



Entrepreneurship and New Venture Opportunities

OBJECTIVES

1. Describe how entrepreneurship evolved from economic theory.
2. Explain entrepreneurship and the characteristics of entrepreneurs.
3. Discuss small business as a dimension of entrepreneurship.
4. Describe the concept of corporate entrepreneurship.
5. Explain how entrepreneurship has influenced economic development and productivity in recent years.

The concept of entrepreneurship has been around for a very long time, but its resurgent popularity implies a "sudden discovery," as if we had stumbled onto a new direction for American enterprise. This is a myth, as we shall see, because the American system of free enterprise has always engendered the spirit of entrepreneurship. America was discovered by entrepreneurs and nourished by entrepreneurs, and the United States became a world economic power through entrepreneurial activity. More important, our future rests squarely on entrepreneurial ventures founded by creative individuals. They are inspired people, often adventurers, who can at once disrupt a society and instigate progress. They are risk takers who seize opportunities to harness and use resources in unusual ways, and entrepreneurs will thrust us into the twenty-first century with a thunderous roar.

Entrepreneurship constitutes the driving force of the American dream. In the chapters that follow, we will study how legendary tycoons created empires from simple ideas, how large corporations evolved from backyard enterprises, and how many new ventures today are poised for growth, perhaps having at their helms the Fords, Rockefellers, and Carnegies of the future.

AN ENTREPRENEURIAL PERSPECTIVE

Entrepreneurship is one of the four mainstream economic factors: land, labor, capital, and entrepreneurship. The word itself, derived from 17th-century French *entreprendre*, refers to individuals who were "undertakers," meaning those who "undertook" the risk of new enterprise. They were "contractors" who bore the risks of profit or loss, and many early entrepreneurs were soldiers of fortune, adventurers, builders, merchants, and, incidentally, funeral directors. How the term "undertaker" became associated with funerals is a mystery, but there is a considerable body of literature on entrepreneurship. Early references to the *entrepreneur* in the 14th century spoke about tax contractors—individuals who paid a fixed sum of money to a government for the license to collect taxes in their region. Tax entrepreneurs bore the risk of collecting individual taxes. If they collected more than the sum paid for their licenses, they made profits and kept the excess. If they failed to collect enough to match the cost of their licenses, government officials, who already had their money from license fees, could not care less. Entrepreneurship was a common topic in economic essays for much of the 18th and 19th centuries. Notable early French, British, and Austrian economists wrote enthusiastically about entrepreneurs as the "change agents" of progressive economies.

Economics and Entrepreneurship

Richard Cantillon, a French economist of Irish descent, is credited with giving the concept of entrepreneurship a central role in economics. In his *Essai sur la nature du commerce en général*, published posthumously in 1755, Cantillon described an entrepreneur as a person who pays a certain price for a product to resell it at an uncertain price, thereby making decisions about obtaining and using resources while consequently assuming the risk of enterprise.¹ A critical point in Cantillon's argument was that entrepreneurs consciously make decisions about resource allocations. Consequently, astute entrepreneurs would always seek the best opportunities for using resources for their highest commercial yields. Cantillon played out his theory in real life, becoming a wealthy arbitrageur investing in European ventures, dealing in monetary exchange, and controlling commodities, such as farm produce, to auction in high-demand markets. His vision is illustrated for farm produce in Figure 1-1.

Adam Smith spoke of the "enterpriser" in his 1776 *Wealth of Nations*² as an individual who undertook the formation of an organization for commercial purposes. He thereby ascribed to the entrepreneur the role of industrialist, but he also viewed the entrepreneur as a person with unusual foresight who could recognize potential demand for goods and services. In Smith's view, entrepreneurs reacted to economic change, thereby becoming the economic agents who transformed demand into supply.

French economist **Jean Baptiste Say** in his 1803 *Traité d'économie politique* (translated into English in 1845 as *A Treatise on Political Economy*), described an entrepreneur as one who possessed certain arts and skills of creating new economic enterprises, yet a person who had exceptional insight into society's needs and was able to fulfill them. Say, therefore, combined the "economic risk taker" of Cantillon

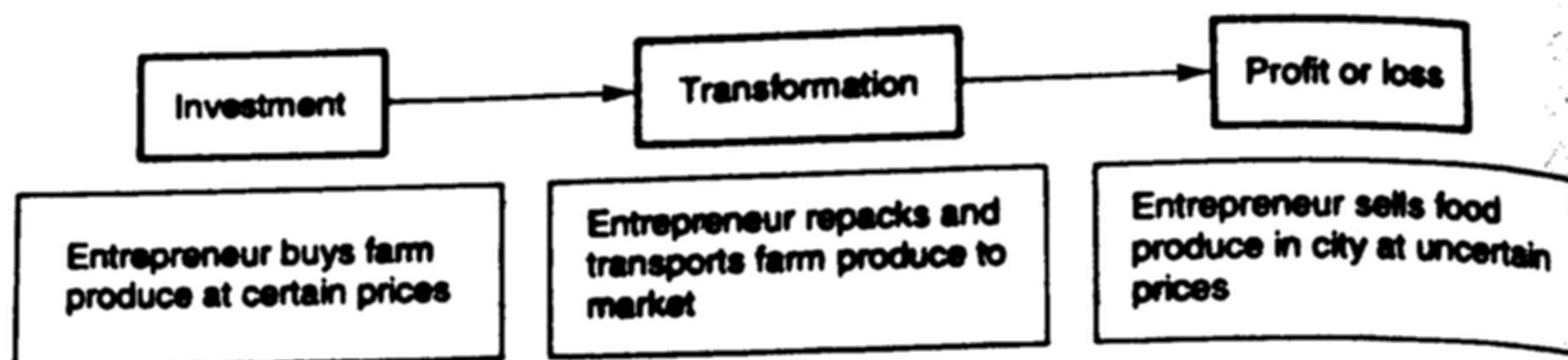


Figure 1-1 Cantillon's Early View of Entrepreneurial Behavior

and the "industrial manager" of Smith into an unusual character. Say's entrepreneur influenced society by creating new enterprises and at the same time was influenced by society to recognize needs and fulfill them through astute management of resources.³

In 1848, British economist John Stuart Mill elaborated on the necessity of entrepreneurship in private enterprise. The term *entrepreneur* subsequently became common as a description of business founders, and the "fourth factor" of economic endeavor was entrenched in economic literature as encompassing the ultimate ownership of a commercial enterprise. Mill's work, however, was among the last of the early economic studies in Britain or France that recognized entrepreneurship as central to economic theory. For the greater part of the next hundred years, British and French economists were more concerned with models of macroeconomics, and most of these were reduced to precise mathematical formulae. The human side of enterprise—the role of the adventurer or risk-taking entrepreneur—was left to history.

During that time, however, there was an important movement in Austria that subsequently influenced our 20th-century concept of entrepreneurship. Carl Menger (1840–1921) established the "subjectivist perspective of economics" in his 1871 *Principles of Economics*.⁴ In Menger's view, economic change does not arise from circumstances but from an individual's awareness and understanding of those circumstances. The entrepreneur becomes, therefore, the change agent who transforms resources into useful goods and services, often creating the circumstances that lead to industrial growth.

Menger envisioned a causal chain of events whereby resources having no direct use in terms of fulfilling human needs were transformed into highly valued products that directly fulfilled human needs; this is the classic theory of production. However, Menger saw the entrepreneur as an astute individual who could envision this transformation and create the means to implement it. Menger assigned priority numbers to different events (or circumstances) in this chain so that a high-priority event would have a low number (e.g., 1) and would be an ultimate "end use" to satisfy a human need such as providing consumers with baked loaves of bread. At the other extreme, Menger assigned a low-priority event with a high number (e.g., 8), and this might represent raw material needed to create the number 1 event; fields of unharvested wheat would have a low priority. The entrepreneur, in Menger's view, was able to see both extremes and conceive of ways to transform the unharvested wheat into fresh bread. Illustrated in Figure 1-2, Menger's model identified intermediate points of

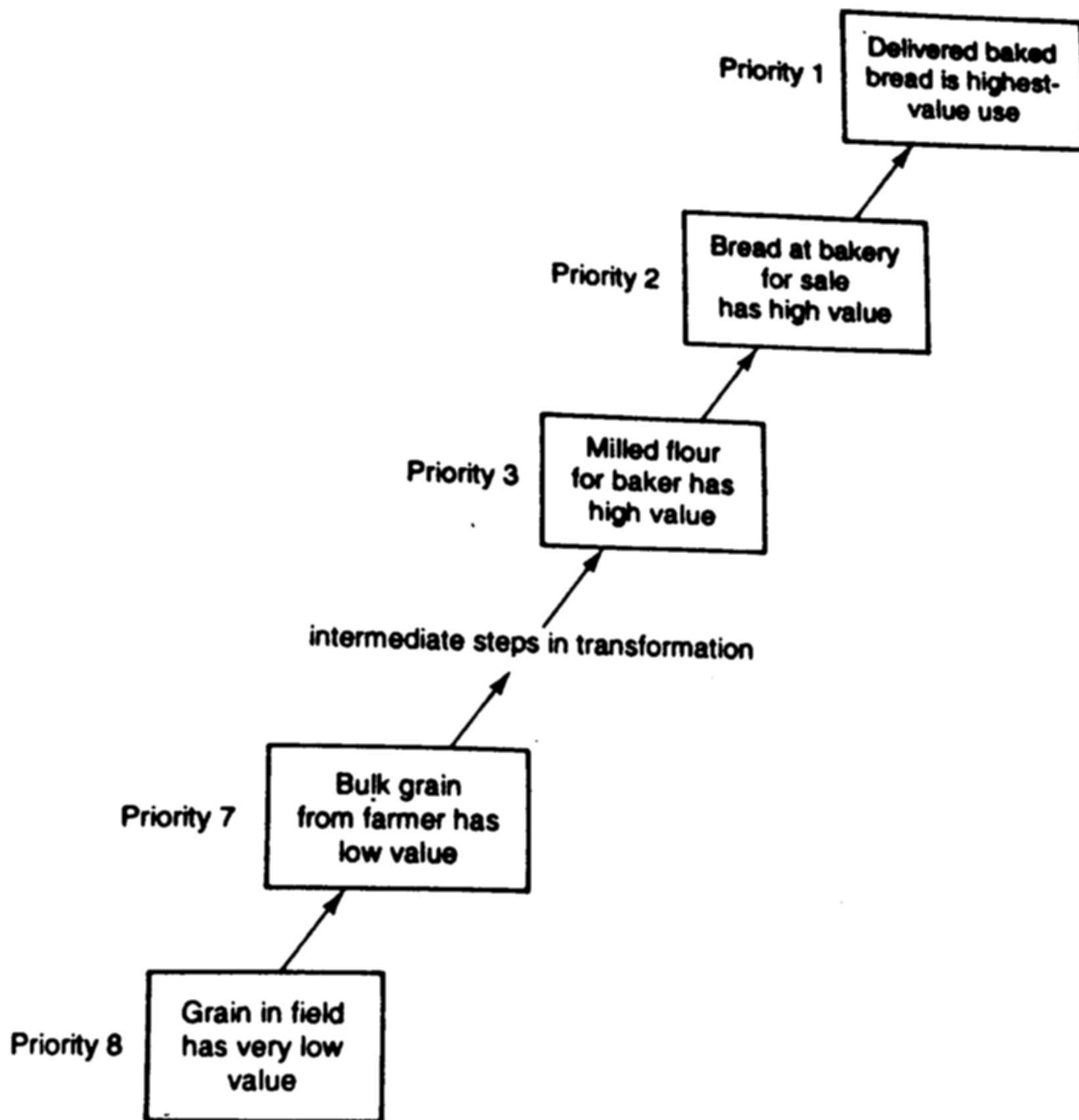


Figure 1-2 Menger's Model of Value-Added Transformation of Resources

transformation—harvesting wheat, grinding grain, making bread, and delivering it—each with opportunities for *adding value to the original resource* in such a way as to eventually satisfy a human need. Critical to Menger's theory was the incentive needed to pursue these transformation activities, and of course that is the profit motive. When value is added to a product, that value is rewarded through profits.

Extending the example, the entrepreneur who invents a way to harvest grain more efficiently or to grind grain into flour more rapidly adds more value to the product because the consumer benefits from more bread at a lower cost. This was precisely what occurred when Cyrus McCormick invented the mechanical reaper in 1831. Farmers had been reaping wheat by hand, just as they had done in ancient times, cutting perhaps an acre or two a day. With the McCormick reaper, farmers could reap a dozen acres a day, and by the 1860s, they were reaping 100 acres a

day.⁵ The reaper not only revolutionized agriculture, but it also inspired new industries in farm implements, grain processing, and food distribution.

In the 19th century, entrepreneurs were the "captains of industry," the risk takers, the decision makers, the individuals who aspired to wealth (and endured commensurate losses) and who gathered and managed resources to create new enterprises. Menger's model of "subjective enterprise" flourished in the United States, and American adventurers were creating the events that linked the chain between raw resources and useful products. Then an interesting picture began to emerge as huge, often embarrassing, fortunes were made. The connotation of an entrepreneur changed from captain of industry to an elusive character who garnered profits at the expense of others, a flimflam artist on the fringe of legitimate business. The term *entrepreneur* was relegated to obscurity in economic literature for several generations, and management writers focused on factory efficiency and administration.

Entrepreneurship as a Process

Another Austrian economist revived the concept of entrepreneurship when he joined Harvard University and his work was published in the United States in 1934. Joseph Schumpeter (1883–1950) wrote a series of economic articles and treatises between 1911 and 1950 that specifically addressed entrepreneurship. Schumpeter described entrepreneurship as a force of "creative destruction" whereby established ways of doing things are destroyed by the creation of new and better ways to get things done. Entrepreneurship is often a subtle force, challenging the order of society through marginally small changes, but in Schumpeter's view, it can be extraordinarily powerful, like the changes caused by McCormick's reaper or the transformation of crude oil into an energy resource. Schumpeter described entrepreneurship as a *process* and entrepreneurs as *innovators* who use the process to shatter the status quo through new combinations of resources and new methods of commerce.⁶

In retrospect, it is important to recognize that entrepreneurship as an economic concept has suffered a century of obscurity. Most executives will not have heard of Schumpeter, Menger, or Cantillon; most know of Smith, but few will recognize Mill or Say. Today, the resurgence of entrepreneurship in higher education has not come from the discipline of economics but from those who teach small business management or who have instituted new courses in entrepreneurship. During the early 1970s, these were often renegade professors in management, marketing, or engineering. During the 1980s, entrepreneurship education attracted mainstream scholars, and new programs of entrepreneurship began to flourish, led by schools such as Babson College, Wichita State, USC, and Baylor University. As we enter the 1990s, many of the nation's most prestigious business schools are taking a lead to encourage serious entrepreneurship education. Harvard Business School, MIT, Stanford, the Wharton School, and UC Berkeley are among more than 300 colleges and universities with studies in entrepreneurship.⁷

Fortunately, entrepreneurs have ignored theoretical arguments and plunged ahead with tremendous energy to forge new enterprises. This phenomenon has been particularly strong in the United States through several generations of explosive

economic activity. It is no accident that every *Fortune* 500 enterprise that exists today was the result of an entrepreneur who took a simple idea and persevered.

► CHECKPOINT

Compare concepts of entrepreneurship put forward by Cantillon, Say, Smith, Menger, and Schumpeter.

Explain entrepreneurship as a process and the importance of innovation to that process.

DEFINING ENTREPRENEURSHIP

We do not have one indisputable definition of *entrepreneurship* or *entrepreneur*. However, Schumpeter provides us with a framework for understanding both in terms of a process. The entrepreneur seeks, in Schumpeter's words,

to reform or revolutionize the pattern of production by exploiting an invention or, more generally, an untried technological possibility for producing a new commodity or producing an old one in a new way, by opening up a new source of supply of materials or a new outlet for products. . . . Entrepreneurship, as defined, essentially consists in doing things that are not generally done in the ordinary course of business routine.⁸

Schumpeter did not equate entrepreneurs with inventors, suggesting instead that an inventor might only create a new product, whereas an entrepreneur will gather resources, organize talent, and provide leadership to make it a commercial success. This viewpoint was mirrored by Peter Drucker, who described the **entrepreneurial role** as one of gathering and using resources, but he added that "resources, to produce results, must be allocated to opportunities rather than to problems."⁹ In Drucker's view, entrepreneurship occurs when resources are redirected to progressive opportunities, not used to ensure administrative efficiency. This redirection of resources distinguishes the entrepreneurial role from that of the traditional management role, a distinction that Henry Ford made in his decisions.

