then the author crafts a business plan of the company Design Towels, using available sources of literature for decisions on the right strategies of foreign market entry, legal considerations of design protection and importing and exporting, and the marketing strategy.

In the Practical part, the author returns to the initial business plan from the Theoretical part, six months after the start of business activities of Design Towels on the Czech market. Here

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<sup>1</sup> *iPodnikatel* [online]. 2011 [cit. 2011-08-14]. Jak v podnikání nezkrachovat. Retrieved from <<http://www.ipodnikatel.cz/Ukonceni-podnikani/jak-v-podnikani-nezkrachovat.html>>.

the thesis describes which assumptions in the business plan were correct, which were wrong, and the author looks for the reasons behind the inaccurate assumptions. He also formulates the recommendations for starting entrepreneurs, on what to avoid and what to keep in mind when crafting a business plan, based on this real-life experience. The author tries to go beyond the advice that can be found in vast amounts of business plan literature. With this real-life experience, the Practical part of the thesis tries to „explore the waters unexplored before“.

# **1. Theoretical part**

The Theoretical part consists of two sections. In the first section, the author provides a short literature review, looking for the arguments whether or not the business plan is necessary for future success of an entrepreneur. In this literature review the author comes to conclusion that the literature to date is ambiguous on the added value of business plan to future success of an entrepreneur. The research, including the empirical research, suggests strong arguments as well as against business planning. It is therefore important that the author tests the importance of a business plan on his own and analyses its added value in the Practical part of this thesis.

In the second section of Theoretical part, the author creates a business plan for the company Design Towels. Based on this business plan the owners of this company will decide on whether or not to enter the Czech market, and if yes the how to do it and what to expect. The business plan is intended to serve not only the owners, but also the company in the Czech Republic that will be responsible for conducting the local activities. Within some of the chapters of this business plan (e.g. Chapter 1.8. Choice of the market entry mode, 1.9. Legal protection of design, 1.10. Legal considerations of importing and exporting, 1.13. Marketing strategy and shcedule) the author includes theoretical considerations and citations from the academic paper, as a proof that certain decisions and actions that the business plan recommends are correct. This is not a very usual structure of a business plan. However, as there is no strict form for writing a business plan, the author chose this way as most suitable for the purposes of a Master thesis, where work with the theoretical sources is of significant importance.

## 1.1. Review of literature

The views of literature on whether business planning should be done or not vary. The opponents argue that in the changing reality that surrounds new venture the business planning is not worthwhile, it consumes the necessary time and is less efficient than good intuition that many entrepreneurs possess. Following is the mention of four views that oppose the business planning, extended by the author into practical examples.

Firstly there is a view that business planning takes time away from more valuable firm-organizing actions that signal the „reality“ of the new venture to stakeholders. *„Behavior such as buying facilities and equipment might be a more significant indicator to others that a nascent business is real than undertaking a behavior such as planning. Buying facilities may show others that the entrepreneur has made a significant commitment to creating a new business compared to what might be a less public demonstration of commitment like planning“* Carter et al. (1996:154). Thus, if entrepreneurs want to show the stakeholders (i.e. the parties they will work with and influence in the future – the customers, the investors, the media) that they are starting new venture, better than doing a business plan they should prove it by for example buying new furniture, computers and software, making necessary business registration steps, or entering into first contractual agreements with future business partners.

Secondly, firm founders have limited downside risk if they make a mistake. *„Entrepreneurs do not have much to lose from an erroneous forecast of relative ability or market size ... They usually do not put much capital at risk“* (Bhide, 2000: 57). If new entrepreneurs are not motivated to make the business plans accurate, how can any entity rely on them? It is possible that if the business plan is designed to attract attention of investors, new entrepreneurs will add much more optimism than appropriate into their turnover forecasts. However, the ones who are betrayed are in the end the entrepreneurs themselves. They may be able to present an over-optimistic business plan to investors to get a good deal on a venture capital investment, or to friends and family to boost their ego and pride in front of other people. However, the reality will arrive, revenues will stumble, and the costs of closing the business will be on the shoulders of the cheating entrepreneur alone.

Thirdly, firm founders possess attributes that make them better off relying on intuition than engaging in planning. Allinson et al. (2000) confirmed in their paper the hypotheses that those

owner managers who are, in practice, successful at identifying and exploiting opportunities for growth and capital accumulation (i.e., successful entrepreneurs) are (1) more intuitive in their cognitive style than the general population of managers; (2) no different in cognitive style from senior managers and executives; and (3) more intuitive than middle and junior managers. The authors do not state explicitly that business planning is not worthwhile. The fact that successful entrepreneurs use more intuition than average managers does not mean that their cognitive processes are highly efficient. If entrepreneurs prefer one cognitive style, such as intuition, over the others, the actions they take are likely to be less efficient than if they combined more cognitive styles, such as intuition and planning.

Fourthly, Bird (1988) states that successful entrepreneurs are more aware of the timing of business events (e.g. business cycles) than less successful entrepreneurs. As a result, business plan can be perceived as a major time-consuming obstacle for some entrepreneurs, especially in fast-growing fields like IT. For example if entrepreneurs plan their business to create an application for certain mobile phone, they may think it will be a bestseller. However, the new model of the phone comes out in four months, running on operation system with completely different characteristics, making their planning activities go to waste. Another example are starting entrepreneurs, who plan their production base in Vietnam and count with the cost of capital 5%. Then if there appears privatisation of state-owned factories in Vietnam and other kind of a financial turmoil in the world, their business plan needs to be changed from its foundations.

Contrary to the opponents of business planning there are the defenders, who argue that the time spent on business planning is worthwhile. In particular, planning provides four benefits to people engaged in new venture development.

First, planning allows people to make faster decisions than they would with trial-and-error learning by facilitating the rapid discovery of missing information (Ansoff, 1991). By planning first and then acting second, people can test their assumptions without undertaking the time consuming process of first expending resources (Armstrong, 1982). For example, if a person wants to travel around the world, it can create a plan of the journey to estimate the budget it will need. By planning, the person can test assumptions about the budget without having to go half way around the world before the actual journey to examine those assumptions. The logic of planning first also applies for new product development processes,

where it is much more convenient to plan and test prototypes first, rather than to launch twenty different products, each with a flaw that could have been spotted in the testing (planning) stage.

Second, *„planning helps people to manage the supply and demand of resources, minimizing bottlenecks that slow their activities. By helping people recognize the relationship between actions and resource flows, planning allows people to more accurately estimate the timing of resource needs and resource slack“* (Armstrong, 1982). *„By allowing people to better estimate the timing of resource flows in the activity in which they are engaged, planning minimizes the occurrence of bottlenecks that cause delays“* (Delmar and Shane, 2003: 1167). For planning the time sequences of different activities with inflows and outflows of resources, new entrepreneur can use for example GANTT charts or PERT graphs.

Third, planning helps to create concrete steps in chronological order that lead to achievement of entrepreneur's goals. When people plan, it is easier for them to keep on the track of important actions and if the track is lost, return to the correct track of actions more quickly than if no planning has been done. It can be imagined as a map, in which the planning helps to have a clear vision of a journey to get to the goal, saving time and resources that otherwise would be spent on going in the wrong directions. The deviations between business plans and business reality are very common, and planning should account for possible deviations and make it easy for them to be fixed, i.e. a scenario planning, etc. Moreover, with planning, the goals and the steps leading to their achievement can be formulated more clearly and accurately to those stakeholders who will want to see them.

Fourth, the principles of organization theory hold that *„planning before taking action improves the quality of most human actions (Ansoff, 1991; Locke and Latham, 1980)“, and suggest that business planning should facilitate new venture development.“* (Delmar and Shane, 2003: 1167).

The work of Delmar and Shane (2003) also proves that business planning is a valuable activity, even in uncertain and ambiguous situations like firm formation. Authors compared 223 new ventures initiated in Sweden in the first 9 months of 1998 with a random sample of Swedish firm founders over their first 30 months. Their results show that business planning reduces the hazard of new venture disbanding, facilitates product development in new

ventures and facilitates venture-organizing activity in new ventures. These findings are in accordance with findings of advocates of business planning, saying that it prevents trial and error way of establishing new ventures and essentially helps to manage resource demand and supply in new ventures, reducing the time-consuming bottlenecks when resources are not available.

All in all, the literature today is ambiguous about the added value of business plans. The facts are that business plan is not the strongest or definite proof of entrepreneur's intentions to start new business, that it may be biased and over-optimistic to attract investors' attention or own good-feeling, and that changing environment may make business planning in certain fields like IT a counterproductive waste of time. However, spending reasonable amount of time on the business plan can help to avoid expensive mistakes, keep track of entrepreneur's new progress with an eye on a long-term goal, and plan the steps and resource needs more accurately.



# Business Plan



## Design Towels

Business plan for entering the Czech market

<b>Name of the company:</b>	Design Towels, Ltd.
<b>Field of Business:</b>	Purchase and sale of cotton and terry textile products
<b>CEO:</b>	Bjørn Aage Krane
<b>Chairman of the Board:</b>	Marit Krane
<b>Address:</b>	Breivikveien 3, N 4014 Stavanger, Norway
<b>Telephone:</b>	+47 51 69 01 13
<b>Mobile:</b>	+47 480 24 312
<b>E-mail:</b>	post@tittidesign.no
<b>Website:</b>	www.tittidesign.no

<b>Author:</b>	Bc. Miroslav Tabernaus
<b>Date:</b>	February 2011
<b>Telephone:</b>	+420 776 465 561
<b>E-mail:</b>	tabernaus@gmail.com

## **1.2. Business plan - Executive summary**

The Norwegian company Design Towels has decided to create a business plan on its expansion into the Czech Republic. The product of the company is a design-protected bathroom towel that makes drying both easier and a rehabilitation procedure. In Norway, the towel has been selling well, for a premium price of EUR 30 a piece. Due to high costs of manual production, the towel will have to have a premium price also in the Czech Republic. Design Towels, having no capital and language knowledge to invest in the expansion, decided to export via a Czech distributor as the best mode of market entry. For this, the company has planned the steps that it is required to take from point of view of the Czech legal system, such as a suitable contract with the distributor to protect itself against possible misunderstandings and violations. The company also plans to expand the design protection from the Norwegian Industrial Property Office (Patentstyret) to the whole EU-27. Design Towels plan to motivate the distributor from the very beginning by providing him with provision from each sold towel. The potential customers in the Czech Republic are the individuals (people with moving difficulties, or their children and grandchildren who buy them presents), and institutions, such as hotels, spas, wellness and rehabilitation centres. The expected distribution channels for the individual customers are a website, translated into Czech language, and the pharmacies and sanitary aid stores. For the institutional customers it is the distributor himself. The competition in Czech market is mostly price-based, as there is no bathroom towel with USP of rehabilitation. The Czech distributor will also be responsible for promotion, mostly via media with lower capital requirements. The expected revenues from the expansion for the first six months are, for Design Towels CZK 200,000 and for the distributor CZK 391,250. The profits for Design Towels are expected at CZK 51,600 and for the distributor at CZK 34,100. Over three years, the accumulated profits for Design Towels are expected to reach CZK 319,200 and for the Czech distributor CZK 586,100.