The evolution of the concept has generated many definitions, but perhaps a recent one by writer Robert Ronstadt captures its essence. For our purposes, we shall use Ronstadt's definition of **entrepreneurship**:

Entrepreneurship is the dynamic process of creating incremental wealth. This wealth is created by individuals who assume the major risks in terms of equity, time, and/or career commitment of providing value for some product or service. The product or service itself may or may not be new or unique but value must somehow be infused by the entrepreneur by securing and allocating the necessary skills and resources.¹⁰

PROFILE Δ

Henry Ford

Starting a decade after most automobile manufacturers had been established in the United States, Henry Ford created the manufacturing miracle that launched a modern era in industry. His genius was in engineering an assembly line process, and his process was an historic innovation. Ford reversed the fundamental way things were manufactured. Rather than have workers go to the product, he brought the product to the workers on highly mobilized assembly lines.

Throughout his life, Ford sought to improve the engineering technology of production. He altered inventory systems to move parts and tools to the workers, structured lines with parts moving along waist high so that workers could perform their tasks comfortably, and grouped tasks logically so that more production could be achieved at lower costs. During his lifetime, Ford instituted more than a thousand innovations, and at one time he had more Ford automobiles on the road than the rest of the world's manufacturers combined.

Source: The Entrepreneurs: An American Adventure (Boston: Enterprise Media, 1987), Film No. 2.

Who Is an Entrepreneur?

With a definition in mind, we still have trouble identifying entrepreneurs, finding them, or determining what they do. Is the local gas station owner an entrepreneur? The realtor, the butcher, the franchise computer retailer? Are there entrepreneurs in corporations? In schools? In government? There are no short answers to these questions, and there are no formal guidelines for classifying entrepreneurs. There is no entrepreneurial licensing procedure and no evidence of professional status.

Karl Vesper has researched entrepreneurship and explains that its nature is often a matter of individual perception.¹¹ Economists, at least those who endorse free enterprise, endorse Schumpeter's viewpoint that entrepreneurs bring resources together in unusual combinations to generate profits. Vesper found that psychologists tend to view entrepreneurs in behavioral terms as achievement-oriented individuals driven to seek challenges and new accomplishments. Marxist philosophers may see entrepreneurs as exploitative adventurers, representative of all that is negative in capitalism. Corporate managers too often view entrepreneurs as small businesspersons lacking the potential needed for corporate management. On a positive note, Vesper suggests that those of us who strongly favor a market economy view entrepreneurs

as pillars of industrial strength—the movers and shakers who constructively disrupt the status quo.

Traits versus Characteristics

In an effort to understand entrepreneurs better, researchers have sought to define traits common to a majority of individuals who start and operate new ventures. John Hornaday of Babson College was among the first to use surveys and intense interviews to develop a composite list of entrepreneurial traits.¹² These are summarized in Exhibit 1-1. Although this descriptive list is supported by impressive data, it has the singular restriction of relating only to highly successful entrepreneurs; there is no way of knowing how these traits relate to a majority of entrepreneurs. For example, some people may have the creative talent to generate new ideas but lack the ability to organize resources, and others may have a compelling need to achieve but lack the resourcefulness to create a new venture. Many of these individuals with a limited profile based on traits will start new businesses and succeed. Others with a majority of the traits may start new businesses and fail. Opponents of the trait approach also reverse Hornaday's logic and ask whether those among us who do not choose to be entrepreneurs have similar traits. Put another way, can a "nonentrepreneur" also be achievement oriented, persistent, and creative?

A. David Silver, a successful venture capitalist and author, described the entrepreneur as "energetic, single-minded," and having "a mission and clear vision; he or she intends to create out of this vision a product or service in a field many have determined is important to improve the lives of millions."¹³ Silver also suggests that entrepreneurs venture out on their own from a sense of dissatisfaction with their organizations, but they are not necessarily unhappy with their career fields. This point is illustrated by the proliferation of Silicon Valley firms that were established by

Exhibit 1-1 Characteristics of Successful Entrepreneurs

Self-confident and optimistic	Energetic and diligent
Able to take calculated risk	Creative, need to achieve
Respond positively to challenges	Dynamic leader
Flexible and able to adapt	Responsive to suggestions
Knowledgeable of markets	Take initiatives
Able to get along well with others	Resourceful and persevering
Independent minded	Perceptive with foresight
Versatile knowledge	Responsive to criticism

Source: John A. Hornaday, "Research about Living Entrepreneurs," in Calvin A. Kent, Donald L. Sexton, and Karl H. Vesper, eds., *Encyclopedia of Entrepreneurship* (Englewood Cliffs, NJ: Prentice-Hall, 1982), p. 28. Adapted with permission.

PROFILE △*Irving Berlin*

As a child, Irving Berlin sang for pennies on street corners in New York, but when he died in 1989, he left behind an unequalled legacy of music and theater innovations. Born in 1888, Israel Baline came to America as a Russian-Jewish immigrant with his parents, and at the age of five, he was on the streets of New York helping the family earn food money with his singing. His first published song was in 1907 at the age of 19, and his first blockbuster hit came in 1911 with "Alexander's Ragtime Band." During his life, he composed more than a thousand songs, complete scores for 19 Broadway shows, and music for a dozen movies.

Irving Berlin was also an astute businessman who started the Berlin Music Corporation, controlled his own copyrights, opened the Music Box (an innovative New York theater devoted to musical plays), and established foundations for creative artists and musicians. His musical innovations ranged from syncopations of ragtime and jazz to composing "God Bless America"—a song many Americans regard as the unofficial national anthem. Berlin was one of the few to write both his own lyrics and music, and he performed in several of his productions. However, he only played piano in the key of F sharp, and because so many scores had to be written in other keys, he had a special piano developed to transpose his compositions automatically to other keys.

Until a few months before his death, Berlin still called in to his office at Berlin Music Corporation, and he was an active supporter of the American Society of Composers, Authors, and Publishers, an organization he founded to help artists protect their creations.

Source: "One of a Kind," Sunday Morning Post (Hong Kong), Spectrum, September 24, 1989, p. 1.

engineers, inventors, scientists, and computer wizards who left established companies to pursue private enterprise, yet did so within the scope of their professions.

Another way to explain entrepreneurship is from a sociocultural standpoint. Albert Shapero made comparative studies between nations, peoples, and ethnic groups, accumulated information from historical trends, and conducted many firsthand interviews with entrepreneurs. He concluded that individuals often become entrepreneurs by being thrown into situations that force them to fashion their own means of economic livelihood.¹⁴ Immigrants fit this model well. As in the past, immigrants come to the United States to avoid war or political oppression. Many leave their home countries because of lack of opportunities and poor economic conditions. When they arrive in the United States, most lack language skills necessary to find decent jobs. Others,

stereotyped by their ethnic group or religion, may be barred from employment. Circumstances afford few options for these "displaced persons," who frequently establish independent ventures. Irving Berlin was one of the many immigrants who overcame these barriers to succeed, and in so doing, enriched our culture.

Shapiro also found a high correlation between increases in new ventures and rising unemployment. Many individuals become "economically displaced" (unemployed) or find themselves disillusioned with faltering careers. For these individuals, starting a new venture can be exhilarating, a breath of fresh air into an otherwise stale life-style. Individuals who retire, particularly those who retire early, are seldom ready to quit working, and for many, starting a business is an exciting opportunity.

Entrepreneurship, Small Business, and Corporate Ventures

The term *entrepreneur* may be properly applied to those who incubate new ideas, start enterprises based on those ideas, and provide added value to society based on their independent initiative. However, individuals who simply substitute income by leaving jobs to operate local stores or independent service businesses are described as small businesspersons. The distinction is subtle but important. The person who establishes a fast-food franchise chain is called an entrepreneur, but the local restaurant owner is called a small businessperson. Distinguishing factors are that entrepreneurs have vision for growth, commitment to constructive change, persistence to gather necessary resources, and energy to achieve unusual results. The small businessperson may exhibit these characteristics, but only coincidentally, not as a prerequisite to establishing an enterprise.

These are controversial issues because many "small businesspersons" reflect the essentials of entrepreneurship. They incubate ideas, gather resources, take individual risks, and persist in seeing their ventures succeed. They do not, however, pursue growth through constructive change in the same way Schumpeter explained entrepreneurship or in the manner of Drucker's description of the entrepreneurial process. Still, what has *not* been accomplished by research is to clearly differentiate small business from entrepreneurship. If we add a third dimension of corporate entrepreneurship, we have a rather complex controversy.

Corporate entrepreneurship, sometimes referred to as intrapreneurship, is concerned with innovation that leads to new corporate divisions or subsidiary ventures in established, larger firms.¹⁵ The concept of entrepreneurship does not exclude managers in large organizations from being entrepreneurs if they combine resources in unusual ways to create innovative new products or services. However, because entrepreneurs take personal investment risks and corporate managers very rarely do, there are grounds for arguing that corporate entrepreneurship is a play on words. Corporate managers may commit time and energy, and perhaps also risk their careers, but there is little evidence of corporate managers risking personal investment capital to champion a corporate innovation. This is an interesting topic that will be explored further in Chapter 3, but for now, let's draw some fundamental distinctions between small business, intrapreneurship, and entrepreneurship.

► **CHECKPOINT**

Describe the critical points in our definition of entrepreneurship.
 Identify and discuss the characteristics of entrepreneurs, and discuss how they might differ from those of people not interested in new ventures.
 Explain how the definitions of entrepreneurship, small business, and corporate entrepreneurship differ.

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PERSPECTIVE ON SMALL BUSINESS

During the 1970s small businesses created more than 6 million new jobs for Americans. At the same time, *Fortune* 500 firms cut employment by nearly 10 percent, for a net loss of more than a million jobs. During the first half of the 1980s, new jobs from small business enterprises eclipsed the gains of the 1970s, and today, more than 16 million small businesses account for approximately 97 percent of all nonfarm businesses. Between 1980 and 1987, 66 percent of all new jobs in the United States were in firms with fewer than 1,000 employees generating less than \$10 million in annual sales.¹⁶ Figure 1-3 illustrates these relative changes.

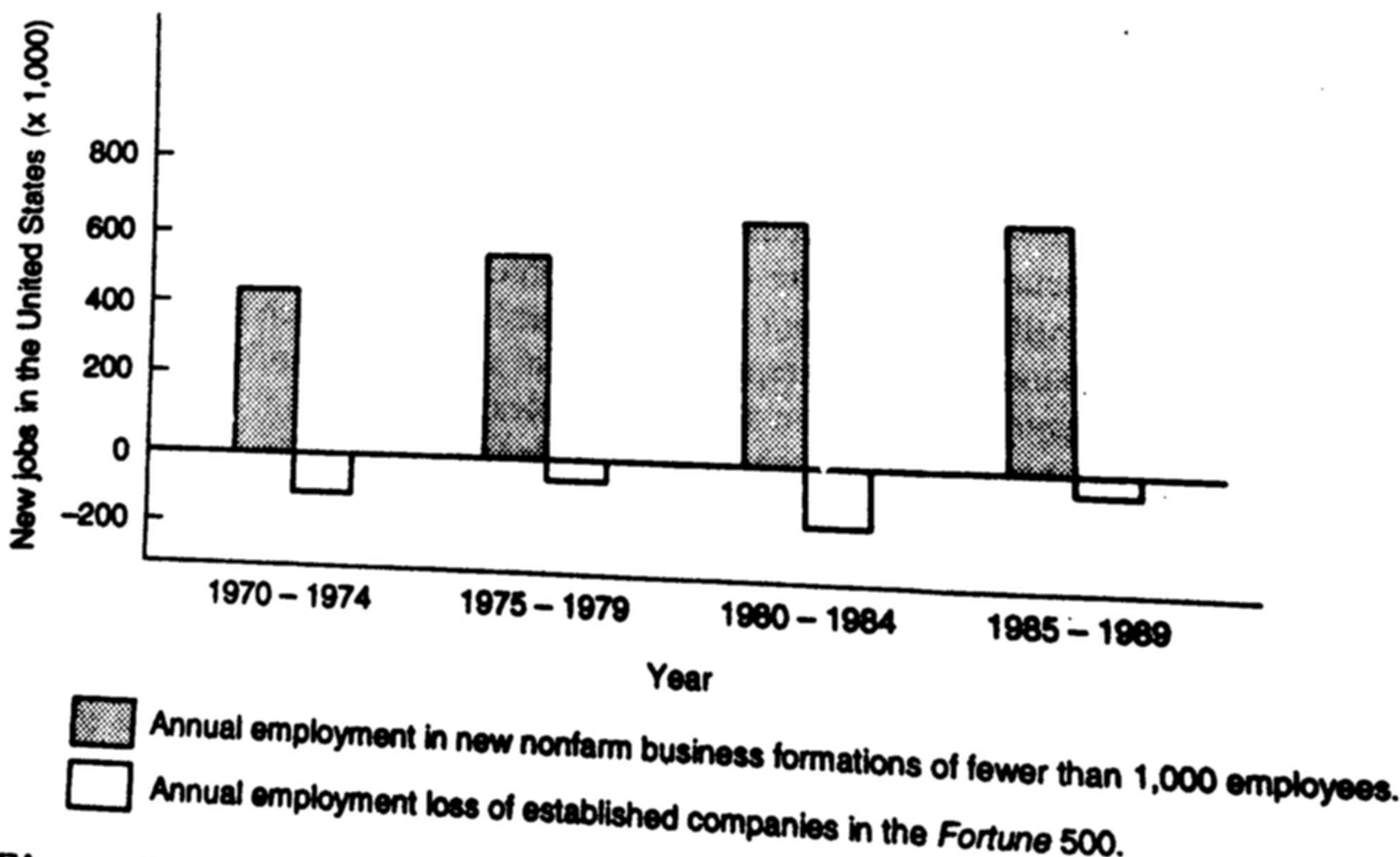


Figure 1-3 Employment Change in NonFarm Businesses, 1970-1989. (Source: U.S. Department of Labor, Bureau of Labor Statistics, *Handbook of Labor Statistics* (Washington, DC: U.S. Government Printing Office, 1985); annual BLS statistics for 1974, 1979, 1984, 1989 (est..))

Although these statistics are impressive, the Small Business Administration and U.S. Census of Business taken each year suggest that about 55 percent of all new small businesses fail. The popular idea is that owning or managing a small business is like riding a tiger—survival is not a probable conclusion. This view is inaccurate for a number of reasons. A firm that changes its name is listed as “out of business.” A firm that changes from a proprietorship to an incorporation is counted as one “quit” and one “new start.” Also, when a firm successfully merges with another, takes on a new partner, or is enfranchised, it can mistakenly be counted as a business failure. In addition, a business may be successfully operated by its owner, then sold, and the assumption of failure is erroneous. For these reasons, research has not accurately established small business failure rates. Recent inquiries suggest that perhaps fewer than one in ten actually dissolves or enters into bankruptcy. Most new ventures and small firms simply go through many changes that disguise their existence.¹⁷

These points are important because many students will be entering the world of small business; perhaps most will find themselves in small organizations shouldering tremendous responsibilities early in their careers. If employment statistics are accurate, nearly half of all graduates will actually be working in firms with fewer than 1,000 employees, and many more will become independent small businesspersons.

Defining Small Business

According to the Small Business Administration, a **small business** is one that does not dominate its industry, has less than \$10 million in annual sales, and has fewer than 1,000 employees.¹⁸ Exceptions to these criteria abound, but the SBA uses these benchmarks for evaluating loans and providing business assistance. “Small” defies clear definition. For instance, in today’s markets, firms with fewer than 100 workers but with high-speed production lines can generate \$50 million or more in sales. Fast-food franchises, such as McDonald’s, generate millions in sales with only a few employees. On the other hand, firms with several thousand workers may have low sales volume. In general, small businesses seldom dominate their industries and rely on filling a “niche” in local or regional markets. Exhibit 1-2 lists three types of small businesses. Their relative advantages and disadvantages are discussed in the following paragraphs.

Family enterprises are locally owned and operated, often by one person called a sole proprietor. Proprietors may have started their businesses in an effort to supplement or replace family income. Many are service-based firms that rely on an owner’s skills. Types of businesses that are family owned vary widely and can include retail stores, contracting businesses, small manufacturing firms, and restaurants, among others. The myth of high rates of business failure is particularly irritating to family business owners who often have no (interested) successors. In the absence of a successor, the life of a venture is limited to the working life of its founder. A florist, for example, may operate successfully until the founder retires, but if no one exists to succeed the owner, the business is sold or closed. Succession is a serious problem, and successful business owners often must resign themselves to dissolving their firms.

Personal service firms rely crucially on unique skills of their founders or key

Exhibit 1-2 Types of Small Business: Advantages and Disadvantages

Type	Advantages	Disadvantages
Family enterprise	Offers economic independence; promotes family unity	Family liability for the business; unsure succession
Personal service firm (PSF)	Offers personal freedom and use of talents and skills for personal growth	Personal liability and lack of secure income without clear succession
Franchise	Franchisor provides most business start-up needs with relative income security	Less freedom and adventure than others; contracted to franchisor for services and royalty lease payments

employees. In most instances, the business *is* the person, and succession is unlikely unless a son or daughter develops comparable skills. Incidentally, the "personal service firm" (PSF) is a formal category of business according to the Internal Revenue Service, and special tax regulations govern income reporting, deductions, and asset management. Such diverse occupations as golf professionals, interior designers, and freelance writers are considered to be PSFs. Since the early 1980s, the premiere personal service firm has been the computer services enterprise that provides software development, business consulting, office system networking, and similar assistance to other firms. Many of these enterprises become quite large and are distinguished from smaller personal service firms by their growth characteristics. Those with highly personalized services that limit sales to local customers are usually considered "small businesses." Those with broader interests that resell hardware systems, develop software for licensing, and create a high volume of billing income are difficult to label as "small" businesses.

Franchises represent an extraordinary growth sector of the American economy that is spreading overseas at an accelerated pace. A later chapter will explore franchising thoroughly, but it is important to recognize how franchises differ from other small businesses. The individual who buys a franchise store or contracts to franchise services typically is a small businessperson seeking a protected local market with an established business line. Those individuals buying into a franchise are called *franchisees*, and those who sell franchises, the patron corporations, are called *franchisors*.

Franchises are created by contract. An individual receives specific help and advantages in exchange for a franchise fee and, usually, a percentage of sales. The franchisor develops a network of income-producing enterprises that share a common name, use common materials, and sell similar products or services. The franchisee may receive financial help, training, guaranteed supplies, a protected market, and technical assistance with matters such as site selection, purchasing, accounting, and operations management.

PROFILE △*Century 21*

Based in Irvine, California, Century 21 is the world's largest real estate sales organization. With more than 6,700 franchised offices in the United States, Canada, Japan, and Great Britain, the company generates \$50 billion annually in world revenue. Century 21 plans to open an additional 500 units in England, Scotland, Wales, and Northern Ireland, and 800 units in France, Belgium, Luxembourg, Switzerland, and the Netherlands during the early 1990s. By awarding "subfranchises"—territories or major regions—to one substantial franchisee, Century 21 has created a global network of expanding enterprises, each capable of opening new locations and managing growth.

Source: John F. Persinos, "New Worlds to Franchise," *Venture*, November 1987, pp. 50-51.

We have grown accustomed to franchises, such as Wendy's and McDonald's, but franchises exist in a great many areas. Most stores in shopping malls are franchises, including stores that sell clothing, books, toys, photographic supplies, records, shoes, and computer services. Printers, furniture stores, auto rental outlets, convenience stores, snack shops, and hundreds more comprise a growing list of independent franchises. In franchising, independent owners invest their personal capital, usually operate their businesses, and are limited to one store or one area. These are seldom "mom and pop" enterprises (the familiar connotation of family enterprises), but they are still small businesses as distinguished from corporate endeavors. They do not constitute entrepreneurship in the sense of creating new products or services, but according to U.S. Department of Commerce statistics, franchising is a \$40 billion a year business sector and also the fastest growing sector in the United States.¹⁹

► CHECKPOINT

Discuss why many new ventures start small and remain small.

Define "personal service firm," and describe three that you frequent.

Distinguish between a franchisor and a franchisee.

△ △ CORPORATE ENTREPRENEURSHIP

△ △ As noted earlier, the popular term for corporate entrepreneurship is *intrapreneurship*. This has a catchy sound to it, but many people avoid the term; it seems too cute to explain a complex concept. To review our introductory comments, corporate managers certainly can be as innovative as anyone else, but when employees create something new within the context of their jobs, there is no requirement that an individual take a personal stake in making it a commercial success. There is no assumption of risk, no assumption of profit, and no assumption of loss. However, many managers are given the opportunity to pursue innovations, and, as we shall see later, many are in farsighted corporations that encourage entrepreneurial activity.

Clearly, larger corporations create remarkable new products and spearhead new technologies. Established corporations have enormous resources to pursue research and development. They can underwrite prodigious innovations, and they have the marketing muscle to commercialize them. Although many corporations back managers with venturesome ideas, corporations reap the lion's share of rewards. Managers generally risk embarrassment, and in some instances their careers, but rewards are usually limited to bonuses and promotions. Corporate entrepreneurship can occur, therefore, with the reservation that risks and rewards are curtailed.

Eminent researcher Hans Schollhammer refers to corporate entrepreneurship as "intra-corporate" entrepreneurship.²⁰ In his view, an entrepreneurial event does *not* take place when the formal organization is involved in traditional research and development unless individuals can work independently to create a *new venture* while sharing both risks and rewards. Corporate entrepreneurship *does* take place when new products or services are explicitly supported with company resources, and when employees are responsible for championing their innovations. More precisely, these individuals have the opportunity to work independently, are given tremendous latitude, and are expected to generate a new "unit" to extend corporate activities. These new units may take the form of divisions, subsidiaries, or entirely new entities having corporate capital backing.²¹

The concept of corporate entrepreneurship is controversial in part because of rather muddy definitions of entrepreneurship and in part because of ambiguity about the roles of managers within their established organizations. We cannot resolve that controversy, but we can examine the nature of the problem. In part, the problem is one of perception. Recall that entrepreneurship is defined differently by individuals with unique perspectives. For example, many corporate managers view entrepreneurs as individuals incapable of working productively in structured organizations. These managers may even deny that corporate entrepreneurship exists. Depending on one's perspective, then, entrepreneurship takes on different meanings. Consider the second issue: that managerial roles related to innovation can be ambiguous. When does a corporate manager stop being an employee working in a prescribed job and become "entrepreneurial"? How do employees redefine their roles apart from the organization? How are risks and responsibilities identified? What reward exists for the employee? These are only a few of the questions that must be answered to stimulate initiative within larger organizations. As we shall see in Chapter 3, organizations

have developed a number of ways to stimulate innovative employees, redefine management roles, and provide rewards commensurate with risks.

► CHECKPOINT

Describe the risks a manager might assume when championing a new corporate innovation.

Discuss the concept of corporate entrepreneurship and whether it can, in reality, take place.



ENTREPRENEURSHIP IN PRACTICE

Entrepreneurship can be explained in part by understanding what motivates individuals to pursue their dreams vigorously. Setting theory aside, students seem to acquire this understanding best by studying examples. Fortunately, the United States is an elegant culture filled with historic precedent and prominent entrepreneurs who have created a national infrastructure of commerce.

Evolution of Contemporary Entrepreneurship

A very long time ago, ancient people invented a hand ax, made the wheel a reality, and discovered new ways to grow crops. Much later, sails mounted on boats made seafaring trade possible. Still later, Robert Fulton's steam engine revolutionized sea and land transportation. These were watershed events in human history, but it was 19th-century entrepreneurs who dramatically thrust the world into industrialism.

Three early pioneers were Samuel Colt, Eli Whitney, and Samuel Morse. Colt's weaponry helped increase the firepower needed to expand westward; Whitney's cotton gin made an extraordinary increase in productivity for exported cotton; and Morse's telegraph revolutionized communications technology. An era of "tycoons" emerged that vaulted America into the 20th century, and during this era the foundations of modern industry were laid. An intrepid adventurer, Andrew Carnegie, founded the American steel industry. Later, Henry Ford pioneered mass assembly of automobiles. Other famous founding names such as Swift (meat packing), Vanderbilt (railroads), and Rockefeller (oil) created empires and fortunes that are legendary. John D. Rockefeller, for example, controlled nearly 2 percent of the entire U.S. gross national product before he was 40 years old, but even more interesting, he was a billionaire and his oil empire was largely in place before he was 30.²²

Perhaps the contemporary period of entrepreneurship began with innovators such as Cyrus McCormick, who, as noted earlier, constructed a mechanical reaper that revolutionized agriculture, and Alexander Graham Bell, who launched the telecommunications industry with the telephone. Bell's invention of the telephone may

have been in great part an accident. Bell had been working for years on a way to improve communications for the deaf and hearing impaired; he really wanted to create a hearing aid, but his mechanical voicebox gave us the telephone. Unlike McCormick and Bell, Henry Ford was *not* an inventor, but he was an astute entrepreneur. When he founded Ford Motor Company, Olds and several other auto companies had been in production for nearly 20 years. Ford, however, created a manufacturing process based on a system of specialization that no one else could match. Some of the early auto inventors that Ford eclipsed combined to become General Motors, but they were pulled together by yet another entrepreneur who was an organizational genius, Alfred Sloan.

Perhaps the most famous individual was Thomas A. Edison, whom we credit with the light bulb. In fact, the light bulb had been around for years, but no one had been able to make one that lasted long, nor one that used alternating current. Edison experimented with more than a thousand models before he was successful, but even then the light bulb was only a gadget. Edison was ridiculed as an "eccentric tinkerer." His light bulb was of little use until it was wired to a source of power, a generating station. Edison was successful only after he made the light bulb *commercially* viable by establishing an electric-generating industry.

These historical underpinnings have one common thread: entrepreneurs were responsible for innovations that significantly improved human productivity. This pattern is repeated time and again. The bicycle mobilized the human race. McAdam (blacktop) gave us the material for commercial highways. Ford gave us the highly productive assembly line. Edison gave us light and a tremendous new use for electric power. And Bell gave us the means to communicate instantaneously.

This productivity pattern is just as clear today. For example, IBM was established through the early efforts of its founder Thomas Watson, Sr., who converted the clumsy mechanical typewriter into an electrically operated office machine. He marketed the electric typewriter aggressively, and then spearheaded the early development of punch card accounting systems. Under the dynamic leadership of Thomas J. Watson, Jr., the founder's son, IBM flourished as a corporate giant in computers.²³ Steven Jobs and Stephen Wozniak made personal computing possible with the Apple.²⁴ Mitchell D. Kapor, who founded Lotus in 1981, was responsible for the best-selling PC software program ever devised, the Lotus 1-2-3 spreadsheet.²⁵ In each instance, productivity was improved by extraordinary measures. From a mechanical typewriter to the electronic model, and then to the personal computer with sophisticated word processing, office capabilities have quintupled. Electronic spreadsheets made pencil-and-ledger accounting practices obsolete, and the calculation power of spreadsheets used with high-speed PCs made slide rules museum pieces. These changes are illustrated in Figure 1-4.

Many corporations that we take for granted as industry giants began very modestly as entrepreneurial ventures. Intel Corporation in microelectronics, Data General Corporation and Digital in business and scientific computing, Ashton-Tate in software, Sun Microsystems in electronic workstations, and Wang Laboratories in office systems come to mind as "high-tech" examples in the computer industry.

"High tech" is not limited to information technology, and other firms with

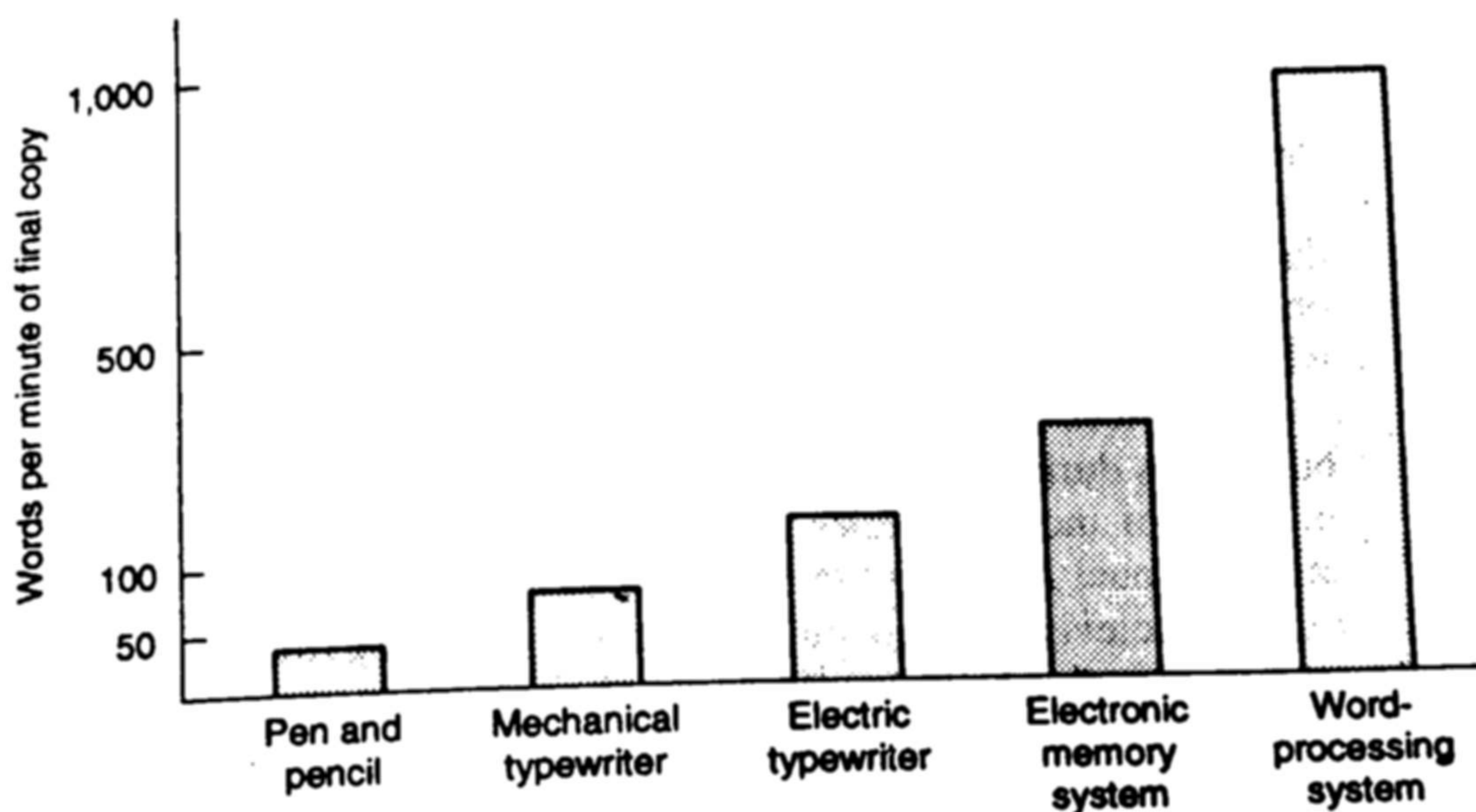


Figure 1-4 Document Preparation Productivity Changes with New Technology

products that seldom become household words have dynamic entrepreneurial foundations. Biopolymers (chemicals secreted naturally from microbes) are being developed for industrial use by a small but rapidly growing firm, Petroferm. These biopolymers allow water and oil to combine, and this ability can in turn help expedite oil extraction. The use of biopolymers could *double* oil field production. The biopolymer process also creates an inexpensive new substitute for fuel oil that alone could free up nearly 2 million barrels of crude oil per day. Genetic engineering is a field only recently making its debut and led by a few entrepreneurial firms that have begun to provide commercially viable medicines and industrial chemicals. These firms have mysterious names such as Genentech and Amgen, and most product names have little meaning by themselves, such as TPA and EPO, but the ramifications of these innovations are awesome. For example, the U.S. Food and Drug Administration recently approved several new genetically engineered products that include therapeutic proteins, human insulin, and human growth hormones. One of these products, interferon, has promising use in cancer treatment. The product known as TPA is now in use in Europe for medical rehabilitation of patients with heart disease, and EPO is being tested for its use in replacing red blood cells for kidney dialysis patients.²⁶

There are literally hundreds of examples that have had (or promise to have) extraordinary implications for society. Our methods of communication have changed, our traditional office systems have changed, our medical treatments of serious illnesses have changed, and *many* of our production and manufacturing processes have changed. But that is only a beginning, and it hardly explains the *nature* of entrepreneurship. "High tech" is a buzzword, and productivity is relative. The commercial application of electricity by Edison, the production of steel by Carnegie, the mass assembly of

automobiles by Ford, and the systematic packaging of meat products by Swift, were all "high tech" in their time; in each instance, productivity improved enormously.