## **1.3. Objectives and users of the business plan**

This business plan aims to provide information to the two owners of the company Design Towels on different aspects of entering the Czech market with their product. Based on this plan the owners will decide on whether or not there is potential for their product in the Czech market, what entry mode is the most suitable for their company, how to produce and price the product for Czech customers, what distribution and advertising will be the most effective and what revenues, costs and profits they should expect if they will take the action described in

this business plan. Other potential users of this business plan may include the person responsible for expansion within the Norwegian headquarters of the company, the person in the Czech Republic, authorized by Design Towels to lead the expansion, the current or future employees of the Norwegian or Czech branch of Design Towels.

#### **1.4. Information about the company, the mission**

The company Design Towels has been established in 2009, at that time by the name Marit Krane Titti. It is a private limited company with branches in England and Norway. It has two owners, Bjørn Aage Krane, who is also the CEO, and Marit Krane, who is the Chairman of the board.

Since its establishment, Design Towels has been designing, purchasing and selling a special cotton towel of high quality. Design of the towel has been invented by Marit Krane, following her diagnosis with Parkinson's disease in the year 2007. Mrs. Krane designed a special towel with oval shape and two handles at the ends, so that it would make it easier for its users to dry remote parts of their body, than if they had an ordinary rectangular towel (see Pictures 2-4 in the Appendix).

Since the product has specific production requirements that are not easy to meet, such as manual sewing of the handles, the owners had to outsource the production to Shanghai, where the whole manufacturing process of the towels is taking place. Shanghai also offers lower production costs than Norway or neighboring countries. After manufacturing on order in Shanghai, Design Towels buy the towels from the manufacturer who sends them to company's address in Stavanger, Norway. From there the towels are distributed per post all around Norway. Design Towels use a Stavanger-based company Invivo for warehousing, as the towels are ordered from China in large quantities due to economies of scale.

Design Towels do not have solely financially-oriented goals. Its product is a sanitary aid that helps people with movement difficulties, designed by a woman who experiences these difficulties herself. Company's primary mission is therefore to reach as many people with a need for this towel as possible, followed by a mission to reward the entrepreneurs themselves and, which was the reason for design protection in Norway. To accomplish both of these goals, the business owners should negotiate as low production prices as possible, look for the most efficient ways of distribution, organize marketing activities to spread the word

about the towel and approach not only people with movement difficulties, but also organisations that provide accommodation to these people, such as hospitals and homes for seniors. Of the same importance is the international expansion that reaches people with movement difficulties outside of Norway.

## **1.5. Description of the product**

Design Towels plans to enter the Czech market with its towel, named by the owners as „Hendig“. This towel's special and in Norway protected design has two main points – oval shape and two handles at the ends of the towel. Its higher price (EUR 30, excluding VAT and distribution) is justified by producing the towel from high quality cotton – 500 g/m<sup>2</sup> in two layers, thus 1000 g/m<sup>2</sup>. The towel is soft from both sides and offers to customers the feeling of luxury and easier drying of remote body parts (see Pictures 2-4 in the Appendix). The towel can be washed repeatedly without losing its shape, which makes it potentially attractive for hotels and wellness centers.

The ideal way to produce the Hendig towel is a combination of machine and manual production. This is due to the irregular shape of the textile and different stitching requirements, such as stitching the handles to the body of the towel, or stitching the line copying the border of the towel. Only the towel manufacturers who are using the combination of machine and manual stitching are able to stitch the towel, so that its oval shape and handles are sustained. The machines usually produce a straight band of cotton, which has to be manually folded, sown together, and finished with stitches and handles. For these reasons the production of Hendig towel is currently outsourced to Shanghai. The company is constantly looking for new production opportunities, and would like to find a producer in Central Europe to keep the costs low, while at the same time being closer to its markets.

## **1.6. Characteristics of the home market - Norway**

The focus market so far has been Norway, with its specificities such as high income level, price level and VAT. The pricing of the towel at EUR 30 a piece excluding VAT and distribution is in the higher category even in Norway. Competitors in this market are mostly large textile producers and retailers, such as IKEA. However, the competition is only based on price, because the design of the company's towel is protected by Norwegian Industrial Property Office (Patentstyret). This is also the competitive advantage of Design Towels, as no other company is allowed to sell a towel of the same or similar design in Norway. What is yet

missing is the EU design protection. If the company decided to show the towels to Czech market, competitors (textile manufacturers and retailers) may start producing this or similar product once they see the demand.

### **1.7. Considerations of changes in current production and distribution**

Design Towels consider moving the production closer to target markets. The reasons are lower distribution costs within Europe compared to China-Europe delivery, and possibility to achieve high quality with lower production costs in Europe, where textile manufacturing has a centuries-old tradition. As the company sees an opportunity of large sales in the Czech market, it plans to authorize a reliable person who besides English speaks also Czech and Slovak, to try to find and negotiate production possibilities in the Central European region. From the research done so far Design Towels believe that Central European region offers favorable conditions for production of the Hendig towel. Estimations say that unit production costs could be achieved at 90% of current costs in China, also due to bulk orders for Norwegian and Czech markets. Distribution costs are estimated to sink to 30% of the current costs, while quality of products is expected to be sustained at the present levels.

Selling and advertising of Design Towels runs mostly on the company's website. At <[www.tittidesign.no](http://www.tittidesign.no)> the visitors have a possibility to see the background of the towel idea, photos of the towel and its use, photos from Shanghai-based manufacturer (see Pictures 5 and 6 in the Appendix), company news and newspaper articles. It is possible to contact the company or to order the towels in the e-shop, with payment via PayPal system. This website is so far available in Norwegian language only, so language variations will have to be added before the expansion can happen.

### **1.8. Choice of the market entry mode**

The amount of overall export from Norway to the Czech Republic reached EUR 800 m. (NOK 6.3 bn) in 2009.<sup>2</sup> This relatively small amount for both countries shows, that some Norwegian products are demanded in the Czech Republic.

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<sup>2</sup> *Business info* [online]. 2011 [cit. 2011-07-02]. Norsko: Zahraniční obchod země. Retrieved from <<http://www.businessinfo.cz/cz/sti/norsko-zahranicni-obchod-zeme/6/1000790/>>.

*„The reasons why companies consider international expansion include sales to other markets, changing domestic conditions, lower cost structures, exploiting global presence by building global brand awareness, worldwide distribution and manufacturing capacity, extranational scale economies and experience effects“* (Foley, 2004). As Design Towels is a young company of two people with one product, its motives for expansion in this stage include sales potential in other markets, building global brand awareness, using scale economies of large order quantities, and learning about the fit between its product and various geographical regions. The company does not seek to avoid domestic conditions, nor establish worldwide manufacturing capacity. It does, however, consider outsourcing the manufacturing to Central Europe instead to Shanghai, to be closer to its markets both in Central Europe and in Norway.

The basic market entry modes that a company can choose from are exporting, licensing, joint venture and FDI. The exporting mode is a low resource (investment) and consequently low risk/return alternative. This mode, while providing a firm with operational control, lacks in providing marketing control that may be essential for market seeking firms. The sole venture mode, on the other hand, is a high investment and consequently high risk / return alternative that also provides a high degree of control to the investing firm. The joint venture mode involves relatively lower investment and hence provides risk, return, and control commensurate to the extent of equity participation of the investing firm. Finally, the licensing mode is a low investment, low risk/return alternative which provides least control to the licensing firm. Table 1 shows the modes consideration for Design Towels.

Mode	Conditions Favoring This Mode	Conditions Against This Mode
Exporting	<ul style="list-style-type: none"> <li>• Liberal import policies (EU-EEA)</li> <li>• Fast distribution per post</li> <li>• Web-based e-shop</li> <li>• Product does not require cultural adaptation</li> </ul>	<ul style="list-style-type: none"> <li>• High prices at home vs. low prices in target country</li> <li>• High costs of importing to Norway and then exporting to Czech Republic</li> <li>• Language barrier with Czech e-shop</li> <li>• Need for new employee if many new orders, maybe a distributor</li> </ul>
Licensing	<ul style="list-style-type: none"> <li>• Legal protection possible in Czech market</li> <li>• Solves lack of experience with target country</li> <li>• Solves language barrier</li> <li>• Saves time and manufacturing, marketing and distribution effort</li> </ul>	<ul style="list-style-type: none"> <li>• Difficult to find a licensee</li> <li>• Need to pay EU design protection before start</li> <li>• No market learning experience</li> </ul>
Joint Venture	<ul style="list-style-type: none"> <li>• No language barrier</li> <li>• Use of partner's distribution channels</li> </ul>	<ul style="list-style-type: none"> <li>• Loss of full ownership and control</li> <li>• Time required for constant negotiations – unsuitable for two-person company</li> </ul>
FDI (Sole Venture)	<ul style="list-style-type: none"> <li>• Overcomes language barrier</li> <li>• High control and learning if new own sales place open in Czech Republic</li> <li>• High sales potential</li> </ul>	<ul style="list-style-type: none"> <li>• Need for local employees (local presence means local laws, taxes and accounting) – not a suitable form for two-person company</li> <li>• Need to do a market research in advance</li> <li>• Expensive solution for company who wants only to sell abroad</li> <li>• Lack of capital</li> </ul>

**Table 1:** Consideration of different market entry modes for Design Towels

*Source:* Author's adaptation of the Table „*Comparison of Foreign Market Entry Modes*“.

Retrieved from <<http://www.quickmba.com/strategy/global/marketentry/>>.

The exporting mode seems the most suitable option for Design Towels, as it requires only low resource dedication and minor changes in how the business is run currently in Norway. The product, the production process and the distribution of towels from Shanghai to Stavanger can remain the same for the time being. Due to the possibility to sell in two markets now, larger order quantities can decrease the production and distribution costs. However, the website and the e-shop will have to be translated to Czech language and operated by one external employee, or rather a freelance distributor, who can deal with orders, comments and claims in

Czech language. This distributor, equipped with Czech and English language, could accept orders and e-mail them to Stavanger, from where the towels could be distributed to Czech customers. This means delivery time for Czech customers of approximately seven days. The distributor could also be responsible for marketing and direct contact with customers, solving orders, claims, and daily communication with the owners in Stavanger. Distributor's pay should be motivational, based on the quantities sold. Products sold in the Czech Republic will have to be sold for different price from Norway, which is determined in Chapter 1.13.

The problem of high distribution costs when first sending towels from Shanghai to Stavanger and then to Czech Republic could be solved by establishing a distribution centre in the Czech Republic. Then the distributor, who is the local sales person, could also store the stock of towels, and send them to the Czech customers. In this case the mode of entry is exporting via a distributor (indirectly), when the owners are sending the towels from production plant directly to the Czech distribution centre, which deals with orders, claims and does local marketing. If company relocates production to Central Europe, a licensing agreement may be offered to the distributor, making him responsible for the whole local business. Design Towels could this way continue to operate Norwegian market, with possible expansion to other Scandinavian countries, while also testing the licensing business model.