In each example, whether taken from early tycoons or contemporary ventures, there were inspired individuals who went out on very thin limbs to create new ventures that *solved problems* or *created new opportunities*. In the evolution of modern industrial nations, the nature of entrepreneurship is best explained by the profound observation that entrepreneurs "created opportunities." It is completely immaterial whether a venture is high tech or not, or whether it offers a product or a service.

Services offered by entrepreneurs represented nearly 46 percent of all new businesses during the 1980s, and many of these firms were among the most dynamic in terms of increased sales and employment.²⁷ For example, the tenth-ranked firm on the annual *Inc.* 100 list for 1987 was the Home Shopping Network.²⁸ This firm created a television "catalog" program for shopping (mainly specialty items of interest to women), and between 1982 and 1987, HSN experienced 17,735 percent growth (annual average rate of 265%). The number of employees expanded from 150 in 1982 to more than 4,200 in 1987. Another firm that recognized an opportunity and capitalized on it was *Inc.*'s highest-ranked firm, Catalyst Energy Development of New York. The energy shortage coupled with deregulation and liberalized laws for cogeneration of electricity led to Catalyst's formation in 1982. Since then, the firm has had a 212,338 percent growth in sales (more than 500% annually), and its employee ranks grew from three individuals to more than 500 in five years.

The *Inc.* 100 represents entrepreneurial firms that are rapidly heading for the "big" list, the *Fortune* 500, but the list comprises more unstable firms because of the high-growth, high-risk nature of most enterprises, and it also reveals a wider assortment of business interests that seldom have "mega" corporation profiles. For instance, Fuddruckers (ranked 85th in 1987 and 62nd in 1989 by *Inc.*) is a chain of unusual and highly successful hamburger restaurants, but not a likely candidate to rival IBM or General Motors. On the other hand, Apple Computers and Lotus Development Corporation began as small companies listed on *Inc.* 100, but both are now major players. The composite *Inc.* list for 1989 shows that 30 percent of the firms were in computers and microelectronics, yet 16 percent of the firms were in health care, and there were several top-rated enterprises in communications, entertainment, food services, genetic engineering, cosmetics, merchandising, and parcel express services.²⁹

An interesting example of how entrepreneurs embrace new opportunities is Dorskocil, a firm with gross annual sales in excess of a quarter billion dollars. The company's founder, Larry Dorskocil, started out in a rented chicken hatchery making sausage in Hutchinson, Kansas. He recognized the growth in the pizza industry during the early 1980s, and began processing wholesale sausage and pepperoni packaged specifically for pizza restaurants. His business has grown to the point of being the pizza-topping king of the United States.³⁰

Entrepreneurs such as Larry Dorskocil either solved a problem or saw an opportunity, took the risk of a new venture, and succeeded because they gave society something of value. Successful entrepreneurs are also usually close to the problem or opportunity in terms of skill, knowledge, access, or resources. Most entrepreneurs

do not dream up radical new ideas or merely brainstorm their way into business. Edison had been working with electricity and various forms of illumination for years. Bell had been working on audio transmission long before he conceived of the telephone. Dostkocil had spent years scratching out a living processing sausages in traditional ways before recognizing the market opportunity in pizza toppings. The founders of nearly all genetic engineering firms were research scientists with substantial qualifications. As other examples are presented, it will become apparent that most founders had some knowledge of their markets, some product experience, or a unique skill that guided them toward opportunities. In many instances they have had opportunity thrust on them, but only rarely have new ventures occurred through luck.

Entrepreneurial Characteristics

Earlier in this chapter, characteristics, or "traits," of entrepreneurs were presented as a starting point in our discussion on the nature and meaning of entrepreneurship. Those characteristics were often value-loaded descriptions, even though accurate for successful entrepreneurs. They included such terms as persistent, self-confident, diligent, creative, optimistic, and independent minded. This list is useful, but there are other characteristics to consider.

Several studies have found that entrepreneurs are in unusually good health, are realistic about working hard and driving toward measurable results, tend to have superior conceptual abilities, and are generally emotionally stable.³¹ In a 1984 study, Jerome A. Katz found that more than 86 percent of entrepreneurs who start new businesses have bachelor's degrees (more than half of those in liberal arts), and about 71 percent who buy into existing businesses have similar degrees.³² Katz also found that, although more than 90 percent in both groups had several years of prior experience, only about 18 percent had an "unstable" record (had held ten or more previous jobs). These data, represented in Figure 1-5, suggest that most entrepreneurs are reasonably well educated with solid work experience. They are *not* renegade dropouts, as folklore would have us believe.

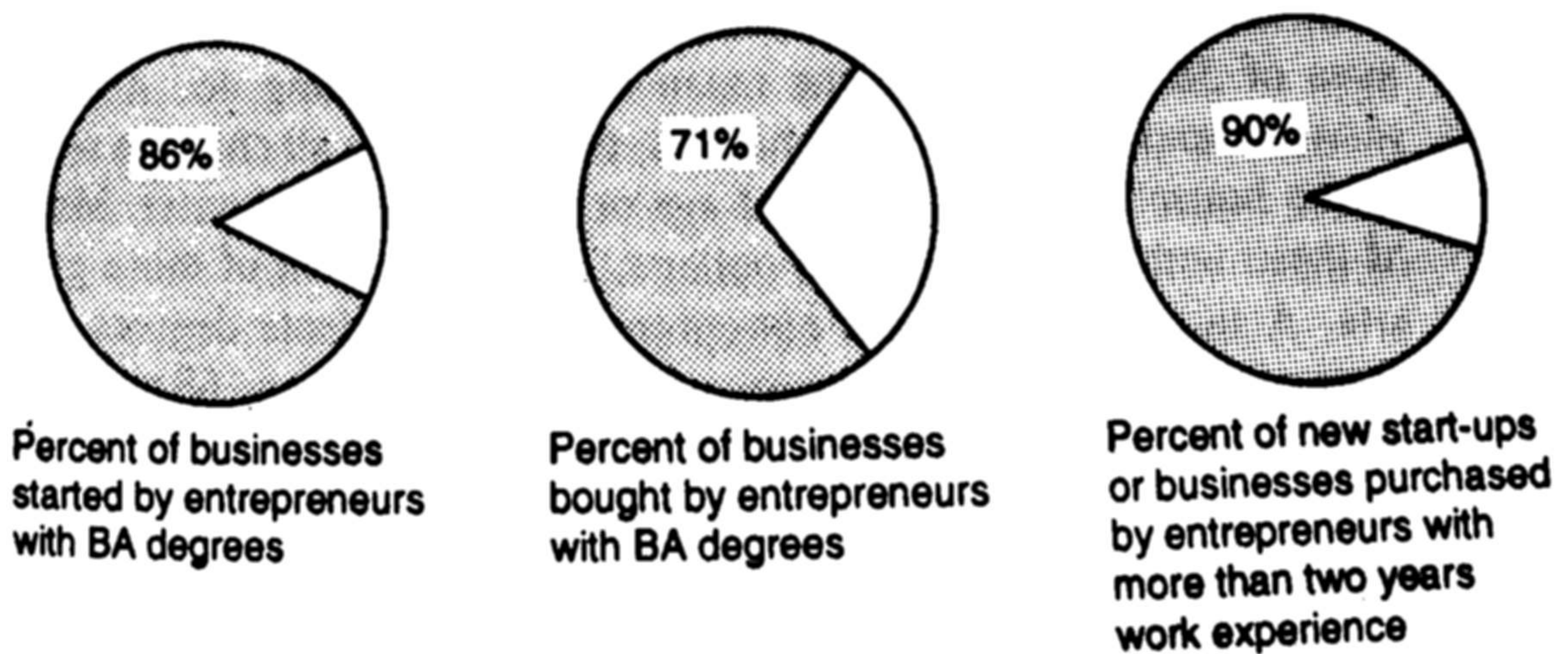


Figure 1-5 Education and Work Experience of Entrepreneurs

Several major research studies also emphasize that many entrepreneurs are coming from the ranks of MBAs, and further, that there is a growing trend by graduates to seek entrepreneurial opportunities rather than corporate careers. For example, at Harvard Business School, nearly half of all MBAs enrolled in entrepreneurship classes during the past several years, and nearly as many have been drawn to new ventures, either as independent business owners or as associates in entrepreneurial enterprises.³³

Robert Ronstadt explored this phenomenon and correlated start-up ventures with better educated youth who, incidentally, often had entrepreneurial parents. Nearly 76 percent had fathers who were also entrepreneurs, and 13 percent had mothers in entrepreneurial roles. He concluded that the seeds of entrepreneurship were planted early by parental role models. Ronstadt also found that the average age of entrepreneurs at start-up was 32. However, a significant number of entrepreneurs began about the age of 25, many more about the age of 30, and another significant group about the age of 35. There was also a noticeable number of new ventures started by youngsters scarcely out of high school as well as men and women near retirement age.³⁴

From Ronstadt's study we can conclude that most new ventures are the result of youthful, reasonably well-educated individuals choosing initially to "go it alone." Further information reveals that more than 60 percent start ventures near their homes, with about 25 percent originating in suburbs, 30 percent in rural towns, and 45 percent in or near urban centers. Slightly more than half of all recently formed ventures are in professional services, but 26 percent are in retailing, and 16 percent are in manufacturing.

Data are only beginning to emerge on minorities in business, and research has not been adequate to support profile characteristics. However, there are accurate data on percentages of different ethnic groups engaged in independent businesses based on Internal Revenue Service records.³⁵ Only about 3.6 percent of all blacks (male and female) were engaged in independent businesses in 1984. That figure is very low compared with 17.1 percent of white males, 6.3 percent of white females, 7.8 percent of Asians, and 5.3 percent of Hispanics. The number of white females may be somewhat higher, approaching 12 percent, based on estimates of dual career families reporting combined income.

In a milestone 1987 report, characteristics of women entrepreneurs were studied with very good results.³⁶ Most women entrepreneurs started in business between the ages of 38 and 48, with the mean start-up age being 46. About 56 percent were married, and 42 percent had children, though nearly all children were essentially "out of the house" (over 20 years of age or not residing at home). More than 62 percent of these women had attended college, with 70 percent of those graduating in liberal arts. A third of all women entrepreneurs had graduate degrees. Their parents, like those of most male entrepreneurs, were well educated, and 68 percent of their husbands held college degrees. Only 4 percent of these women entered financial service businesses, another 9 percent were involved in manufacturing, and the remaining 87 percent pursued personal service enterprises or specialty merchandising.

A clear profile of entrepreneurs does not emerge from these studies, yet there is strong evidence that most are well educated and have had successful work experience. Many also have had entrepreneurial parents, are emotionally stable, and have

superior conceptual skills. Men tend to launch ventures early in their lives, but women tend to become entrepreneurs after their children are grown. Perhaps the lower percentage of blacks, Asians, and Hispanics implies fewer educational opportunities, less access to resources, or less relevant work experience, but there is little evidence to support these arguments.

► CHECKPOINT

Describe how McCormick, Bell, and Ford solved social problems and created new opportunities through their entrepreneurial efforts.

Explain our contemporary view of an entrepreneurial "profile" and the conclusions we might draw about tomorrow's entrepreneurs.

△ △
△ △
△ △

FOCUS OF THE TEXT

Our introductory comments have emphasized that entrepreneurship can be explained in several ways. The text focuses on new venture creation more than on corporate ventures or small business; however, all three will be addressed. Each has its place in entrepreneurship education, but it is perhaps important here to explain how we distinguish between them.

Most small businesses start small and remain small. They may be constrained by the nature of the enterprise (laundry services, independent restaurants, etc.) or may be limited by their founders' intentions. The new venture orientation of this text emphasizes those small start-ups that *do* grow. The entrepreneurs that the text focuses on are those who *want* to expand, and those who do so through innovative combinations of resources. Because such growth can also occur in large organizations, corporate venturing is important to discuss. Small business is addressed because so often the process of launching new high-growth ventures is similar to that of starting small businesses.

The concept of *business planning* is a vital part of the entrepreneurship process and of this text. The critical elements of a formal business plan are similar for all new ventures, and although the text is not locked into a planning format, planning criteria will be emphasized. Appendixes provide supplemental business plan guidelines and procedures for drafting a feasibility study.

Chapter 2 will enhance the historical perspective of high-growth ventures with a view toward sensitizing students to changes taking place today. Chapter 3 addresses small business and corporate entrepreneurship. Chapter 4 is a pivotal chapter to establish a model of entrepreneurship and to provide a framework for business planning. This will conclude Part One of the text.

Part Two includes three chapters. Chapter 5 introduces product development from a new venture perspective. Chapter 6 is concerned with product protection such

as patents, trademarks, copyrights, and other legal considerations, including recent initiatives for protection of intellectual property. Chapter 7 looks more closely at the service industry and new venture opportunities.

Part Three focuses on marketing concepts. Chapter 8 introduces marketing research for new venture planning. Chapter 9 concentrates on marketing strategies and implementing a marketing plan. Chapter 10 extends the concept of new venture creation to international markets, addressing the opportunities for exporting, overseas investments, and importing.

Part Four looks into four aspects of new venture creation. Chapter 11 examines the legal options for business formations and correlates these with the entrepreneurship team, skills, and needs of the proposed business. In Chapter 12, the process of buying an existing business is explored, and a significant part of the chapter is devoted to franchising. Chapter 13 is concerned with venture financing and ways to obtain financial backing. Chapter 14 concludes by addressing entrepreneurial careers and challenges of managing a growing business.

Appendixes provide students with guidelines for creating a business plan. Appendix A outlines the fundamental questions in a realistic business plan, and Appendix B provides an example that can be used in conjunction with chapter material to enhance presentations.

SYNOPSIS FOR LEARNING

1. Describe how entrepreneurship evolved from economic theory.

European economists sought to define entrepreneurship based on how entrepreneurs behaved. Richard Cantillon argued that entrepreneurs made conscious decisions about resource allocations, thereby seeking higher yields for their money and materials. Jean Baptiste Say believed that entrepreneurs behaved with exceptional insight to fulfill society's needs through the process of taking risks. He noted that entrepreneurs typically bought goods at known prices and transformed them (or transported them to markets) to sell at unknown prices. Adam Smith described the role of "enterpriser," a person who organized industrial activity, matching demand with supply through commerce. Carl Menger described entrepreneurship as the process of converting resources into goods and services of value to consumers. And Joseph Schumpeter extended the concept to include the importance of innovation. These contributions provide our contemporary foundation for understanding entrepreneurial behavior.

2. Explain entrepreneurship and the characteristics of entrepreneurs.

Entrepreneurship is defined as a dynamic process of creating incremental wealth by individuals who assume the risks of equity, time, and careers to infuse resources with value for society. In Drucker's view, the entrepreneur uses resources not merely to solve problems but also to take advantage of opportunities. Combining these concepts with Schumpeter's notion of innovation and his observation that entrepreneurs engage in "creative disruption," we explain entrepreneurship as a process of innovation that

reallocates resources to new opportunities, often creating new opportunities through unusual combinations of resources and the skills of risk-taking entrepreneurs.

Research has tried to identify traits or characteristics of entrepreneurs based on explanations of entrepreneurship. They are called risk takers, high achievers, persistent innovators, and inspired, energetic, and single-minded individuals. Few attributes explain entrepreneurs well, and many of these attributes are shared equally by salaried managers and employees. However, entrepreneurs had been described by their activities, and perhaps this approach is more fruitful. They are individuals who start new ventures with a vision for growth, seek constructive change, have the persistence to gather essential resources, and use their energy to achieve unusual results.

3. Discuss small business as a dimension of entrepreneurship.

Small business, by definition, includes entrepreneurs because most new ventures start small. However, small business is distinguished by the nature of the enterprise or the intention of its owner. The small businessperson is likely to start a venture that serves a local market with products or services without growth potential (or without the intention of growing). Many businesses are small by their nature. These include "personal service firms" such as beauty salons, medical practices, interior designers, and freelance writers. Others are small by choice, such as "family businesses" in which ownership is retained by family members actively engaged in operating the enterprise. Many restaurants, contractors, small manufacturers, and local service enterprises are family owned and operated. Small businesses may often be created through legal contracts, such as "franchises" that limit the size and scope of commercial activity. These include fast-food outlets, print shops, car dealerships, distributors, retailers, convenience stores, and hundreds more. Small business is a vital sector of the American economy, and a majority of new and existing jobs exist in small businesses.

4. Describe the concept of corporate entrepreneurship.

Corporate entrepreneurship, also called intrapreneurship, describes the innovation that occurs inside established companies through efforts of creative employees. It implies more than helping a company to become more productive or to introduce new products or services. Specifically, the corporate entrepreneur is one who helps a company set a "new course" and in the process often generates new divisions, subsidiaries, or new companies that "spin off" from the parent organization. The concept is controversial because no one can accurately explain how a manager assumes the risk of a new venture while remaining employed in a structured organization.

5. Explain how entrepreneurship has influenced economic development and productivity in recent years.

In practice, entrepreneurs have historically altered the direction of national economies, industries, or markets. They have invented new products and developed the organizations and means of production to bring them to market. They have introduced quantum leaps in technology, such as the introduction of semiconductor electronics, and they have forced the reallocation of resources away from existing uses to new

and more productive uses. Many innovations have altered our pattern of living, and many services have been introduced to alter or create new service industries. These include commercial banking, insurance, credit systems (and credit cards), telecommunications, entertainment, office information systems, medical treatment, food distribution, and many more.

These advances were historically attributed to "inspired tinkerers" like Edison and Bell, but the same can be said about entrepreneurs today. The critical point is that entrepreneurs disrupt the status quo, putting economic development and society on a new course. They create new means of production and new systems of services. Today, these inspired tinkerers are well-educated, experienced, and independent thinkers who can transform society through innovation.

NOTES

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3. Jean Baptiste Say, *A Treatise on Political Economy*, 4th ed., translated by C. R. Prinsep (Philadelphia: Grigg & Elliot, 1845), pp. 99-100, 127, 330-332.
4. Carl Menger, *Principles of Economics*, translated by J. Dingwall and D. F. Hoselitz (Glencoe, IL: Free Press, 1950), pp. 8-14, 56-57.
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10. Robert C. Ronstadt, *Entrepreneurship: Text, Cases and Notes* (Dover, MA: Lord, 1984), p. 28.
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13. A. David Silver, *The Entrepreneurial Life: How to Go for It and Get It* (New York: John Wiley and Sons, 1983), p. 26.
14. Albert Shapero and Lisa Sokol, "The Social Dimensions of Entrepreneurship," in Kent, Sexton, and Vesper, eds., *Encyclopedia of Entrepreneurship*, pp. 72-88. Also see Shapero, "Why Entrepreneurship? A Worldwide Perspective," *Journal of Small Business Management*, Vol. 23, No. 4 (1985), pp. 1-6.

CASE 1-1

Progress Through Innovation

Throughout history, great innovations have periodically occurred to thrust humankind forward with new technologies, new industries, or new economic systems. These innovations were scarce prior to the 1800s, and those that we recognize had profound effects on society. Portuguese navigational instruments, for example, opened the world to rapid colonization, and Scottish steam engines and power looms vaulted us into the industrial age. American technology during the early 20th century created an industrial society founded on engines of growth such as Ford's assembly-line technology, Bell's telephone, and Edison's electric system. In recent years, major innovations in microelectronics have thrust us into the postindustrial information age.

Many other innovations have occurred, but their significance has been forgotten along with most of their inventors. Nevertheless, efforts by a few inspired entrepreneurs have changed society in extraordinary ways. One of those was inventor and entrepreneur Cyrus McCormick, who created a revolution in agriculture with the first mechanical reaper. He invented the reaper in 1831 and unveiled it in the Shenandoah Valley, cutting 6 acres of wheat in less time than a healthy farmer could cut one acre.

The McCormick Reaper replaced the way farmers had harvested grain for more than 2,000 years, and farm productivity was increased more than tenfold. The invention was not, however, a sudden brainstorm. The idea began with McCormick's father, who was determined to find a way to provide more food for America's growing population. He had witnessed starvation in the cities and undernourished children

in townships, and the answer, in his mind, was to create a new method of harvesting food grains. Until that time, farmers would sow only what they could reap, and the amount they could reap was limited to what they could cut with a hand sickle or scythe. McCormick's father died with his dream unfulfilled, but young Cyrus pursued the idea. When the first reaper went into production, it created chaos among farmers because those who had a McCormick suddenly outproduced their neighbors by a substantial amount and could market grain at very low prices. The farmer who worked only with a scythe quickly realized that he had to accept the inevitable change and purchase a reaper or lose his farm.

However, during those early days farmers had little money, so McCormick founded International Harvester Corporation, let farmers use the reapers and pay on credit terms, and soon had sales offices in every state and territory in the country. Later, McCormick refined his credit policies and introduced installment sales with low down payments and periodic payments. This innovation in financing may have been as monumental as the invention of the reaper, and although a credit craze did not materialize, many companies such as Kraft and Wells Fargo quickly adopted credit policies. A commercial finance industry evolved several years later to provide equipment loans to manufacturers.

McCormick was an inventor-turned-entrepreneur who recognized the value of marketing, but he also hired the best people he could find with marketing and engineering talent. He encouraged them to think and act independently, and many unusual innovations

were made. Prior to the Civil War, for example, the company introduced four-color advertisements and posters; these were the forerunners of billboards. Later, he created brochures to attract customers, and these evolved into mail-out orders that were among the first efforts at direct marketing.

The heart of McCormick's business, however, was his line of International Harvester machinery. During 20 years spanning the reconstruction period following the Civil War, IH introduced more than 200 models of field planting and harvesting equipment. Each item was based on the simple idea that a standard model using interchangeable parts could be produced in large quantities and sold, repaired, and serviced at very low costs. This system made field repairs easy and allowed farmers to replace worn machinery parts. The idea was adopted by Samuel Colt, who used interchangeable parts in his manufacture of firearms, and the Winchester Company quickly followed. Together, their firearms became legends in western folklore.

CASE QUESTIONS

1. Explain McCormick's experience in entrepreneurial terms based on the concepts of Adam Smith and Carl Menger.
2. Cyrus McCormick was responsible for the first mechanical reaper and the critical idea of interchangeable parts; however, the success of McCormick is often attributed to his ability to organize a company with exceptionally talented engineers and marketers who were responsible for most of the firm's innovations. Evaluate this statement in terms of the classic idea of an entrepreneur and the concept of corporate entrepreneurship.
3. Compare McCormick's contributions that led to a revolution in agriculture with Apple Computer's introduction of the microcomputer that revolutionized how we think about information technology.

Source: The Entrepreneurs: An American Adventure (Boston: Enterprise Media, 1987), Film No. 2. Also International Harvester: A History of Invention (Chicago: International Harvester Corporation, 1964).

CASE 1-2

Luck or Persistence?

When she was 11 years old, Kim Merritt sampled chocolate at a candy store and thought she could do better. She made her own recipe and began selling small candy bars in her hometown of Cumberland, Maryland. The effort was much like that of many youngsters who open lemonade stands to earn a few dollars to spend at the movies; however, people began asking her for more. Using meager profits and her mother's kitchen, Kim began making large batches of candy, then designed her own wrap-

pers and developed a commission system for friends who sold chocolates at several schools.

Business was so good that it became an obsession. Kim worked after school, weekends, and holidays, and aside from a brief period when the health department suspended her operations until she could obtain proper permits to cook candy, she made candy by hand until she graduated from high school. At first, she could meet demand without special equipment or sacrificing other activities, but when she pro-

vided candy for a school fund-raising event, demand exceeded capacity, and Kim found herself buying professional equipment, hiring helpers, and purchasing bulk supplies.

Looking back, Kim recalls the obsession, the long hours, and the challenge to learn about business. Always on the initiative, Kim set about placing orders with local stores and developing contracts with dozens of schools and civic organizations. Her business, Kim's Khocolates, soon occupied her entire family and closest friends, and she registered the company and set up a chocolate boutique. During her first month, she had 18,000 orders, and before graduating from high school, Kim was distributing specialty chocolates to retail stores in three states.

In 1989, at age 21, Kim repositioned her company as a major distributor of specialty candies and began planning a chain of upscale chocolate shops for the 1990s. The chain would complement her candy manufacturing and distribution system, but it would also mean major changes in her organization. She paused to think about her plans, realizing that to launch a regional or national chain would mean a corporate endeavor. She and her family could not handle all the responsibilities, and the nature of Kim's Khocolates would change. This was not a pleasant thought, although the idea of pursuing a major business was exciting.

Reflecting on her business, Kim realized that she had had fun and made a great deal of money, but many people considered her success no more than the luck of a personable young lady who made good candies and accidentally stumbled into a few good markets. On the other hand, Kim knew that she had worked extremely hard to attract clients. Most of her customers had not been comfortable buying from a young high school student, and she was seldom taken seriously by customers until they had dealt with her for a long time. Winning over her customers

had always been a challenge to Kim, not a roadblock, and creating unusual candies had been a joy, not a job.

Thinking about her plans, she was not anxious to become a corporate manager, and although she had always worked well with others, Kim liked the feeling of independence. Running a company would mean sacrificing her autonomy, yet the idea of a chain of stores selling her specialty candies had been a dream for years. At the same time, expansion would mean financial risk, and Kim had always avoided debt; she dealt in cash and had always carefully calculated her expenses to avoid even the slightest loss. She realized that she was at a major crossroad in her young career, and the choice seemed to be whether to follow her dream and expand or to be content with her existing business.

CASE QUESTIONS

1. Identify the entrepreneurial characteristics of Kim Merritt and how they correspond to characteristics described for successful entrepreneurs.
2. Take a position regarding the decision facing Kim whether to expand into a chain of stores. Explain your position in terms of personal objectives you perceive essential to Kim and in terms of her perceived abilities.
3. Based on what you know about Kim and what you believe her characteristics to be, would you say her success was due to luck or persistence? Explain your position, and how luck plays a role in any new venture.

Source: William Tucker, "Campus Capitalists," *Success!* October 1985, pp. 42-49, and personal interview with Kim Merritt, Association of Collegiate Entrepreneurs convention, March 1990.

Entrepreneurship and Innovation



OBJECTIVES

1. Explain the process of creativity.
2. Describe how innovation is important as a dimension of entrepreneurship.
3. Identify major changes that create opportunities for entrepreneurs.
4. Explain the concepts of “windows” and “corridors” for new ventures.
5. Discuss popular myths of entrepreneurship and why they are more fantasy than fact.
6. Describe the main factors that lead to success for new ventures.

Chapter 1 provided a general overview of entrepreneurship and included examples of entrepreneurs who exemplify free enterprise. We also introduced a working definition of entrepreneurship in terms of contemporary high-growth new ventures. An essential part of that working definition is that entrepreneurs instigate change thereby shifting economic resources away from established endeavors into areas of greater yield and higher productivity. This is the process of *wealth creation* rather than *wealth accumulation*. A crucial dimension of wealth creation and every new venture is *innovation*.

In Chapter 2, we explore innovation and the creative endeavor that leads to entrepreneurship. We also discuss how entrepreneurs develop new ideas and, from their ideas, establish new enterprises that *add value* to society. Peter Drucker gives us the following framework for study:

Admittedly, all new small businesses have many factors in common. But to be entrepreneurial, an enterprise has to have special characteristics over and above being new

and small. Indeed, entrepreneurs are a minority among new businesses. They create something new, something different; they change or transmute values.¹

Building on Drucker's viewpoint, we will explore how entrepreneurs create wealth by creating something new or different and how the opportunities arise. We begin with the topic of innovation. Then we shall see how opportunities arise as "source changes" to inspire new ventures. We will also examine characteristics of new ventures and "myths" about entrepreneurship. We conclude the chapter by describing prerequisites for succeeding in new ventures.



CREATIVITY AS A PREREQUISITE TO INNOVATION

The terms *creativity* and *innovation* are often used to mean the same thing, but each has a unique connotation. **Creativity** is "the ability to bring something new into existence."² This definition emphasizes the "ability," not the "activity," of bringing something new into existence. A person may therefore conceive of something new and envision how it will be useful, but not necessarily take the necessary action to make it a reality. **Innovation** is the process of doing new things. This distinction is important. Ideas have little value until they are converted into new products, services, or processes. Innovation, therefore, is the transformation of creative ideas into useful applications, but creativity is a prerequisite to innovation.³

The Creative Process

Clearly, action by itself has no meaning; it is of little value to simply "do things" without having inspiration and direction. Entrepreneurs need ideas to pursue, and ideas seldom materialize accidentally. Isaac Newton may have been hit on the head by a falling apple, but he discovered gravity through a lifetime of scientific investigation. Ideas usually evolve through a *creative process* whereby imaginative people germinate ideas, nurture them, and develop them successfully. A model of the creative process is shown in Figure 2-1.

Various labels have been applied to stages in the creative process, but most social scientists agree on five stages that we label as *idea germination*, *preparation*, *incubation*, *illumination*, and *verification*. In each stage, a creative individual behaves differently to move an idea from the seed stage of germination to verification, and as we will discuss, behavior varies greatly among individuals and their ideas.⁴

Idea Germination. The germination stage is a *seeding process*. It is not like planting seed as a farmer does to grow corn, but more like the natural seeding that occurs when pollinated flower seeds, scattered by the wind, find fertile ground to take root. Exactly how an idea is germinated is a mystery; it is not something that can be examined under a microscope. However, most creative ideas can be traced to an individual's *interest in or curiosity about* a specific problem or area of study.