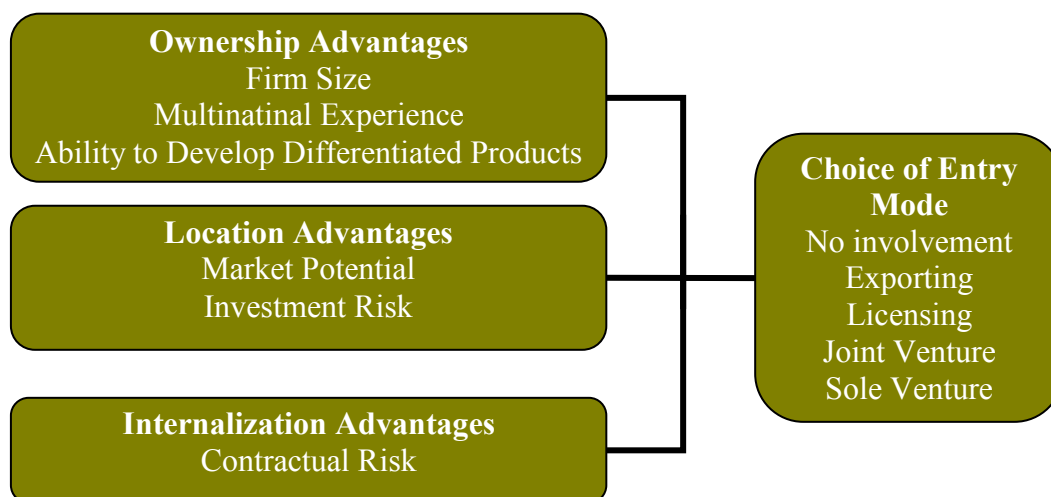
One more step in moving responsibilities onto the distributor depicts the licensing. This mode of market entry would enable Design Towels to get rid of provisions paid to the Czech distributor. Design Towels would sign a license agreement with a distributor, giving him rights to produce and sell the Hendig towel. Before this permission is made, the towel must be design-protected in the markets where the licensee will sell the product, otherwise the licensee can sell the towels without any cooperation with Design Towels. The licensee will have to pay an annual licence fee to Design Towels. The licensee will use his own knowledge of local market and language, do the market research and hence the marketing campaign. Moreover, the risks of product acceptance in foreign market will lie fully on the licensee, as he will be responsible for production, distribution and selling, Design Towels being only receivers of license fee for their idea of Hendig towel's design. Licensing is therefore suitable market entry mode for a company with no market knowledge, such as Design Towels entering the Czech Republic. The downside of licensing is that the control over licensee is very limited, subject to the license contract. As Design Towels see large potential in their product, they are more in favor of a motivational mode, based on provisions paid to the Czech distributor from



each sold towel (the profits of exporting are supposed to be higher than the license fee that the company would be able to charge).

Joint venture and foreign direct investment are entry modes, which Design Towels do not consider in this early stage of existence. Main reasons are loss of decision-making power and high resource requirements. The company has currently very few spare resources.

As Agarwal and Ramaswami (1992) write, several factors that determine the choice of a specific foreign market entry mode have been identified in the previous literature. These factors can be classified into three categories: ownership advantages of a firm, location advantages of a market, and internalization advantages of integrating transactions (Figure 1). Theretically, company should choose that foreign market entry mode, which brings the highest risk-adjusted return on investment. Empirically, companies' decisions are not this rational. They are often guided by keeping high control over new expansion (not giving away ownership and decision-making for future benefits) and by availability of managerial resources to enter the concrete foreign market.



**Figure 1:** Factors determining the choice of foreign market entry mode

*Source: Author's adaptation from Agarwal and Ramaswami (1992: 5)*

## 1.9. Legal protection of design

The cornerstones of the TRIPS agreement (under administration of WTO) secure transparency of registered intellectual property in most of the developed and developing countries. For

a product such as Hendig towel, it is important to protect the design before entering to the new market. Since Design Towels do not have a diversified portfolio of products – they sell only this one product, any competition in the market would threaten the existence of the company.

The protection for all EU-27 states costs EUR 350. Advantages are single application, single administration centre and a single file to manage. Applications are done online at OHIM (The Office for Harmonization under Internal Market), by describing the product category, its design features which should be protected described in words and in pictures, and paying online with a credit card. International registration of industrial design with scope outside the EU is the done via WIPO (World Intellectual Property Organization). „*Holders of valid registered designs have exclusive rights to use the design concerned and to prevent any third party from using it anywhere within the European Union. They will be protected against both deliberate copying and the independent development of a similar design.*“<sup>3</sup>

In the Czech Republic, the industrial design protection means the sole right of design owners to use the industrial design, prevent third parties from using the design without owners' consent, give consent for using the design to third parties or transfer the ownership of design onto third parties, according to the act 207/2000 Sb. about the protection of industrial design. By use is meant mainly production, offering, market introduction, import, export, or usage of product on which this design is applied, or warehousing of such product for the stated purposes. Validity of protection is 5 years with possibility of 5-yearly prolongation up to 25 years.

For purposes of licensing in the Czech environment, the § 33 of the act 207/2000 Sb. states that industrial design can be owned by more co-owners with same rights for use of design, unless agreed otherwise between them. If the ownership of industrial design is transferred onto third party after design has been registered, a license for the third party is created, with rights equal to design owners.

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<sup>3</sup> Office for Harmonization in the Internal Market [online]. 2011 [cit. 2011-08-20]. What is a Community design? Retrieved from <<http://oami.europa.eu/ows/rw/pages/RCD/communityDesign.en.do>>.

## **1.10. Legal considerations of importing and exporting**

Textile yarn, fabrics and products fall under EU import restrictions. If the importers import certain groups of textile classified under TARIC from countries where unilateral or bilateral agreements apply, the importers need to apply for an import licence. Import of non-raised cotton fabric from both Norway and China is currently taxed at 0%. As of January 2011, only textile imported to EU from Belarus is subject to restrictions and hence to the licence application of the importer.<sup>4</sup>

There are three options for entering the Czech market that Design Towels have to consider from legal point of view: direct exporting from abroad, selling via a distributor, and registering a company residence in the Czech Republic.

### **1.10.1. Direct exporting from abroad**

Norway, as part of EEA and the Schengen area, counts as part of the European Free Market. The import of towels from Norway or even from China directly to the customer in the Czech Republic is not subject to any restrictions.

### **1.10.2. Selling via a distributor**

In this case, Design Towels need to sign a contract with the Czech distributor. In the contract, attention should be paid to Incoterms (International Commercial Terms), which are issued by ICC, Paris, and which regulate which of the two entities will carry the costs of freight, the insurance, risks of damage, and the duties that are connected with international transport.<sup>5</sup> Apart from that, the distributor must hold a valid Czech Trade allowance No.48 – Wholesale and retail.

### **1.10.3. Registered company residence in the Czech Republic**

Company can register its residence in the Czech Republic by registering itself as an “Organizational Entity of Foreign Company in the Czech Republic“ (Czech: Organizační složka), or by establishing a subsidiary. Organizational Entity is more closely tied with mother company than subsidiary. The Organizational Entity has no basic capital that needs to

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<sup>4</sup> Ministry of Industry and Trade [online]. 2011 [cit. 2011-08-23]. Licenční řízení - dovoz některých vybraných textilních a oděvních výrobků - na základě dvoustranných ujednání nebo autonomních opatření. Retrieved from <<http://www.mpo.cz/dokument7639.html>>.

<sup>5</sup> Business info [online]. 2011 [cit. 2011-09-12]. Správní používání Incoterms 2000. Retrieved from <<http://www.businessinfo.cz/cz/clanek/pravni-prostredi-celni-problematika/spravne-pouzivani-incoterms-2000/1000487/2143/>>.

be paid down and its name is the same as mother company but with addition “Organizační složka”. It is independent of the mother company concerning property. It is guided by Czech accounting and tax law and it files Czech accounting and makes Czech tax declaration. The tax base can be decreased by counting mother company’s expenses for support of Organizational Entity to the expenses of this Entity, or by transferring part of Entity’s untaxed profits to the mother company. The taxed profits can then as well be transferred to the mother company. The establishment of Organizational Entity is done in the following steps.

### **Step 1**

Obtaining the tentative Trade allowance no.48 – Wholesale and retail, based on which a company can carry out the wholesale and retail activities in the Czech Republic. To obtain this allowance, the company needs:<sup>6</sup>

- Confirmation of company’s foreign residence, i.e. official extract from home country’s business registry. It must not be older than three months and must be translated into Czech language.
- Written consent of the owner of premises, where company will reside in the Czech Republic, stating that the owner gives his consent to residence of a company. Signature does not need to be officially attested.
- Confirmation of appointing the director of the Organizational Entity of Foreign Company in the Czech Company, and his consent with this appointment. This can be any person affiliated with the company, including CEO or Chairman of the Board.
- Procuracy for the director of Organizational Entity, either general procuracy with notary’s statement, or specific procuracy, where notary’s statement is not needed.
- To make an administration payment of CZK 1,000 for the registration.

If all documents are submitted properly, the Office of Trade Allowances will issue the tentative Trade allowance no. 48 – Wholesale and retail within five days.

### **Step 2**

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<sup>6</sup> *Business info* [online]. 2011 [cit. 2011-09-12]. Živnost volná pro právnické osoby se sídlem v některém z členských států EU, EHP a Švýcarska. Retrieved from <<http://www.businessinfo.cz/cz/clanek/zivnosti-volne/zivnost-volna-po-sidlo-eu/1001897/55921/>>.

Obtaining the full trade allowance. The tentative trade allowance must be delivered to the Registry court in that municipality, where the residence of the company is going to be, i.e. the same address where the owner of premises has previously issued a written consent with company's residence. At the court, company must apply for registration in official Czech Business Registry by submitting a form. When the registration in Czech Business Registry is successful, the Court will issue the Company Identification Number (IČO), and that day the full trade allowance is established.

## 1.11. Market size

The general trend of ageing and enriching population of the Czech Republic offers an opportunity for products such as the Hendig towel. Potential customers can be divided into two types – individual and institutional, as shown in Table 2.

Type of customer	Number in the Czech Republic
Individual customers	
People above the age of 60	2,292,977 <sup>7</sup>
People with moving difficulties*	500,000
Institutional customers	
Private hospitals	22 <sup>8</sup>
Rehabilitation centres	1,514 <sup>9</sup>
Private senior homes	108 <sup>10</sup>
Pharmacies and sanitary aid stores	2,774 <sup>11</sup>
Spas	84, with 378,000 clients per year – 57% heal their moving difficulties <sup>12</sup>
Wellness and relaxation centres	381 <sup>13</sup>
Wellness hotels	121 (+ 36 five-star hotels) <sup>14</sup>

\* estimate, includes patients with Parkinson's disease, screws, palsy, the disabled and the women in later stages of pregnancy

**Table 2:** Numbers of potential customers of Design Towels, individual and institutional

Sources: Czech Statistical Office, SSNCR, ÚZIS, Firmy.cz (see footnote)

With a precondition of successful design protection, the Hendig towel can potentially find its way to the hands of over 2 million people over the age of 60, mostly bought for them by their children or grandchildren. Moreover, in the Czech Republic there are 500,000 potential customers with moving difficulties. Many of the country's healing water springs and spas, together with high-end wellness hotels, create potential market for more than 100,000 towels.

<sup>7</sup> Czech Statistical Office [online]. 2011 [cit. 2011-08-26]. Demografická ročenka ČR 2009. Retrieved from: <<http://czso.cz/csu/2010edicniplan.nsf/p/4019-10>>.

<sup>8</sup> Sdružení soukromých nemocnic ČR [online]. 2011 [cit. 2011-08-27]. Seznam členů. Retrieved from <<http://www.ssnr.cz/>>.

<sup>9</sup> Ústav zdravotnických informací a statistiky ČR [online]. 2011 [cit 2011-07-27]. Zdravotnictví ČR ve statistických údajích. Retrieved from <<http://www.uzis.cz/cr-kraje>>.

<sup>10</sup> Firmy.cz [online]. 2011 [cit. 2011-07-20]. Retrieved from <<http://www.firmy.cz/>>.

<sup>11</sup> Ústav zdravotnických informací a statistiky ČR [online]. 2011 [cit 2011-07-27]. Zdravotnictví ČR ve statistických údajích. Retrieved from <<http://www.uzis.cz/cr-kraje>>.

<sup>12</sup> Ústav zdravotnických informací a statistiky ČR [online]. 2011 [cit 2011-07-27]. Zdravotnictví ČR ve statistických údajích. Retrieved from <<http://www.uzis.cz/cr-kraje>>.

<sup>13</sup> Firmy.cz [online]. 2011 [cit. 2011-07-20]. Retrieved from <<http://www.firmy.cz/>>.

<sup>14</sup> Firmy.cz [online]. 2011 [cit. 2011-07-20]. Retrieved from <<http://www.firmy.cz/>>.

To reach the people over 60 and people with moving difficulties, Czech pharmacies and sanitary goods stores could be used as distribution channel. The net of these stores is dense in the Czech Republic, with a total of 2,774 points of sale. The regional breakdown within the Czech Republic is noted in Table 3.

Region	Pharmacies and sanitary goods stores
Hl.m. Praha	330
Středočeský	265
Jihočeský	199
Plzeňský	165
Karlovarský	103
Ústecký	212
Liberecký	108
Královéhradecký	164
Pardubický	143
Vysočina	123
Jihomoravský	318
Zlínský	149
Olomoucký	173
Moravskoslezský	322

**Table 3:** Regional Breakdown of pharmacies and sanitary goods stores

*Source:* Ústav zdravotnických informací a statistiky ČR [online]. 2011 [cit 2011-07-27]. Zdravotnictví ČR ve statistických údajích. Retrieved from <<http://www.uzis.cz/cr-kraje>>.

## 1.12. Competition Characteristics

The competition of Design Towels in the Czech Market are, in broader sense, all the companies focused on selling the high quality towels, even towels as such. So far there is no competition in the more narrow sense, such as producers of towels that help people with moving difficulties.

The main competitive disadvantage of Design Towels' is the price of Hendig towel, at approximately three-times more than the price of standard quality towels. Second disadvantage is the assortment, when customers who are looking for more than one towel will prefer the stores with all bathroom supplies under one roof. Design Towels' USP that company should build on are:

- the help aspect for people with moving difficulties
- the best quality on the market (two-sided 500 g/m<sup>2</sup>)
- easy to use e-shop
- excellent customer service to be conducted by the distributor

Table 4 shows the competitive comparison. Plus (+) indicates the USP that the competition has better over the Design Towels, minus (-) indicates the aspects, in which the competition is lacking behind.

		USP				
		Can try in shop before purchase	Established customer contacts	Established customer reputation	Low price	Variety of colors, sizes and quality
Competitor	IKEA	+	-	+	+	+
	Supplier of towels to hotels	-	+	+	+	+
	E-shop with lux. textile*	-	-	-	-	+
		USP				
		Additional bathroom sortiment	Shape that helps in rehabilitation	E-order and delivery	Quality over 500 g/m <sup>2</sup>	Personalized approach, packaging
Competitor	IKEA	+	-	-	-	-
	Supplier of towels to hotels	+	-	+	-	+
	E-shop with lux. textile*	+	-	+	-	+

\* [www.luxusni-zupany-rucniky-pyzama.cz](http://www.luxusni-zupany-rucniky-pyzama.cz) ; [www.e-povlezeni.cz](http://www.e-povlezeni.cz); [www.jolis.cz](http://www.jolis.cz); [www.styltex.cz](http://www.styltex.cz)

**Table 4:** Comparison of USP's of competition versus Design Towels

*Source: Author, Company websites*

### 1.13. Marketing strategy and schedule

*„The marketing strategy is concerned with decisions relating to market segmentation and targeting, and the development of a positioning strategy based on product, price, distribution,*



*and promotion decisions*“ (Slater and Olson, 2001). The authors suggest the following view on the questions within the 4P's of marketing strategy.

Among the most important product decisions is that regarding the breadth of the product line. The product line can either be narrowly focused or sufficiently broad to cover a set of complementary products, different performance specifications, or different price points. Related issues to consider are the innovativeness of the products in the product line, their relative customer-perceived quality, and customer service.

The fundamental issue in pricing is whether or not the firm should charge a premium price. Premium prices may be justified based on innovativeness, superior product or service quality, or brand equity. On the other hand, lower prices may be justified when market share or sales growth is the objective or when the firm's product is somehow disadvantaged.

The most common distribution decision is whether to use a selective or an intensive distribution system. Products that require substantial pre- or post-sale service, that have high costs related to stocking and selling, or that are positioned as prestige products, will typically require a selective distribution system. Relatively low cost and self-service items are most efficiently handled with intensive distribution.

The two dominant forms of promotion are advertising and personal selling. Advertising is particularly appropriate for creating awareness and interest, and for reaching a broad market. Personal selling is particularly appropriate when customers require more in-depth information in real time. For more expensive, complex, or high-risk products, personal selling may be necessary to close the sale. Related to promotion is the support provided through specialist personnel such as order processors and sales engineers.

The presented theory suggests the following marketing strategy for Design Towels:

### **1.13.1. Short term (0-6 months)**

#### **Product**

The Hendig towel will start with a special value proposition for group of high-income healthy people and medium- and high-income people with moving difficulties. The company will provide premium customer service, including short waiting period for deliveries and a small

present inserted in the packaging. There will be only this one product within the first six months.

### **Price**

Premium prices can be justified on uniqueness and premium quality and customer service mentioned above. The wholesale price, for which the distributor will be selling to pharmacies and sanitary goods stores will be set so that they could sell for premium price similar to website, with their margin included. For hotels, spas and wellness and rehabilitation centres, the premium price means a price only slightly above distributor's purchasing price.

### **Place**

Selective distribution system means that the website will be the only distribution channel during the first six months. Delivery will be provided via post, or courier, if required by customer. The distributor will during the first six months look for other selective distribution channels.

### **Promotion**

The distributor will choose the combination of advertising (to create interest in individual customers) and personal selling (to address the institutional customers and justify the high price with appropriate pre- and post-purchase service). During the first six months, cheaper ways of advertising should be tried (Google Adwords, leaflets, WOM by friends and family) as well as cheaper ways of personal selling (one sales person, payed only from proportion of what he sells, personal contact with customers through e-mails sent by the sales person). Website promotions, such as 10% discount for a certain period of time, should also be exercised and its results monitored to find out efficiency and return on each marketing expenditure.

## **1.13.2. Mid term (7-18 months)**

### **Product**

The Hendig towel will remain the only product in mid term. All the distributor's marketing efforts will be focused on this towel. The company Design Towels will, however, already be working on development of a new towel-related product, which must be introduced by the third year of distribution, as the market for Hendig towel will become saturated, and the towel

emulated by competitors (the design protection can be bypassed by producing towels of not the same, but similar shape).

### **Price**

The price of the towel will be adjusted after the initial trial phase. The mid-term period will mean changing the price and conducting several price sensitivity analyses in real conditions, so that the best price could be settled. If the best price will appear to be the low price, the efforts will focus on finding a cheaper production facility, and if this is impossible, new e-shop with bathroom supplies will be created – shifting the whole business idea.

### **Place**

Depending on the level of revenues in the first six months, the effort in mid-term period will be to establish the e-shop, where customers could easily buy the towel and pay for it online. The intention is to keep selective distribution, mainly due to inability to produce the towels cheaply enough to enter retail stores. Therefore, the sales person will be active also in the mid-term period, approaching pharmacies, sanitary goods stores, hotels, spas and wellness and rehabilitation centres.

### **Promotion**

Depending on the revenues and profits from the first six months, the promotion will use means of different expense. If the business is developing well, advertising will focus on more expensive placements than in the first six months (i.e. links and banners on popular websites) and the distributor will own higher quality brochures and more free samples.

### **1.13.3. Long term (19 – 36 months)**

It is difficult to foresee the long-term period. The core business of a start-up may change completely within the first eighteen months. The factors that this depends on include the sales volumes, prices, cost base, but also personal and other circumstances of the freelancer or small business owner. The strategy of Design Towels in this period should, at least theoretically, be the following:

### **Product**

The product base should be extended for at least one more innovative product. Research time and money should be invested in the development of a towel-based product, which could have

a market potential and be design-protected or patented. This new product will sustain the continuation of the business, as the Hendig towel is expected to become obsolete with competitors imitating its design. The traditional theory of product lifecycle describes this phenomenon on a reversed U-shaped curve (with uneven skewness), the BCG Matrix describes it in terms of losing relative market share and growth – the „poor dog“ quadrant of the Matrix.

### **Price**

The price of the Hendig towel will be slowly decreasing, with high possibility that the cheaper production facilities will be found. The new product will start with high price, due to its innovative nature and uniqueness, justified by design protection or a patent.

### **Place**

The e-shop that will already exist and will be building its name among the Czech customers will be the main distribution channel for Hendig towel and the added bathroom supplies. The personal selling efforts will focus more on the new product with higher margins. It is highly possible that Hendig towel will be able to enter the first textile stores, thanks to its track-record of sales in previous months.

### **Promotion**

The advertising will slowly decrease for the Hendig towel, relying on the spreading WOM and popularity of the whole bathroom supplies e-shop, which will be dominated by the Hendig towel. The presence in textile stores may be sufficient promotion for this product. The new, innovative product will be advertised by personal selling to its target groups. The process will already be enriched by experiences with the start of Hendig sales.

Miles and Snow (1978) suggest the theoretical framework how companies define the product-market domains (strategy) and construct mechanisms to pursue these strategies. In terms of their framework, Design Towels in the Czech Republic will start as a "defender" – a company trying to defend their leading position in a narrow and stable domain. The transformation towards prospector and analyzer are very much dependent on success of the Hendig towel – whether the market will react positively and can be exploited successfully for a longer period of time, and whether the results of the design protection process will be positive, i.e. there will not be space for the competitors.

## 1.14. Financial projections

For the first three years, the exporting of towels into Czech market will be done with help of the Czech distributor. Distributor's responsibilities will include adding Czech version to the website, operating the Czech e-shop, and conducting the advertising and direct sales. Design Towels will quote a "wholesale" price that they require to receive from every towel sold in the Czech market, and the distributor will keep the sum that he receives from customers above this wholesale price. The process of EU-27 design protection will be conducted and paid for by Design Towels.

### 1.14.1. Profit and loss

The following tables depict the expectations about the profit and loss of Design Towels, and of the Czech distributor.

For Design Towels, the profit from the first six months is expected to reach CZK 51,600. The profit is driven by a stable margin of CZK 60 on each towel, when towels are purchased for CZK 140 (including delivery from China) and sold to the distributor for CZK 200. The delivery to the Czech Republic is covered by the distributor. The full cost of European Design protection, CZK 8,400, is to be paid by Design Towels.