For example, Alexander Graham Bell had been fascinated with the physics of

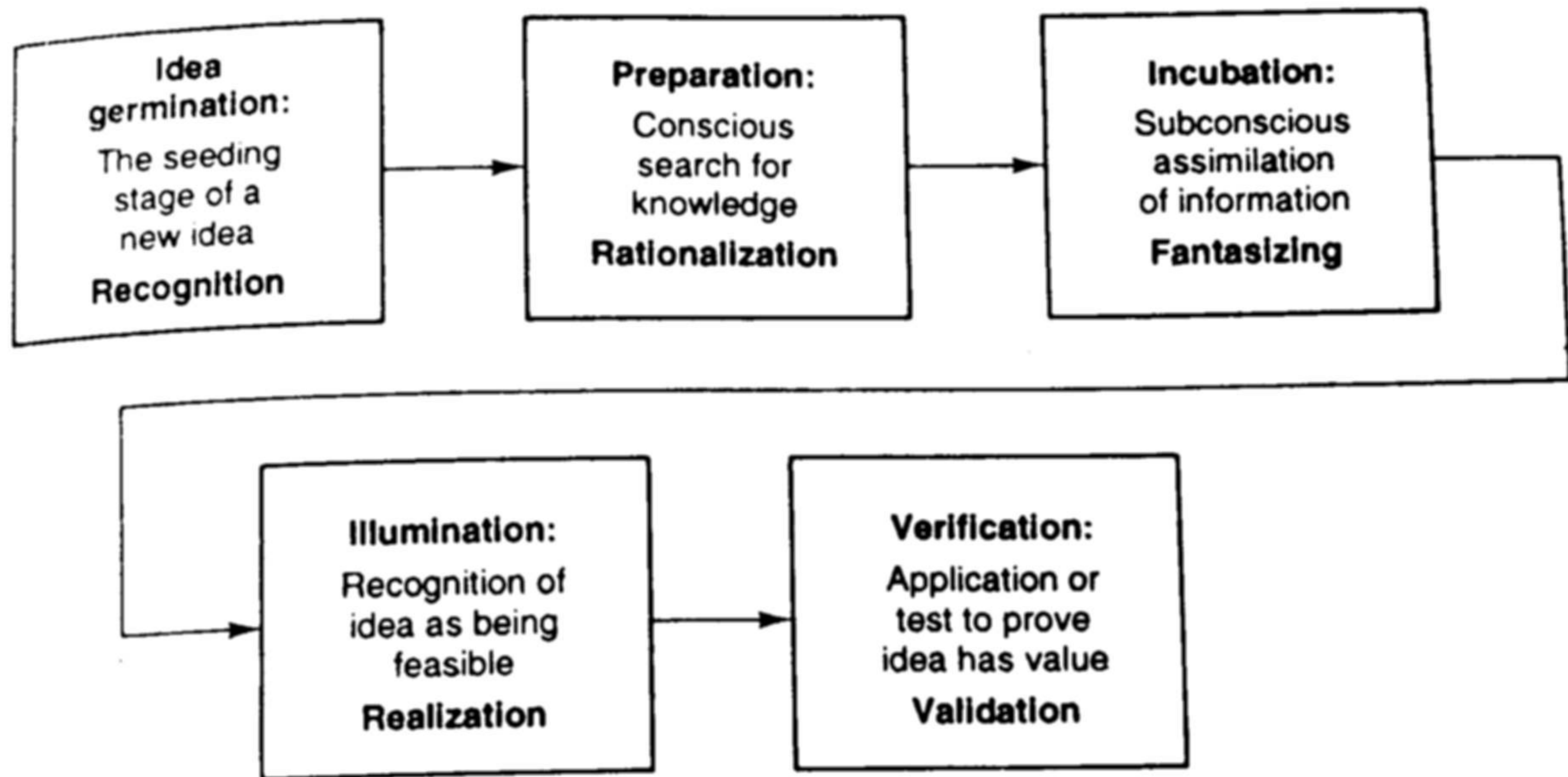


Figure 2-1 The Creative Process

sound since childhood. He was influenced to study human hearing systems by his mother, who had a serious hearing problem. As a young adult, Bell taught at a school for the deaf and hearing-impaired, and he set up a laboratory for testing new hearing devices. Many of these devices were awkward mechanical “horns” that amplified sound waves. Bell realized the possibilities of altering sound waves in various types of materials such as steel wire during the 1870s, and he experimented for several years with magnetic devices in an effort to produce a hearing aid. In 1875, his lab assistant, Thomas A. Watson, accidentally clamped a magnetized steel reed too tightly to a magnet, and when he plucked at it, the reed came loose with a “twang” that echoed, sending a signal along a wire to Bell’s magnet receiver. Bell heard the twang and recognized that an electrical signal had replicated the vibration caused by Watson’s steel reed. At that instant, the harmonic hearing aid became a feasible idea, but exactly when Bell conceived of a harmonic telegraph (telephone) is unknown. It was several years before he turned his attention to commercial communications.⁵

Bell’s “idea” for a hearing aid was evidently seeded years before he invented the telephone, and it evolved through his interest in helping others. He had already spent years studying the physics of sound and experimenting with sound-transmitting materials so that his mind was “fertile” and open to the opportunities for harmonic telegraphy. For most entrepreneurs, ideas begin with *interest* in a subject or *curiosity* about finding a solution to a particular problem. More recently, Nolan Bushnell founded Atari and the video game industry by trying to create a way to use micro-electronic circuitry to convert home television sets into interactive media.⁶

Preparation. Once a seed of curiosity has taken form as a focused idea, creative people embark on a conscious search for answers. If it is a problem they are trying to solve—such as Bell’s determination to help those with impaired hearing—then

PROFILE △*Nolan Bushnell*

In 1972, Nolan Bushnell, an electronics engineer with a passion for mind-teasing games, launched a \$20 billion industry with Atari Corporation. His first video game was a version of Ping-Pong, but it was Pac Man that institutionalized video games and created a world market for new games, T-shirts, toys, pop songs, and, later, movies based on video war games. By 1982 more than 400,000 Pac Man machines on three continents had generated 7 billion coin-operated plays. The company that Bushnell started using toy parts and scrapped electronics in his daughter's bedroom was sold to Warner Communications in 1976 for \$28 million. Although Atari has had a roller-coaster history, Bushnell has gone on to found new enterprises, including Pizza Time Theater, a restaurant chain; Catalyst Technologies, a company designed to help other entrepreneurs start business ventures; and Axlon Corporation, a research company engaged in robotics.

Source: An unpublished profile of Nolan Bushnell at the founding meeting of the Hong Kong Venture Capitalist's Association, 1988.

they begin an intellectual journey, seeking information about the problem and how others have tried to resolve it. If it is an idea for a new product or service, the business equivalent is market research. Inventors will set up laboratory experiments, designers will begin engineering new product ideas, and marketers will study consumer buying habits. Any individual with an idea will consequently think about it, concentrating his or her energies on rational extensions of the idea and how it might become a reality. In rare instances, the preparation stage will produce results. More often, conscious deliberation will only overload the mind, but the effort is important in order to gather information and knowledge vital to an eventual solution.

Incubation. Individuals sometimes concentrate intensely on an idea, but, more often, they simply allow ideas time to grow without intentional effort. We all have heard about the brilliant, sudden "flashes" of genius—or more precisely, we have developed fables about them—but few great ideas come from thunderbolts of insight. Most evolve in the minds of creative people while they go about other activities. The idea, once seeded and given substance through preparation, is put on a back burner; the subconscious mind is allowed time to assimilate information.

In Alexander Graham Bell's example, research on harmonic sound transmission occupied a small percentage of his time during a two-decade period. Perhaps the incubation period for the telephone could be expressed as a three-decade, on-again-off-again fascination with human hearing problems. Art Fry, the 3M engineer who

invented Post-it Notes, first thought of semi-sticky paper six years earlier when, as a church choir director, he wanted to have page markers for hymn books that would neither damage the books nor slip out easily. He worked on the idea during his spare time at 3M without success, forgot about it for nearly a year, then tried making a new adhesive for the paper, once again forgot about the project for some time, and eventually envisioned a pad of small hymn notes with tear-off edges impregnated with a nonpermanent gum.⁷

Incubation is a stage of "mulling it over" while the subconscious intellect assumes control of the creative process. This is a crucial aspect of creativity because when we consciously focus on a problem, we behave rationally to attempt to find systematic resolutions. When we rely on subconscious processes, our minds are untrammelled by the limitations of human logic. The subconscious mind is allowed to wander and to pursue fantasies, and it is therefore open to unusual information and knowledge that we cannot assimilate in a conscious state. This subconscious process has been called the art of *synectics*, a word coined by W.J.J. Gordon in 1961.⁸ **Synectics**, derived from Greek, means a joining together of different and often unrelated ideas. Therefore, when a person has consciously worked to resolve a problem without success, allowing it to incubate in the subconscious will often lead to a resolution.

Illumination. The fourth stage, illumination, occurs when the idea resurfaces as a realistic creation. There will be a moment in time when the individual can say, "Oh, I see!" Bell heard the twang of the steel reed, Fleming watched his penicillin attack infectious bacteria under a microscope, and Art Fry envisioned his gum-lined note pads in use. The fable of the thunderbolt is captured in this moment of illumination—even though the often long and frustrating years of preparation and incubation have been forgotten.

Illumination may be triggered by an opportune incident, as Bell discovered harmonic telegraphy in the accidental twang created by Watson. But there is little doubt that Bell would have had his moment of illumination, triggered perhaps by another incident or simply manifested through hard work. The point, of course, is that he was prepared and the idea was incubated. Bell was ready for an opportune incident and able to recognize its importance when it occurred.

The important point is that most creative people go through many cycles of preparation and incubation, searching for that incident as a catalyst to give their idea full meaning. When a cycle of creative behavior does not result in a catalytic event, the cycle is repeated until the idea blossoms or dies. This stage is critical for entrepreneurs because ideas, by themselves, have little meaning. Reaching the illumination stage separates daydreamers and tinkerers from creative people who find a way to transmute value.

Verification. An idea once illuminated in the mind of an individual still has little meaning until verified as realistic and useful. Bell understood what the twanging steel reed meant, yet he still had years of work ahead to translate this knowledge into a commercial telephone system.

Entrepreneurial effort is essential to translate an illuminated idea into a verified, realistic, and useful application. **Verification** is the development stage of refining knowledge into application. This is often tedious and requires perseverance by an individual committed to finding a way to "harvest" the practical results of his or her creation. During this stage, many ideas fall by the wayside as they prove to be impossible or to have little value. More often, a good idea has already been developed, or the aspiring entrepreneur finds that competitors already exist. Inventors quite often come to this harsh conclusion when they seek to patent their products only to discover similar inventions registered.

► CHECKPOINT

Define creativity and distinguish it from innovation.

Identify the five stages of creativity and explain why each is important to the creativity process.



INNOVATION AND ENTREPRENEURSHIP

If creativity is the seed that inspires entrepreneurship, innovation is the process of entrepreneurship. This was Schumpeter's conclusion when he wrote about the economic foundations of free enterprise and entrepreneurship, points that we discussed in Chapter 1. Drucker agrees and elaborates: "Innovation . . . is the means by which the entrepreneur either creates new wealth-producing resources or endows existing resources with enhanced potential for creating wealth."⁹

Earlier, we defined innovation as the process of doing new things. It is important to recognize that innovation implies *action*, not just conceiving new ideas. When people have passed through the illumination and verification stages of creativity, they may have become inventors, but they are not yet innovators. The difference between invention and innovation is shown in Figure 2-2.

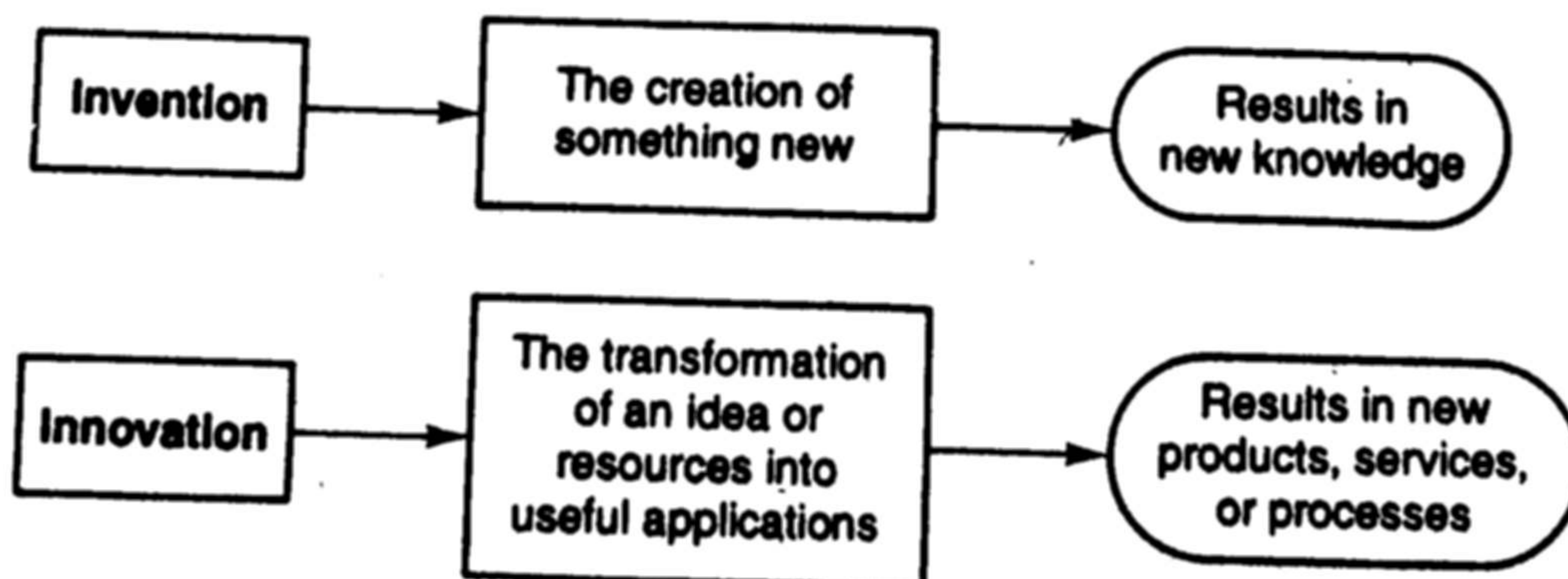


Figure 2-2 Invention versus Innovation

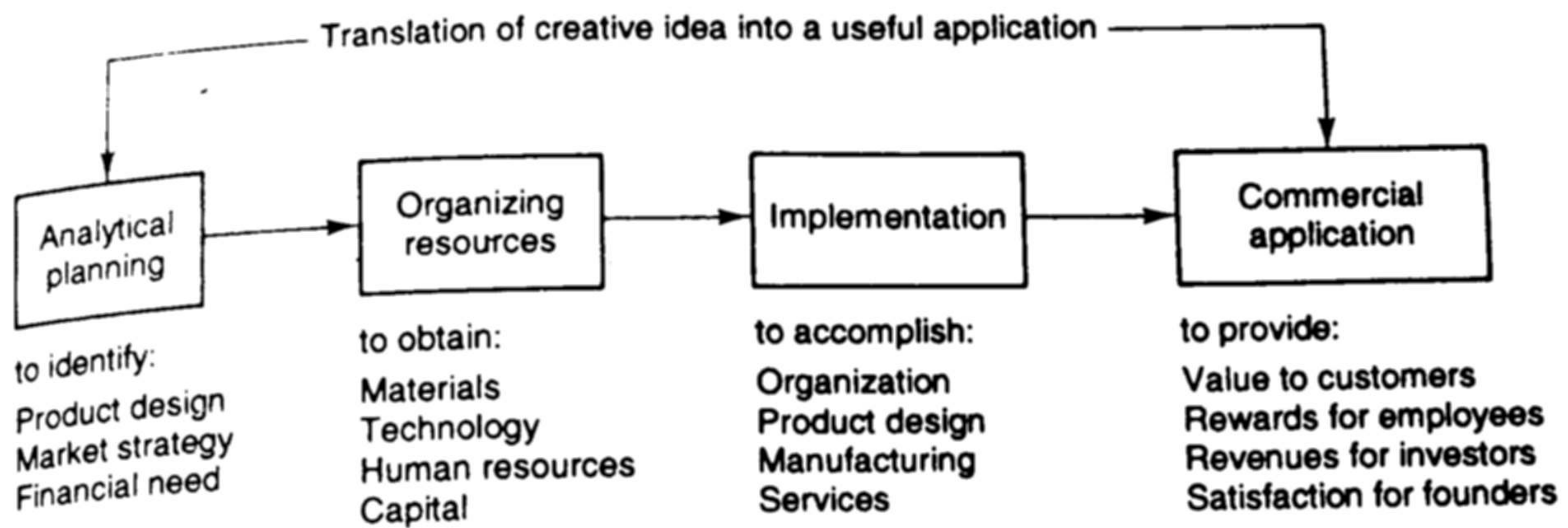


Figure 2-3 Elements in the Innovation Process

Inventors are not limited to those who create new products. They include those who identify new technological processes, new forms of plant life, and new designs. Each of these, incidentally, can lead to new patents, as we shall discuss in a later chapter. Inventors usually are stereotyped as people who deal with "things," such as new products, but most inventions have dealt with new processes or new technical knowledge. Our examples of Bell's harmonic sound transmission and Edison's electric power system illustrate the point, and many new products (and entire industries) were founded on their ideas.

Nevertheless, for an idea to have value, it must be proven useful or be marketable, and to achieve either status, the idea must be developed. Innovation is the development process, as shown in Figure 2-3. It is the translation of an idea into an application. It requires persistence in analytically working out the details of product design or service, to develop marketing, obtain finances, and plan operations. If the entrepreneur is going to manufacture a product, the process includes obtaining materials and technical manufacturing capabilities, staffing operations, and establishing an organization.

Using Left-Brain Skills to Harvest Right-Brain Ideas

Creativity was partially explained as a nonrational process of incubating ideas, allowing the subconscious mind to wander and to pursue fantasies. More precisely, half the subconscious mind is working to wander intuitively through nonrational territory. Substantial research has shown that the human brain has two distinct hemispheres. One, the *right hemisphere*, is the creative side where spatial relationships are developed, intuition prevails, and nonverbal imagining influences one's behavior. The other, the *left hemisphere*, is the analytical side where abstract thoughts and concepts may be formulated, but only through logical and rational processes.¹⁰

Exhibit 2-1 lists attributes of both hemispheres together with types of managerial activities often associated with skills in each area. Psychologists suggest that most people tend to have a dominant orientation, either to the left side (prone to rational, analytic behavior) or to the right side (prone to creative, intuitive behavior). Indeed,

Exhibit 2-1 Left-Brain, Right-Brain Attributes

Left Hemisphere	Right Hemisphere
Conscious—Aware and focused on specific problem	Unconscious—Unaware and unfocused on specific issues
Rational—Conscious modeling of issues; linearity	Nonrational—Spatial imagining without direction
Analytical—Use of knowledge in discrete applications to evaluate issues	Intuitive—Total experiences and emotions allowed to influence one's ideas
Logical—Deductive reasoning to establish relationships	Synthesizing—Illogical reasoning and fantasizing to create analogies

Source: Jacquelyn Wonder and Priscilla Donovan, *Whole-Brain Thinking* (New York: Morrow, 1984), pp. 60–61. Also Terence Hines, "Left-Brain/Right Brain Mythology and Implications for Management and Training," *Academy of Management Review*, Vol. 12, No. 4 (1987), pp. 600–606.

many cultures encourage skills and values that bias human development toward one of these hemispheres. Japan, for example, has been singled out as more left-brain orientated than the United States. The implication is that Japanese youngsters are taught to sharpen their analytical skills and subsequently are rewarded for their technical expertise, but they are not necessarily encouraged to become adept at creative, abstract thinking. In contrast, American youngsters are rewarded for independent thought and abstract, nonrational synthesizing of information. There is, however, no consensus that people can, or should, be taught left- or right-brain skills.¹¹

From an entrepreneurial perspective, the right-brain skills are crucial for the vision necessary to be creative, but innovation does not occur until left-brain rationalization takes place. Integrating predispositions from both hemispheres is the critical behavior needed to be a successful innovator, to use left-brain rationality to "harvest" right-brain creativity. Unfortunately, many individuals are only gifted at one or the other. They may be logical and practical, and in the process, be efficient managers, but without some degree of inspired fantasizing, they may be paralyzed by their own analytical behavior. On the other hand, the "inspired tinkerer" may bask in the purity of artistic oblivion without the necessary ability to convert dreams into reality. This dichotomous behavior has been called Janusian thinking. (Janus was a mythological god with two faces looking simultaneously into the future and the past.) To be innovative, the entrepreneur must resolve this dilemma.¹²

Technological Innovation

The battle between rational, left-brain behavior, and creative, right-brain behavior, is a common problem for technological innovation. Because innovation is often explained in technical terms—tangible products or processes that result from technological development—there has been a preoccupation with rational, analytical in-

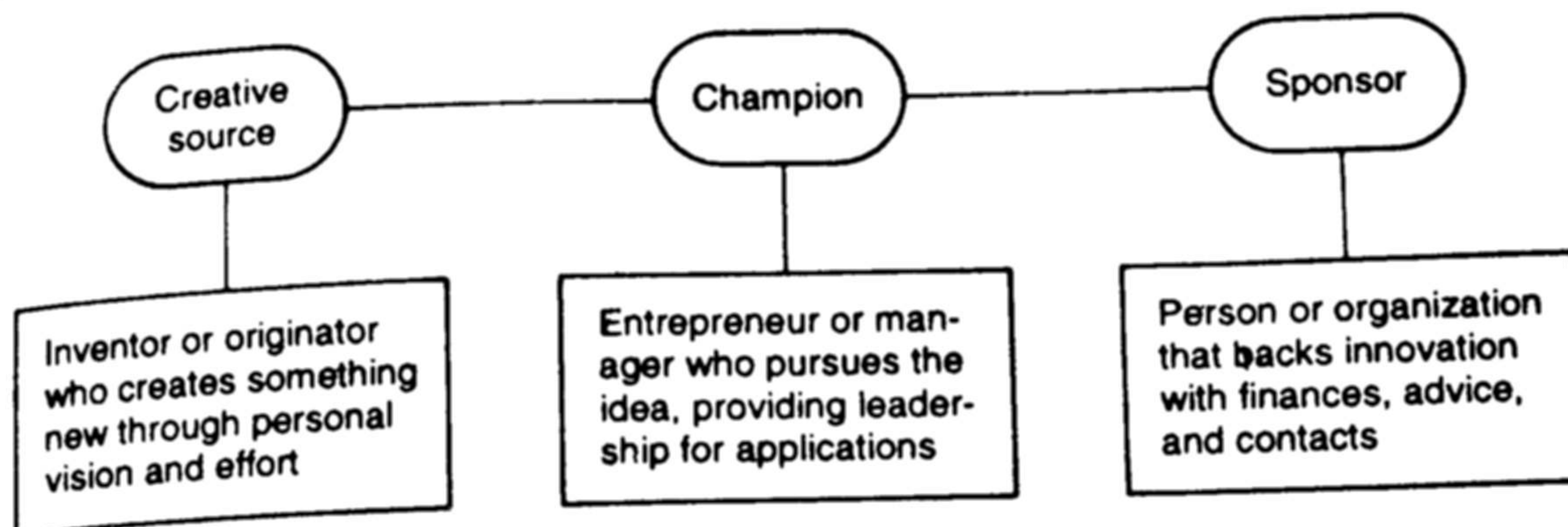


Figure 2-4 Key People in Technological Innovation

novation models. A general model of technological innovation is shown in Figure 2-3. However, a number of industrial studies reveal that for a technological innovation to succeed, there are three important people involved and seven important conditions to satisfy. The combination of these people and conditions satisfies the need for creativity and implementation. The three key people are the creative source, the champion, and the sponsor. Their roles are identified in Figure 2-4 and explained as follows:¹³

Creative source: The inventor or originator of the idea that led to the knowledge or vision of something new; the artist of creative endeavor.

Champion: The entrepreneur or manager who pursues the idea, planning its application, acquiring resources, and establishing its markets through persistence, planning, organizing, and leadership.

Sponsor: The person or organization that makes possible the champion's activities and the inventor's dreams through support, including finances, contacts, and advice.

The creative source is an individual; organizations do not create ideas or incubate fantasies. The champion is also an individual—perhaps the creative source, or an entrepreneur who joins with the inventor, or a corporate manager who has the insight to help pursue a creative idea. The sponsor may be an investor (such as a venture capitalist, described in Chapter 13), or an organization, such as 3M, where corporate resources are allocated to innovative projects and their champions.

The seven conditions required for success in technological innovation are related partially to the success of the three key people involved and partially to the environment in which innovation takes place. Although these conditions were derived from corporate studies in research and development, they apply equally to new entrepreneurial ventures, and they include the following:¹⁴

1. An outstanding person in an executive leadership position to support strategic decisions that encourage creativity and innovation development.
2. An operational leader to carry out the essential tasks of converting knowledge into a commercial application.

3. A clear need for the application by sufficient potential consumers to warrant the commitment of resources to the innovation.
4. The realization of the product, process, or service as a useful innovation providing value to society
5. Good cooperation among the crucial players and among diversified functions in an organization, all of whom, together, must bring the idea to fruition.
6. Availability of resources and the supporting technology to succeed in the endeavor.
7. Cooperation and support from external sources who can influence the success of an innovation, including government agencies, investors, vendors, suppliers, and creditors.

These seven conditions and the three major players are illustrated in an extraordinary new development in quantum mechanics. Research is being conducted at Spectra Diode Laboratories in California to develop the manufacturing process and applications for a semiconductor laser no larger than a child's thumb.¹⁵ This tiny laser is a thousand times more powerful than anything commercially available in semiconductors. The "creative genius" of quantum physics (the science that made possible innovations in atomic energy and semiconductor electronics) was Albert Einstein.

A number of "champions" in several industries have taken Einstein's creative genius to practical applications, but at Spectra Diode Labs, it is CEO Donald Scifres who is leading the way into semiconductor lasers. The "sponsor" is Xerox Corporation, a joint-venture underwriter of the laser project that provides financial resources and technological knowledge of semiconductor applications markets.

The seven conditions are partially accounted for by the leadership of Scifres, the sponsorship of Xerox, and the collective assimilation of knowledge during the past half century in quantum physics, semiconductor electronics, and computer applications. Still, the tiny laser is no more than a laboratory model because, to date, several conditions for successful innovation remain unsolved. First, the manufacturing technology (process methodology) to produce the lasers does not exist. The lasers require microscopic parts, called quantum wells, that are so small that a million of them would fit onto a pinhead. Second, the lasers must be proved in applications such as replacements for computer chips. In working models, this step has been accomplished—and one laser only $\frac{1}{100}$ the size of a conventional computer chip would quadruple chip performance at one-quarter the power required now. Unfortunately, without cost-effective mass-production technology, the laser is not yet applicable, and consequently, there is no immediate market for it.

Beyond the world of high-tech innovation, entrepreneurs take up the creative challenge of new ideas daily. Many of those innovations we take for granted as we enter the 1990s, but half of all our existing technological applications did not exist two decades ago. This applies equally to products, such as microcomputers; process technologies, such as synthetic fabrics; and services, such as bank credit cards.¹⁶

In each instance of innovation, there has been an entrepreneurial champion who persisted in developing a creative idea into a marketable application. In each instance,

the entrepreneur has been able to recognize *change*, envision the *opportunities*, and harvest right-brain inspiration through left-brain hard work.

► CHECKPOINT

Explain “innovation” and distinguish it from invention.

Describe the concept of right- and left-brain processes.

Identify and describe the three key roles and seven conditions important for technological innovation.

OPPORTUNITIES THROUGH CHANGE

Entrepreneurs tend to be “strategic thinkers” who recognize changes and see opportunities where others do not. By creating new ventures based on these strategic changes, entrepreneurs make a contribution and are rewarded in terms of wealth and personal satisfaction. Entrepreneurship is therefore the result of inspired strategy to exploit change, but first “change” has to be recognized. In the next few passages, major sources of change are examined together with examples of how entrepreneurs turned these changes into opportunities.

Scientific Knowledge

The history of the Nobel Prize is replete with examples of new scientific knowledge, and our concept of entrepreneurship is stereotyped as a process of commercializing new inventions. Without a doubt, “scientific knowledge” has been at the heart of many new enterprises, and we can see how important it is by tracing the development of computers.

Charles Babbage created a mechanical calculating machine more than a century ago; it was the forerunner of mechanized adding machines. Babbage is mentioned historically as contributing to the concept of a computer because he helped revolutionize numerical manipulation. Herman Hollerith used the binary system to create the first punch card in 1890, but this was to be significant only a half century later. Howard Aiken of Harvard University teamed up with IBM and the U.S. War Department in 1944 to create the first “automatic calculator,” and although it was only an electromechanical switching system, his work led to an electronic computer developed at the University of Pennsylvania by J. Presper Eckert and John W. Mauchly. It was not until 1951, however, that a commercial electronic computer was sold to the U.S. Census Bureau by Eckert and Mauchly as the *UNIVAC I*.¹⁷ This early progression of events is shown in Figure 2-5.

That brief history of computers is interesting because the only scientists to exploit their inventions were Eckert and Mauchly of Univac. Meanwhile, hundreds

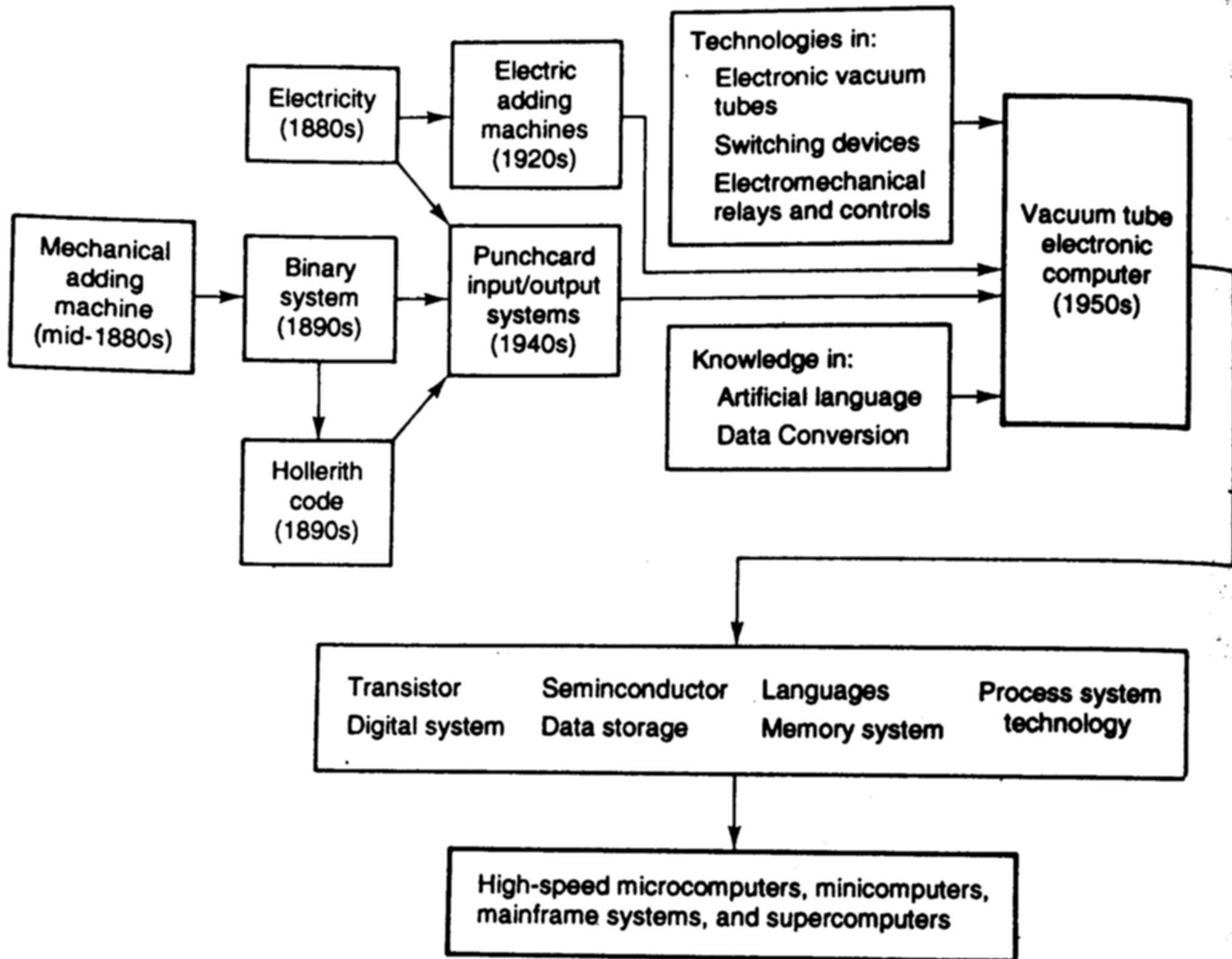


Figure 2-5 Evolution of the Electronic Computer

of companies evolved from these pioneer efforts. Burroughs, NCR, and IBM emerged through efforts by their founders, who recognized the commercial value of scientific changes and developed products around early technological advances. The contemporary history of computing includes literally thousands of scientific innovations, each one making computers better, faster, more accurate, easier to use, and less expensive.