Item	Month 0	Month 1	Month 2	Month 3	Month 4	Month 5	Month 6
Pcs. sold to distributor	100	100	100	100	200	200	200
Price/towel	200	200	200	200	200	200	200
Revenue	20,000	20,000	20,000	20,000	40,000	40,000	40,000
COGS	14,000	14,000	14,000	14,000	28,000	28,000	28,000
Cost design protection	8,400	0	0	0	0	0	0
Profit	-2,400	6,000	6,000	6,000	12,000	12,000	12,000
Profit accumulated	-2,400	3,600	9,600	15,600	27,600	39,600	51,600

**Table 5:** Design Towels' revenue and cost projection over the first six months of the Czech expansion

*Source: Author*

The distributor will purchase the towels for CZK 200 during the first six months. In addition, he will pay CZK 100 per towel for the delivery from Norway. His profit during this time is expected to reach CZK 34,100. In accordance with the short-term marketing strategy (Chapter 1.13.), the prices vary for individual and institutional customers. The pieces sold are estimated with an assumption that the distributor engages in the project on full time. The gross margin between CZK 490 for individual customers, and CZK 150 for hotels, spas, wellness and

rehabilitation centers is significantly lowered by the costs of the delivery. The above mentioned delivery from Norway at CZK 100 per towel, and delivery to customer in Czech Republic at CZK 30 per towel. The sum of COGS and inbound and outbound deliveries then leaves only small space for administrative costs (communication, transportation) and marketing, so these will have to be kept as low as possible, in order for the distributor to achieve profit (Table 6).

Item	Month 0	Month 1	Month 2	Month 3	Month 4	Month 5	Month 6
Price/towel, individual customers	0	690	690	690	690	690	690
Pcs.sold to individual customers	0	5	10	20	30	30	30
Price/towel, pharmacies	0	450	450	450	450	450	450
Pcs.sold to pharmacies	0	0	10	20	30	30	30
Price/towel, sanitary stores	0	450	450	450	450	450	450
Pcs.sold to sanitary stores	0	20	20	40	40	40	40
Price/towel, hotels, spas, wellness	0	350	350	350	350	350	350
Pcs. sold to hotels, spas, wellness	0	20	30	60	60	60	60
Price/towel, private clinic, rehab center	0	350	350	350	350	350	350
Pcs. sold to private clinic, rehab center	0	0	30	30	30	30	50
Revenues	0	19,450	41,400	72,300	83,700	83,700	90,700
Cost/towel	200	200	200	200	200	200	200
Towels on stock, end of month	100	155	155	85	95	105	95
Pcs towel ordered & delivered	100	100	100	100	200	200	200
Delivery from Norway	10,000	10,000	10,000	10,000	20,000	20,000	20,000
Delivery to customers	0	1,350	3,000	5,100	5,700	5,700	6,300
COGS	20,000	20,000	20,000	20,000	40,000	40,000	40,000
Cost/Leaflet	2	0	0	0	2	0	0
Pcs Leaflets	1,000	0	0	0	1,000	0	0
Cost/Brochure	5	0	0	0	0	5	0
Pcs Brochure	200	0	0	0	0	200	0
Cost Telephone	0	1,000	1,000	1,000	1,000	1,000	1,000
Cost Transportation	1,000	2,000	2,000	2,000	2,000	2,000	2,000
Cost AdWords	0	1,000	1,000	1,000	1,000	1,000	1,000
Total costs	33,500	35,350	37,000	39,100	71,200	70,700	70,300
Profit	-33,500	-15,900	4,400	33,200	12,500	13,000	20,400
Profit accumulated	-33,500	-49,400	-45,000	-11,800	700	13,700	34,100

**Table 6:** Distributor's revenue and cost projection over the first six months of the Czech expansion

*Source: Author*

The annual profit projections for Design Towels show an increasing tendency (Table 7). In the first two years the stable margin of CZK 60 per towel will drive the profits. In the third year, the new production facility is expected to be found, where the towels can be produced for CZK 90 (including delivery). The margin in the third year will remain the same, as the selling price for the distributor will also be reduced to CZK 150 in the third year. The revenues in the third year will be driven by volume increases when entering Czech textile stores. The costs will be driven up in the second and third year by the necessary development expenditures for the new product, and its Europe-wide design protection.

Item	Year 1	Year 2	Year 3
Pcs. Sold to Distributor	2,000	1,600	3,500
Price/towel	200	200	150
Revenue	400,000	320,000	525,000
COGS	280,000	224,000	315,000
Cost design protection	8,400	0	8,400
Cost R&D / 2	30,000	60,000	0
Total costs	318,400	284,000	323,400
Profit	81,600	36,000	201,600
Profit accumulated	81,600	117,600	319,200

**Table 7:** Design Towels' revenue and cost projection over the three years of the Czech expansion

*Source: Author*

The distributor is expected to achieve the profit of CZK 180,600 in the first year. The channel, which is expected to have highest sales are hotels, spas, wellness and rehabilitation centres, with the total of 650 sold towels. The highest margin, however, will be in individual customers, with gross margin of CZK 490 per item. The sales to individual customers are expected to increase over the three years, while the hotels, spas, wellness, rehabilitation centres, as well as sanitary goods stores, are expected to decrease. In the third year, the assumption is, that the towel will be successfully introduced to a chain of textile stores, where the gross margin of CZK 150 can create profit of CZK 300,000, due to high volumes.

Item	Year 1	Year 2	Year 3
Price/towel, individual customers	690	590	490
Pcs.sold to individual customers	325	500	750
Price/towel, pharmacies	450	400	450
Pcs.sold to pharmacies	300	400	200
Price/towel, sanitary stores	450	400	450
Pcs.sold to sanitary stores	440	400	300
Price/towel, hotels, spas, wellness	350	330	330
Pcs. sold to hotels, spas, wellness	650	300	300
Price/towel, private clinic, rehab center	350	0	0
Pcs. sold to private clinic, rehab center	240	0	0
Price/towel, textile stores	0	0	300
Pcs. sold to textile stores	0	0	2,000
Revenues	868,750	714,000	1,291,500
Cost/towel	200	200	150
COGS	391,000	320,000	532,500
Costs Delivery from Norway	195,500	160,000	355,000
Costs Delivery to customers	58,650	48,000	106,500
Costs leaflets	4,000	2,000	1,000
Costs brochures	2,000	2,000	1,000
Costs communication	12,000	12,000	12,000
Costs transportation	13,000	12,000	12,000
Costs AdWords	12,000	12,000	12,000
Total costs	688,150	568,000	1,032,000
Profit	180,600	146,000	259,500
Profit accumulated	180,600	326,600	586,100

**Table 8:** Distributor's revenue and cost projection over the three years of the Czech expansion

*Source: Author*

### 1.14.2. Capital and cash requirements

For Design Towels the expansion does not create high capital requirements. The deliveries to the distributor will occur in bunches of 100 or 200 pieces, for which the distributor will pay immediately.

It will take the distributor four months to achieve positive accumulated profit. Therefore, the distributor should start with a reserve of CZK 50,000 to cover the initial cash requirements of the first four months. Otherwise, as the payment for sales occurs within a week from the moment of sale, and the volumes sold are expected to grow with margins being more or less stable, the distributor does not need any more cash reserves for the beginning.



## **2. Practical part**

In the Practical part, this Master thesis describes the deviations of business reality from the business plan shown in Theoretical part. The author aims to look for the mistakes that occurred in crafting the plan, and give recommendations to starting entrepreneurs on how to avoid making similar mistakes when writing a business plan. The first section of the Practical part extracts from the business plan in Theoretical part the assumptions that the author has made when creating the plan. The second section focuses on author's own invention of an assumption tree and describes its use on an example of Design Towels. The third section provides information on real events that have happened during the first six months of distributor's entrepreneurial activity and provides recommendations to starting entrepreneurs, how not to make similar mistakes in their business planning.

### **2.1. Assumptions of the business plan**

After submitting the business plan to Design Towels in March 2011, the two owners decided to act according to its recommendations. They and the Czech distributor, whom they have chosen, became the major users of the business plan. Since the distributor and the author of this thesis are the same person, the thesis contains the most accurate data and information about the Czech venture of Design Towels.

To sum up the assumptions and expectations that were made in the business plan, see Table 9. Out of thirteen assumptions that the business plan counted with, two were proven to be correct and eleven wrong, during the first six months of entrepreneurial activity. This may seem like an alarming number. However, in the turbulent times of the 21st century, an entrepreneur should count with the option that none of the assumptions will be fulfilled in the reality, and have a set of tools and scenarios ready to adapt to the new situation, different from the one expected. The fact is that the assumptions coming across wrong may actually mean even higher opportunities for profit.

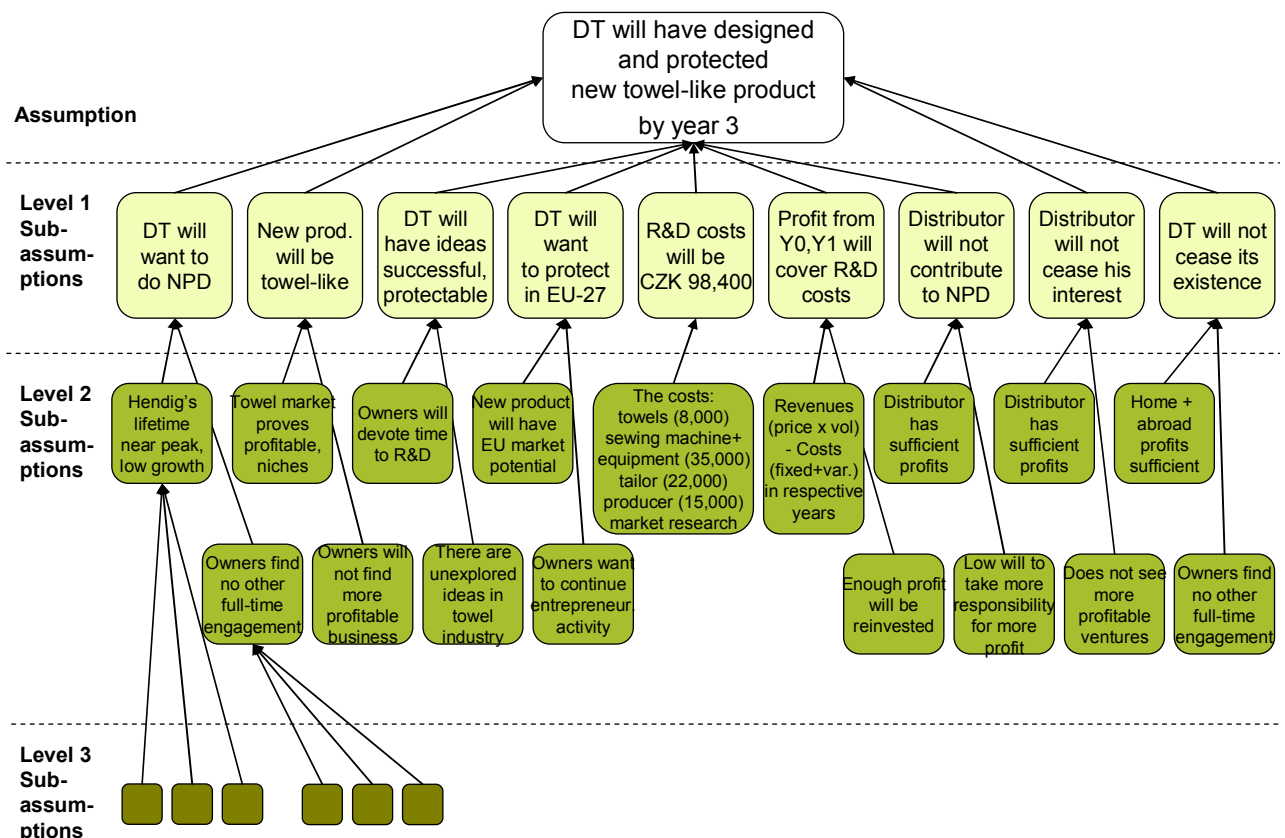
	Area of Assumption	The Assumption	Result
1	Choosing the Market Entry Mode	The most suitable market entry mode is exporting, with Czech distributor paid from provisions from each sold towel.	Correct
2	Legal Protection of Design	Design Towels will protect the design for EU-27 states, company will bear the costs of EUR 350.	Wrong
3	Changing the Region of Production	Production of Hendig towel will be moved to Central Europe after year two.	Correct
4	New Product Development	Design Towels will have designed and protected new towel-like product by year three.	Wrong
5	Competition	There is no competition with USP of towel that helps people with moving difficulties. Some competitors rely on low price and wider variety. Due to design protection, competition will not enter for the first 3 years.	Wrong
6	Potential Market Volume	Potentially there are two million customers in the age group of over 65, 0.5 million customers with moving difficulties, over 500 hotels, spas, wellness and rehabilitation centres.	Wrong
7	Customer Reaction	The towel will be generally accepted by hotels, spas, wellness and rehabilitation centres addressed by a sales person, and by the individuals who notice it on the website or in pharmacy or a sanitary goods store.	Wrong
8	Short-term Product Strategy	There will be one type of towel with premium quality and customers service.	Wrong
9	Short-term Price Strategy	Premium price will be accepted by both individuals and institutions (pharmacies, sanitary goods stores, hotels, spas, wellness and rehabilitation centres).	Wrong
10	Short-term Place Strategy	Selective distribution via website and pharmacies to individual customers and via one sales person to hotels, spas, wellness and rehabilitation centres.	Wrong
11	Short-term Promotion Strategy	Cheaper forms of promotion, such as Google AdWords, leaflets, brochures at points of sale.	Wrong
12	Revenue Structure	Price and volume sold through different channels is in detail described in Chapter 1.14.	Wrong
13	Cost Structure	For assumptions on cost structure and its influence on capital requirements see Chapter 1.14.	Wrong

**Table 9:** Summary of assumptions made in the initial business plan

*Source: Author*

## 2.2. Sub-assumptions

Each of the assumptions in Table 9 was a result of a combination of sub-assumptions. Each of these sub-assumptions could be further analysed to be found that it also is a result of other group of assumptions, which can be called „Level 2 Sub-assumptions“. If the levels of sub-assumptions were developed further and further, an entrepreneur would arrive to a reversed tree structure (Figure 2). The main advantages of such an analysis are twofold. Firstly, it helps entrepreneurs see what influences their assumptions. Thus entrepreneurs who use this tree will know, what they should be aware of, what they should watch more closely, or where to try making precautions, such as signing contracts, to ensure higher probability of certain desired outcome. Secondly, some of the assumptions that are at the bottom of the assumption tree are easier to verify than the main assumption itself or its Level 1 Sub-assumptions.



\* DT = Design Towels

**Figure 2:** The tree of assumptions. This tree is still incomplete, as the author could go much deeper (Level 7 or 8) to see all the basic assumptions

Source: Author

### 2.2.1. Example

How can both users of the business plan, the company Design Towels and the Czech distributor, know that one of 13 assumptions, the NPD assumption (Design Towels will have designed and protected new towel-like product by year 3), will be fulfilled? The probability of fulfillment could range from 0% to 100%. Therefore, the owners and the entrepreneurs should both look for drivers behind this assumption. In this case there are the following nine Level 1 Sub-assumptions:

- The company Design Towels will want to develop a new product (spend time and resources).
- The product will be of towel-like nature, so that some of distribution channels acquired during the three years could be easily used with new product.
- The company will have enough ideas to create a product that shows a potential of success, and can be patented or design-protected in EU-27 states.
- The company will want to protect the product in EU-27 states.
- The money needed for NPD will be about CZK 90,000 + EU design protection CZK 8,400.
- The company will have enough money for R&D from profit of the years before expansion, year 1 and partly year 2.
- The distributor will not contribute to the development, nor will want to own the rights to the new product.
- The distributor will not cease his interest in working full-time on the project over at least 3 years.
- The company will not cease its existence or shift its focus away from towel/health-aid industry (psychological factor).

Taking a closer look on the Level 1 Sub-assumptions, it can be seen that all of them have drivers of their own, and that, without looking for these drivers, one cannot say with high certainty whether any of Level 1 Sub-assumptions will be fulfilled or not. Therefore, an entrepreneur should ask once more the question: „What does it depend on?“ and create Level 2 Sub-assumptions.

Among the Level 2 Sub-assumptions, there can already be named a few common denominators. Five of Level 2 Sub-assumptions are directly connected with the psychological will of the owners. These are:

- Owners will find no other full-time engagement, besides the company.
- Owners will not find more profitable business than the towel business.
- Owners will devote necessary time and will reinvest necessary part of profit into R&D.
- Owners will want to continue their entrepreneurial activity.
- Owners will find the profits they are making at home and in expansion as sufficient.

Three are connected with the psychological will of the distributor:

- Distributor will not want to take on more responsibility for larger profit (by participating in R&D and obtaining part of a new license/patent for himself)
- Distributor will find the profits he is making in expansion as sufficient
- Distributor will not see more profitable business opportunities

Three are connected with the market:

- Hendig towel's product lifetime will prove to be coming close to peak and towards end (as suggest a classic curve of product lifetime). In the words of the BCG matrix, the Hendig towel will start losing market growth rate, deteriorating from a question mark (at its highest point the Hendig towel will still be quite exclusive, therefore relatively low market share is predicted throughout its lifetime) to a „poor dog“ quadrant of the matrix.
- The towel market will prove to have opportunities for profit and niche competitors, niche-needs of customers that are currently not fulfilled.
- The majority of the EU-27 market will seem to be able to accept the new product, i.e. the new product will have a potential to succeed in all or most of the EU-27 states.

Two are connected with financial performance of Design Towels (part of which is a direct function of volume sold by the distributor in Czech market):

- The costs of NPD will amount to CZK 98,400, of that CZK 30,000 in year 1 and CZK 68,400 in year 2 (R&D + design protection expenses).

- Profit from activities in Norway, combined with profit from expansion, will amount to at least CZK 30,000 in year 1 and CZK 68,400 in year 2 (profit reinvestment sub-assumption is mentioned in the group dependent on owners' psychological will).

More questions of „What does it depend on?“ would enable the author of the business plan to create a few more levels of sub-assumptions. Some of the assumptions would start to cycle, i.e. to come to assumptions that have already been mentioned above. At the very end, the person who will be able to estimate the probability of assumption fulfillment will be the one with a very good knowledge of three matters – the two participating parties (the company and the distributor) and the market.

### 2.3. The reality of choosing the market entry mode

Assumption 1	The most suitable market entry mode is exporting, with Czech distributor paid from provisions from each sold towel.	Correct
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Exporting with a local distributor has proven itself as the best (and eventually the only) choice of market entry mode for Design Towels. Without knowing the local language and environment in textile nor health-aid industry, exporting with the distributor has enabled the owners to start the exporting process very soon – mainly because they have known the distributor for a longer time already. The choice fell on a Slovak national living in Prague, who was willing to start the business with Hendig towel in the Czech Republic immediately, as a freelancer.

The company took advantage of distributor's knowledge of local culture and his motivation to sell as many towels as possible, since the reward from each sold towel has been set by equation „price received by distributor - price paid to Design Towels“. The capital required from Design Towels included only costs of goods sold, i.e. their purchases of towels from China. This way the company mitigated the risks that would have been connected with unsuccessful capital-intensive expansion, while it secured its profit margin of CZK 60 per towel (COGS for Design Towels CZK 140 / piece, selling price CZK 200). The gentlemen agreement between the company and the distributor, to keep the selling price unchanged, was held by both parties for the whole six months.

The one problem that appeared was that the distributor did not devote his full-time engagement to the project. This may happen in case of licensing and exporting via a distributor. In case of licensing the danger is lower, as the distributor would be asked to pay annual license fee in advance, motivating him more to act. However, licensing came out of question as the company has found out that the towel cannot have the legal protection of design in EU-27, thus anyone can be selling it outside of Norway, where it had the protection (more in Chapter 2.4.). The more capital-intensive market entry modes were out of question for Design Towels and for direct exporting they did not have language knowledge. For these reasons, the exporting via the distributor was the only possible choice for the company.

### **2.3.1. Recommendations**

The starting entrepreneurs will more likely be on the side of a distributor of a company, then a company that decides to expand abroad. In any case, entrepreneurs should always make sure that the chosen business partner will be motivated to cooperate with them for desired period of time. i.e. that this cooperation is, and probably will remain, the best option for the partner. The cooperation should thus never be pushed and lobbied for by one party, since the other party will sooner or later realize that the truth has been crooked, and that there are better opportunities for using its time and resources. The costs of withdrawal of a strategic partner, such as paused production or purchasing, denied or long-waiting customers, loss of know-how, change in the details of product or service that comes with a new strategic supplier, may cause the end of business activity to a starting entrepreneur, especially if the early-stage companies have no spare capital and a short-lived reputation.

There are, of course, the means to ensure the strategic partnership, such as in case of Design Towels and the distributor, when there should have been a contract, framework contract or other binding agreement signed by both sides. The partner may not want to sign this agreement, or if he is a friend of an entrepreneur, neither party is willing to act too officially and presuming unreliability of the other. In that case, there are softer kinds of agreements that the parties can discuss, such as in case of Design Towels the gentlemen agreement on the prices of towels between the two partners, which worked well. Moreover, the performance of the strategic partner is to be watched carefully, regularly compared to monthly schedules set up in the business plan, and in back of the head, a plan should be kept for set of actions, should ever the partner withdraw.

The recommendation on the choice of market entry mode is to create a table, similar to Table 1, with conditions favoring each mode, conditions against, and to name the deal-breakers (such as lack of capital, knowledge of local language, etc). For starting entrepreneurs it is usually easier to choose the best mode of entry, and the choice gets wider with more resources that the company has access to.



## 2.4. The reality of legal protection of design

Assumption 2	Design Towels will protect the design for EU-27 states, they will bear the costs of EUR 350.	Wrong
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At the start of Design Towel's expansion to the Czech Republic, it caused a big surprise when they have found out that the design of the only product, the Hendig towel, cannot be protected on the EU level. The mistake was, for Design Towels, not obtaining the full information in internet research, and for the distributor, relying too much on promises of the strategic partner. The towel has been commercially used in Norway for 30 months at the time of intended application. However, the regulations of OHIM (The Office for Harmonization under Internal Market) state that entity has 24 months after commercialization of its product, protected in some country or not, to apply for design protection on the EU or other national level. After this period, the product loses the right to obtain new protection in any EU country.

The results of this change of expected events could be classified as both positive and negative. The positive were:

- Design Towels saved CZK 8,400 planned for the protection.
- The owners were more motivated to develop a new product, which they therefore developed more than a year before the plan, and with lower costs (see Chapter 2.6).
- Motivation of both parties to pre-empt the market before competition notices the product has increased.

The negative results:

- Higher vulnerability
  - of individual sales in case that the large textile stores notice the potential of the product
  - of hotel sales in case that large textile suppliers notice the potential of the product
  - of pharmacy sales in case that anyone notices the potential of the product
- Worse justification for premium price, where the argument of protected design should have played a role – as the distributor left the price high, this affected negatively the volumes and thus the revenues.

### **2.4.1. Recommendations**

The design protection would mean advantages for both parties. The mistake occurred in crafting of a business plan. The website of OHIM does not list all requirements for design protection in one site, but scattered over various sites. The author did not know that he should look for information on period of commercialization, hence has not known that he should ask Design Towels to find out this period. In this case, a contract could save the party that is relying on the protection to be done by strategic partner, saying „if partner A devotes resources to project, partner B is obliged to protect the product on EU level, or to return the resources spent by partner A to them, if they so require“.

Another solution to legal protection of design is to contact the local Office for protection of intellectual property, ideally by a visit, and gain as many information as possible from an employee. The information on the internet is rarely the full information, unless there are actual quotations from the Codex. The time spent to present full information to the employee of such an office in an EU member state to acquire detailed information is worth it.

## 2.5. The reality of changing the region of production

Assumption 3	Production of Hendig towel will be moved to Central Europe after 2 years.	Correct
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The production and delivery costs were expected to decrease in year three, as the production of towels would be moved to the Central Europe. This required efforts on the side of any of the two partners. Both of them would profit from lower production price – Design Towels could increase its CZK 60 margin and the distributor could also increase his margin. However, none party said, what steps it will take and when. That is why the distributor in the end completed the whole search for new production facility, including order of samples, quality considerations and negotiation about prices and quantities. The distributor now has two new producers from Turkey, ready to start producing the towels immediately. However, the MOQs (Minimum Order Quantities) are very high at both available producers, therefore two events must happen before an order is placed. Firstly, the stock of Design Towels ordered from Shanghai must be depleted. Secondly, market has to be researched to find the real potential for the new order.

### 2.5.1. Recommendations

When thinking about buying products directly from a producer, in most cases the MOQs are too high to be realized by a starting entrepreneur. Loans are not only difficult to get (especially bank loans with reasonable interest rate), but also one has to know the market perfectly well before taking a loan – which is rarely the case in start-ups. The considerations should therefore be threefold:

- Can a loan be provided by someone out of the entrepreneur's 3F – Family, Friends or Fools?
- Is there any producer that can produce lower quantities? This would often be a local, small producer, like a tailor or a sewer in case of specially-shaped towels. Entrepreneur can visit such producers and discuss the needs and possibilities with them.
- Can the orders be bulked, so that entrepreneur can summon as many of them as is the producer's MOQ? This would be rather difficult in individual sales, but it might be possible to collect orders from ten organizations that each orders one tenth of MOQ, and agree with them that they will wait for some time.

A mistake that start-ups make in production considerations is that they assume the production capacity and willingness of unknown, distant companies, such as: „Someone will produce it for me in Asia, for one or two dollars a piece“. Any calculation of COGS that comes out of this will prove to be a disaster. Therefore, searching a business directory and contacting producers, until entrepreneur gets real price quotations for different order quantities, including payment terms, delivery terms, etc, is highly advisable.

## 2.6. The reality of new product development

Assumption 4	Design Towels will have designed and protected new original product by year 3.	Wrong
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In Chapter 2.2. the author has designed an assumption tree, showing what are the drivers influencing the fulfillment of an assumption about NPD. In reality, the new product has been designed by Design Towels by month three after starting the cooperation with the distributor. The stimulus was the finding that the Hendig towel cannot have an EU-protected design, due to its Norwegian commercialization of over 24 months. The costs of NPD were merely CZK 20,000, mostly spent on sewing machine and supplies, which helped the owner in creation of towel-like prototype of new product. After the product has been developed, the distributor used his contacts and has found a producer in Turkey, able to produce the towel exactly as required. The consequences of such a quick NPD will be product's much sooner adoption, and a significant positive change in planned sales.

### 2.6.1. Recommendations

The prior contract, as mentioned in Chapters above, can significantly reduce surprises. The positive surprise from appearance of the new product will change entirely the plans for distribution and promotion, the budget, costs, revenues, profit and capital requirements. Therefore, entrepreneurs should always have in mind a back-up plan, in case the company they cooperate with changes some part of the equation, i.e. stops producing the product, changes the product by adding or stripping some features, (significantly) changes the price of the product. This back-up plan should be a set of very clear and definite steps that need to be taken if change occurs. If entrepreneur manages to keep in touch with a back-up strategic supplier, the faster his reaction will be once the change occurs.

## 2.7. The reality of competition

Assumption 5	There is no competition with USP of towel that helps people with moving difficulties. Some competitors rely on low price and wider variety. Due to design protection, competition will not enter for the first 3 years.	Wrong
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The research of existing competition has resulted in the Table 4 in Chapter 1.12. of the business plan, with identification of IKEA and e-shops with luxury bathroom textile as competitors for the individual sales, and hotel textile suppliers with established contacts as competitors in hotel sales. However, there is another competitor, who only became apparent after the start of business activity. It is Magnet, or newly Blancheporte, large and already traditional Czech brand for household textile shop, selling since 1967 via a catalogue, currently mostly via e-shop. Their washcloth (Picture 1) is aimed at easier washing of a person's back, although due to its material can also be used for drying of any remote part of body. Although this wascloth fulfills the medical (or aid) USP of Design Towels, its appearance, quality and feeling of luxury is far behind that of Hendig towel. The distributor is therefore including this product on the Czech website of Design Towels, creating an option for customer to order both the towel and the washcloth in a set – the full set for washing and cleaning of remote body parts, while stretching the stiff muscles at the same time.



**Picture 1:** A washcloth on a screen of Magnet Blancheporte website

*Source: Magnet Blancheporte [online]. 2011 [cit. 2011-09-15]. Retrieved from <<http://www.blancheporte.cz/zinka>>.*

Second mistake was counting with an assumption, or rather a promise, of design protection. The design of Hendig towel could not be protected, which resulted in more fear that the established textile stores and other competitors with larger budget for orders and advertising, will try their luck with the same towel. This, however, did not happen during the first six months of activity, although the details of the towel were revealed to many towel producers, in and outside of Central Europe, to textile and furniture stores, pharmacy distributors and hundreds of individuals.

### **2.7.1. Recommendations**

For the research of competition (i.e. SWOT analyses and tables similar to Table 4 in Theoretical part) an entrepreneur should use various sources. Internet research may often not reveal some competitors that a simple questionnaire in public will. If the author of the business plan had asked 100 people in the street to name bathroom textile companies or sales channels that they use or know for this kind of goods, Magnet Blancheporte would have definitely appeared among the responses. Although the market research should be as extensive as possible, and done on a variety of representatives from the target group, even a simple questioning of family members and friends is better than nothing. Scanning the catalogues of as many competing firms as possible would also provide much information and it is a source for inspiration, such as when the Czech distributor of Design Towels creates a set of the towel and the special washcloth.

Two decisive factors from Table 4 are competition's price and established contacts. The USP might be of highest originality, but some markets are plainly price-sensitive, which is also a case of the Czech Republic. The low interest in towel proved that the customers' decisions are primarily based on price, and only after that on quality. The solution is a selective distribution, only among the groups that need the product, and thus are less price-sensitive to it, such as distribution via pharmacies. Trying to push product for high price to highly price-sensitive customer groups is a waste of resources.

The established contacts and contracts in case of institutional customers are the second big obstacle. An entrepreneur might say that if his product is superior in quality or price, he definitely will be chosen by institutional customer. The long-cultivated B2B contacts are, however, not easy to break. Costs of disbanding the partnership for both partners would be too high, as they already know the people, the delivery terms, help each other out in payments,

etc. Also, trusting a new supplier straightaway would be unreasonable. Therefore, acquiring customers who already have established contacts with other suppliers can happen only if the price the that new entrepreneur is offering is significantly lower than the existing one for the same quality, or the existing relationship is worrisome, with the existing supplier making mistakes and showing signs of difficulties.



## 2.8. The reality of market volume

Assumption 6	Potentially there are 2 million customers in the age group of over 65, 0.5 million customers with moving difficulties, over 500 hotels, spas, wellness and rehabilitation centres.	Wrong
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The size of the potential market proved to be overestimated in the business plan. The corrections that should be done to the market estimations in the business plan are following:

- People over the age of 65 – only women over 65, whose children are from higher income group
- People with moving difficulties – only people with the “lighter“ disabilities, who are still able to move and turn well, in higher income groups or whose children are in this group
- Hotels, spas, wellness and rehabilitation centres – the price would have to be below current COGS for these customers. They come more in question once the cheaper MOQ can be ordered from new Turkish producers. Moreover, the towel was refused from some hotels due to its loops that make it unable to be washed and folded by machines used in hotel washrooms
- One new target group should be added, which was not counted before, and that is women, who enjoy quality or luxury lifestyle. The reality has proven that the need in this target group is existing and that customers are ready to give the towel a try by purchasing it.

### 2.8.1. Recommendations

Market research is the key. From the experience it is apparent that an entrepreneur will do well if he does a proper market research, asks as many people as possible, using photographs and other aids, asks the intended distribution channels and the prospective institutional customers. He should ask respondents for price, shape, quality, competition, and leave space for free comments and suggestions. When it is time to conduct a market research, there is no space for usual excuses such as laziness, shyness, lack of money or blind trust that the product or service will be selling well, just because it is perfect, or because it is successful abroad. Every entrepreneur should make a proper market research, the best mean for gaining new insights, inspiration and understanding. The entrepreneur should do his market research on his own, and afterwards evaluate the results critically.

## 2.9. The reality of customer reaction

Assumption 7	The towel will be generally accepted by hotels, spas, wellness and rehabilitation centres addressed by a sales person, and by the individuals who notice it on the website or in pharmacy or a sanitary goods store.	Wrong
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As written in Chapter 2.8., market research is the key. Very often entrepreneurs fall in love with their product or service and are too little critical to its potential. The adoption of Hendig towel by hotels proved to be problematic due to its inability to be machine folded. Most spas and hotels required a price below current COGS, and as written in Chapter 2.7., the costs of their withdrawal from current suppliers are quite high.

The individuals did notice the product on the website. The Google AdWords campaign has brought over one hundred visits to the website, while costing CZK 1,500. However, the price sensitivity in the Czech market has caused that not a single person has ordered the towel. Therefore the price has now been set to CZK 690, and the distributor plans to keep lowering it slowly until he can make good price-sensitivity analysis and establish a price that people are willing to pay.

### 2.9.1. Recommendations

Besides conducting a perfect, deep and wide market research, and entrepreneur should plan the steps that lead to realizing the sales. That means describing to the very detail when will he address whom, what he wants to achieve and what will he say to achieve it. Having a clear plan of selling works firstly as a motivator, and secondly in making more realistic financial projections.

## 2.10. The reality of short-term marketing strategy

Assumption 8	There will be only one type of towel, with premium quality and customers service.	Wrong
Assumption 9	Premium price will be accepted by both individuals and institutions (pharmacies, sanitary goods stores, hotels, spas, wellness and rehabilitation centres).	Wrong
Assumption 10	Selective distribution via website and pharmacies to individual customers and via one sales person to hotels, spas, wellness and rehabilitation centres.	Wrong
Assumption 11	Cheaper forms of promotion, such as Google AdWords, leaflets, brochures at points of sale.	Wrong

The fact that Design Towels have developed a new towel-like product four months after the expansion into the Czech Republic, made both the company and the distributor change their plans (Chapter 2.6.). Due to current lack of interest of institutional customers in Hendig towel, the new product acts as a good substitute, as it is specially designed for use in hotels and wellness centres. The characteristics of Hendig towel remain unchanged until the stock that Design Towels have, will be depleted. After that the new order will probably be taken from Turkey, where the production prices are about 50% of the current prices, with a slightly worse quality of cotton fibres.

The premium price was harder to justify due to inability to protect the design of the towel. However, even if the design was protected, the Czech market proved to be more price-sensitive than expected. The margin for the distributor had to be therefore lowered, as there were no orders from the individual customers during the whole six months.

The distribution channels also did not work as assumed in the business plan. The lack of market research and no plan of selling steps lead to lack of knowledge about pharmacy purchasing. If the research was done properly, the distributor would know that the pharmacies purchase from pharmaceutical distributors. Selling to pharmacies should from the very beginning be done via contacting the pharmaceutical distributors, who could list the towel in their systems. Not knowing this has caused that the distributor has first contacted the distributors in month five of the activities – a delay to the business plan. The website as

a channel for individual sales has been complemented by cooperation with a health and beauty clinic in Prague, encountered by a lucky accident in month four of the activity.

The type of short-term promotion that should be used in the case of specific and expensive towels was assumed correctly by the distributor. The amount needed was, however, different. The Google AdWords campaign would require twice as many funds as planned to be running non-stop. Since the one hundred website visitors made no order, the distributor has decided to change into an affiliate program with the website Nový Dodavatel (The New Supplier) at [www.novy-dodavatel.com](http://www.novy-dodavatel.com). Now there is a graphical banner of towel of the homepage of this website. Other expenses on promotion included the business cards and a free sample of towels used as a present for the journalists, who agreed to write about the towels in Czech women's magazines.

#### **2.10.1. Recommendations**

Most of the recommendations from the Chapters above apply also in case of marketing strategy. The proper market research should include a wide range of potential customers, and look for their opinions and suggestions on product and price. It should be complemented by interviews with distribution channels. In addition, the flexibility of an entrepreneur should be backed up by having scenarios planned for every possible situation that might occur. That way an entrepreneur can take faster advantage of any change. Leaving of a strategic partner may mean a possibility to establish contact with a cheaper one, discovery of a new competitor may mean an inspiration by his products, services and the way of doing business, and finding of new product may mean immediate boos of the revenues.

## 2.11. The Reality of Revenue and Cost Structure

Assumption 12	Price and volume sold through different channels is in detail described in Chapter 1.14.	Wrong
Assumption 13	For assumptions on cost structure and its influence on capital requirements see Chapter 1.14.	Wrong

Wrong market research resulted in over-optimistic assumption about the sales. Design Towels was hedged against the risk of low sales by carrying no fixed costs and binding no future activities on the forecasted returns. The distributor, however, who has managed to sell only 12 towels, while the business plan has counted with 905 towels sold during first six months to various groups of customers (Chapter 1.14.), had to carry the fixed costs of promotion (Google AdWords and business cards) and the telephone, which amounted to CZK 5,750 for the whole period (Table 11). The first six months have let the Design Towels with a negligible accumulated profit of CZK 720, compared to forecasted CZK 51,600, and the distributor with a loss of CZK 4,150, compared to the forecasted profit of CZK 34,100.

Item	Month 0	Month 1	Month 2	Month 3	Month 4	Month 5	Month 6
Pcs. Sold to Distributor	0	0	0	0	0	12	0
Price/towel	200	200	200	200	200	200	200
Revenue	0	0	0	0	0	2 400	0
COGS	0	0	0	0	0	1 680	0
Profit	0	0	0	0	0	720	0
Profit accumulated	0	0	0	0	0	720	720

**Table 10:** Real costs and revenues from expansion for Design Towels, first six months

*Source: Author*

Item	Month 0	Month 1	Month 2	Month 3	Month 4	Month 5	Month 6
Price/towel, individual customers	0	890	890	890	890	690	690
Pcs.sold to individual customers	0	0	0	0	0	0	0
Price/towel, pharmacies	0	450	450	450	450	450	450
Pcs.sold to pharmacies	0	0	0	0	0	0	0
Price/towel, sanitary stores	0	450	450	450	450	450	450
Pcs.sold to sanitary stores	0	0	0	0	0	0	0
Price/towel, hotels, spas, wellness	0	350	350	350	350	350	350
Pcs. sold to hotels, spas, wellness	0	0	0	0	0	0	0
Price/towel, private clinic, rehab center	0	350	350	350	350	350	350
Pcs. sold to private clinic, rehab center	0	0	0	0	0	12	0
Revenues	0	0	0	0	0	0	4,200
Cost/towel	0	200	200	200	200	200	200
Pcs towel ordered & delivered	0	0	0	0	0	12	0
Delivery from Norway	0	0	0	0	0	1,200	0
COGS	0	0	0	0	0	2,400	0
Cost/Business card	0	0	5	0	0	0	0
Pcs Business cards	0	0	200	0	0	0	0
Cost Telephone	200	150	200	250	350	300	300
Cost AdWords	0	1,000	1,000	0	0	0	0
Total costs	200	1,150	2,200	250	350	3,900	300
Profit	-200	-1,150	-2,200	-250	-350	-3,900	3,900
Profit accumulated	-200	-1,350	-3,550	-3,800	-4,150	-8,050	-4,150

**Table 11:** Real costs and revenues from expansion for the Czech distributor, first six months

*Source: Author*

### 2.11.1. Recommendations

The revenues that are calculated from incomplete market research will always be over-optimistic. Even based on a great market research, it is advisable to calculate different scenarios for the financials, at the minimum a base case, negative and positive scenario. Contractual binding of the strategic partner to some minimum performance would also have increased the sales in case of the Czech distributor. It may require longer time to find a partner, who would agree to such a contract, but a successful and experienced company should have no problem with recognizing that the minimum an entrepreneur requires is reachable. Thus such a contract may help to find the business partners that will really be able to do the job, while unwillingness to sign shows that the potential partner is inconfident.

There are some stories of entrepreneurs who spent all their resources to buy one item, thanks to which they became rich. This is not recommended. If the market research is lacking and entrepreneur does not see the errors that his product or service has, he may spend all the money, including friends', family's and fools' money, on something that he will never be able to sell at a profit. Such as if the Czech distributor had ordered MOQ from a Turkish producer and tried to sell it on his own, disbanding from Design Towels, he would probably end with thousands of towels on stock, and 12 sold pieces.

At the beginning of entrepreneurial activity, the target should be to minimize the fixed costs, just in case the business idea will prove to be disfunctional. The added value of the costs, i.e. the return on all types of costs, should be measured. As in the case of promotion, entrepreneur can find out what source of promotion attracted the customer, and divide the profit generated by that type of promotion by its cost. In this way the most efficient ways of promotion will become visible.

## **2.12. Seasonality and the human factor**

Two more assumptions that entrepreneurs rarely count with in their business plan, although they might be crucial, are seasonality and the human factor.

Seasonality is crucial in case of short-term sales projections. For example, if an entrepreneur takes out a loan that is to be repaid six months after the start of business, he must bear in mind the question of seasonality of his product or service. If he is doing outside construction or selling refreshment, the summer months will more than double the sales in winter months. On the contrary, for many conventional products summer sales are far below pre-Christmas or spring season. This was the case also with Design Towels, when the Norwegian sales before Christmas were at over 200% of late-summer sales.

The considerations of the human factor should be on the side of entrepreneurs themselves, of business partners, and of customers. Design Towels did not examine thoroughly the motivation of Czech distributor to devote full time to the project. As a result, when after some days the sales appeared to be difficult to achieve and the usefulness of the towel discredited by some potential customers, the motivation to keep the high pace of business development decreased.

The feelings of disappointment, insecurity and loss of long-term objectives are often resulting in resignation, low work performance and devotion of entrepreneur. Starting entrepreneurs should know themselves well, so that they knew in advance what reaction they can expect when the events start varying away from the plan. Personal belief of the author is that every entrepreneur will encounter these feelings within less than a year from the start of business.



## Conclusion

This Master thesis has analyzed the mistakes that an entrepreneur is likely to make in creation of a business plan and recommended ways to avoid these mistakes. In the Theoretical part the author has created a business plan for the owners of the company Design Towels, who would like to export its product to the Czech Republic, and for their future Czech distributor. In the Practical part, the author has looked back on this business plan six months after the entrepreneurial activities of the Czech distributor have started, and analysed the mistakes that were made. The recommendations are also a part of the Practical part.

To summarize the findings of this Master thesis, an entrepreneur has to always keep in mind that the reality will differ, to different extent, from the business plan. In case of the analysed business plan of Design Towels 85% of the assumptions were proven to be wrong and 15% correct. An entrepreneur has therefore to be flexible and have back-up plans ready. To ensure the highest possible accuracy of the business plan, an entrepreneur should use a tool designed by the author, called assumption tree. This will help the entrepreneur in knowing the basic sub-assumptions that drive each of the major business plan's assumptions. These sub-assumptions are easier to verify, they usually come down to perfect knowledge of the participating entities (company, business partners) and the market. Knowing the sub-assumptions helps in staying alert to better forecast coming changes to the major assumptions of the business plan.

The main reasons for deviation of business reality from the created business plan were poor market research, no contractual agreements on minimum performance of a business partner, mistakes in an internet research of competition and of legal requirements, and over-optimistic expectations. These appear most often in recommendations to the starting entrepreneurs. Other recommendations, based on real-life experiences of this new venture, include being true to themselves and to the (potential) business partner, enquiring in detail the conditions of potential producers and distributor, realizing tightness of existing B2B contacts, creation of a very detailed sales plan, creation of scenarios if a certain variable changes (the back-up plans), finding ways to avoid high fixed costs in the beginning, seasonality awareness, and dealing with the probable feelings of disappointment and loss of long-term vision.

To summarize the first six months of Design Towels' expansion, it was successful. This may sound surprising, as only 12 towels were sold in this period. However, it provided learning experience to the company and to the distributor, tested distribution channels and ways of promotion, and helped in creation of a price-sensitivity analysis of Czech customers. The future of this venture may be bright, as the contacts are now established with interested resellers and a new interesting product for hotels has been developed to substitute the disfunctional Hendig towel in this customer group.

As for the reflection on the literature review and the question on whether crafting a business plan is worthwhile or not, this thesis comes to an answer that it is worthwhile (although it is a matter of the personal characteristics). Buying the equipment may be a clearer signal to stakeholders, and an average entrepreneur may have better intuition than an average manager. However, without a business plan, entrepreneurs will be left with low knowledge of the market, no idea of the flows of cash, no chronological list of actions that lead to the desired state – in other words, they will be less efficient. Because as it has been proven in this thesis, the better the business plan, the higher the entrepreneur's efficiency.

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## Appendix



**Picture 2:** The Hendig Towel

*Source: Company website*



**Picture 3:** Marit Krane on the towel's presentation

*Source: Company website*



**Picture 4:** A model with the towel, website of Design Towels

*Source: Company website*



**Picture 5:** Manual production of the towel in Shanghai, China  
*Source: Company website*



**Picture 6:** A box of towels ready for dispatching  
*Source: Company website*



**Picture 7:** A screenshot from the Czech version of the Design Towels' website  
*Source: Company website*