William Shockley won his Nobel Prize while at Bell Labs for creating solid-state electronics and the transistor. Shockley left Bell Labs with a group of young engineers to form his own electronics company, but it was Robert N. Noyce, one of those young engineers, who set the pace as the archetypal modern entrepreneur. Noyce left Shockley, cofounded Fairchild Semiconductor, then moved on to found Intel Corporation. Noyce transformed scientific knowledge of the "silicon" technology into an industry and became known as the "Moses of Silicon Valley," where he established Fairchild and Intel, and he is credited with being the father of integrated circuitry. Noyce provided the inspiration to exploit knowledge. He was the change master who gave *strategic* direction to the microelectronics industry.¹⁸

Process Innovations

Closely associated with new scientific knowledge is the implementation processes, techniques, and methods essential to make knowledge useful. As noted in Chapter 1, Edison's light bulb was only a curiosity until he developed an electric system for supplying power to consumers. Early computers had little value until operating systems and data storage techniques were developed. In fact, computers had only limited value until symbolic languages were created to encode, manipulate, and store data. Because it developed and controlled the processes needed to make computers useful, IBM came to dominate a hardware computer industry. During the late 1950s, when virtually every major company making electrical apparatus and communication equipment was also making computer hardware, IBM was relatively unknown, but IBM technicians created symbolic languages in FORTRAN and COBOL, subsequently setting the industry standards.¹⁹

This pattern of entrepreneurial activity has been repeated often. Steven Jobs and Stephen Wozniak were largely successful establishing Apple Computer because of their proprietary software processes. William Gates III founded Microsoft Corporation and set industry standards in MS-DOS operating systems to coincide with the introduction of the IBM PC in 1981. Gates had been out of high school only five years when he and a companion launched their trend-setting venture.

There are literally thousands of examples of entrepreneurs who have recognized opportunities and transformed knowledge into commercial value. For example, typesetting had not changed since Gutenberg's time when, in 1885, Ottmar Mergenthaler developed the linotype machine. The linotype was an inspiration based on growth in publishing and a demand for timely news. The process of typesetting was archaic prior to the linotype, but with its development, there was the technical method needed to establish a nationwide industry of daily newspapers.²⁰ Today, word processors coupled with desk-top publishing systems enable even small businesses to create professional-quality documents. Each of these innovations has precipitated hundreds of new ventures that provide, for example, desk-top software, data storage systems, and publishing supplies.

Industrial Changes

There is little doubt that eventually power sources will be based on solar devices. Safe nuclear systems are also on the horizon. Meanwhile, energy is based on fossil fuels with some alternatives such as hydroelectric and geothermal power, but someone, someday will instigate the transition, and the switch will be turned off on fossil fuels. Petroleum replaced whale oil as an important fuel a century ago when Rockefeller built a refining and distribution system capable of making crude oil usable. An energy revolution happened again with Edison's electric generating system. It may happen again with solar power, and many entrepreneurs will be involved. Figure 2-6 illustrates this transition.

Industrial change can occur through natural events, such as the discovery of oil, or as a result of human events. For example, the recent deregulation of the airline

PROFILE Δ

William Gates III

At 34, William Gates III became the youngest individual billionaire in the world in 1989. He taught himself computer programming at the age of 13, dropped out of Harvard at 19 to start Microsoft Corporation, and at 31 took his company public, cracking the billion-dollar mark for his personal net assets. Microsoft is the power behind MS-DOS computer-operating systems, dozens of software applications, and innovative computer systems technology.

Source: Julianne Slovak, "The Billionaires," *Fortune*, September 11, 1989, p.66; also Microsoft, *Annual Report to Stockholders* (Seattle: Microsoft Computer Systems, 1989).

industry forced dozens of major airlines to compete with regional "upstarts" and commuter airlines. Competitors introduced innovations in flights, new fares, travel plans, and new services. People Express, Presidential Airlines, New York Air, USAir, and many others jolted the industry during the 1980s with low-priced fares, no-frills service, and innovations in ticketing, baggage handling, and convenient routing. Some of these have not survived, but others such as Texas International have grown rapidly to be among industry leaders.²¹

A similar pattern of change occurred in postal services that provided unexpected opportunities for UPS, Federal Express, and dozens of regional courier services to

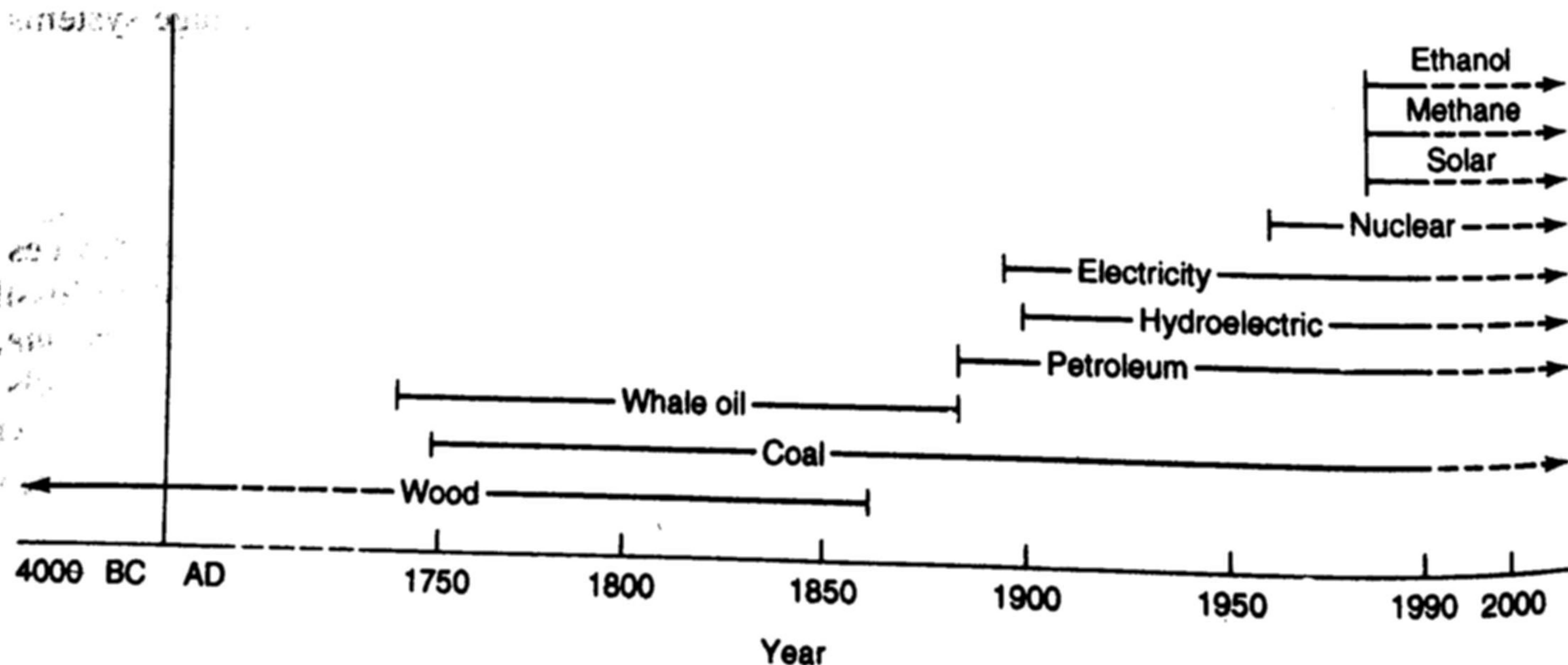


Figure 2-6 Major Shifts in Industrial Energy

establish growth ventures in parcel delivery systems. The breakup of AT&T is yet another incident that created opportunities for competition in long-distance telephone services exploited by MCI and US Sprint. New telephone systems have evolved in dozens of regions, and there have been hundreds of new businesses sprouting from the fringes of the AT&T change. New telephone repair services, PBX systems, telecommunications firms, phone leasing companies, and pay phone franchises are among the many examples.

These opportunities occur often because every industry is fragile and subject to sudden change. New laws, the dissolution of old laws, economic influences, social changes, and new technologies are all threats to industrial stability, providing in their wake ample opportunities for entrepreneurs.

Market Changes

Closely associated with industrial changes are those that take place in markets. Historically, we look at the success of Henry Ford when he developed an inexpensive automobile. Until his Model T, most automobiles were luxuries. He recognized the demand and decided that a car built on simple principles would revolutionize the automobile industry. Domino's Pizza was built on the single, important observation that a lot of people ordered pizza to take out. John H. Johnson, the founder of Ebony magazine, recognized a neglected segment of American readership, the black American. During World War II, Johnson launched Negro Digest, and today he heads a publishing empire with subsidiaries in cosmetics, fashions, perfumes, and entertainment that is the largest black-owned corporation in the United States.

An extraordinary change is taking place now as government services are being privatized.²² The government has long been a major market, particularly for federal programs such as defense, and on state and local levels, government agencies dole out hundreds of millions of dollars to private contractors for everything from cleaning services to construction projects. An important trend emerged during the late 1980s as government agencies began to rapidly endorse privatization. This is the process of turning over to private contractors activities once controlled through government agencies. Government has become a more active consumer and a less active employer. Governmental agencies in Washington are contracting lawn services rather than employing maintenance personnel to do these jobs. Trash collection, rapid transit systems, government document printing, road repair services, security systems, training services, and public utilities are "going private" at an accelerated pace.

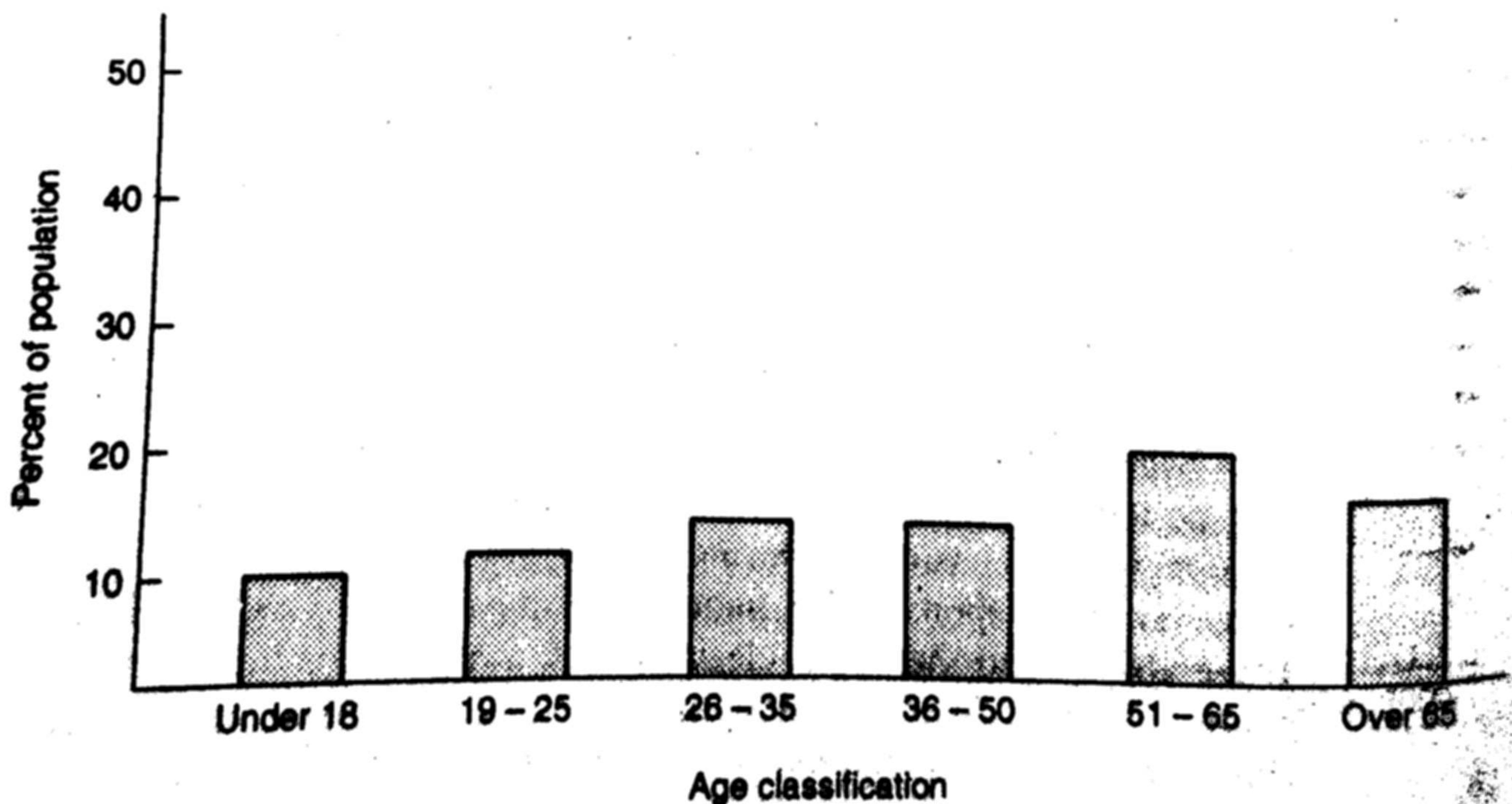
Market changes have also had a tremendous effect on education. For the 200-year period prior to World War II, the university system was a market reserved for the upper-class consumer. During a brief but active period just prior to World War II, government sponsored a nationwide movement to expand land-grant colleges. These also served the upper class through a number of limited and specialized programs, but after World War II the American university system became a middle-class market with diversified programs. Metropolitan universities and private institutions grew at a tremendous rate, including such entrants as Pace University, the New York Institute of Technology, Northeastern, and Santa Clara. State systems

modified their missions and actively sought the middle-class student. Universities in Wisconsin, New York, and California joined this trend, and with extensive tuition-aid programs, education is now attempting to reach everyone. Entrepreneurs have been an integral part of this change, creating new educational tools, textbook publishing empires, and innovative student services. They have cultivated sporting events and sports-related enterprises, and today entrepreneurs help students compete for limited university spots through programs such as SAT preparation courses, home study courses, and data base search systems that identify scholarship opportunities.

Demographic Changes

Demographic data are concerned with population trends, age, sex, and ethnic characteristics, educational status, and income of a nation's population. As a nation's demographics change, new opportunities to serve human needs arise. By tracking these changes, entrepreneurs can identify opportunities and react to them. Population statistics are well documented by the U.S. Census Bureau, by state and local authorities, and by an enormous number of sociological studies. The composition of human resources is closely tracked to document career behavior, family structures, emigration and immigration, life expectancies, birth rates, and on and on. The data are widely distributed through government publications at all levels, through Chambers of Commerce, and virtually every public library in the United States. An example is illustrated in Figure 2-7.

This information can be exceptionally useful. For example, assume a shrinking family size with, on average, about two children per household born to women with careers who wait several years to bear children. This pattern suggests a trend toward



smaller housing units, better access to child care for dual-career families, and eating patterns that imply convenience-type foods. Much more can be read into that scenario.

At the other end of the life spectrum, more older people exist and are living longer. They are also retiring earlier, spending more of their improved retirement incomes, demanding more recreational opportunities, and traveling more. We tend to stereotype "the elderly" as retired persons who settle into retirement homes, but this view is fallacious. The retirement years span nearly two decades of life, from the early 60s to the late 70s; lumping the "elderly" together under one umbrella would be like calling all individuals under the age of 21 "children." There are many subtle changes in demand for products and services among more refined stages of retirement. For example, as individuals near retirement, they are at the pinnacle of their careers, and planning for retirement opens opportunities for preretirement counseling, benefit planning, and estate management. Many retirees also seek alternative work, and a question comes to mind: Who provides employment search services for these persons?

Abrupt changes also take place in the composition of populations, such as the periodic thrusts of immigration that have brought significant numbers of Europeans and Asians to the United States. During the 1800s, potato famines brought waves of Irish, and the Chinese arrived in shiploads as the West Coast developed. During the early 1900s, large numbers of Russians and Germans arrived. After World War II, many European Jews came to America. Southeast Asians came in the wake of the Vietnam war. Today, more and more Mexican workers are finding their way into the Southwest. Latin American nations have experienced chronic poverty and periodic revolutions, landing Cubans in Florida, Haitians on the Gulf Coast, and Puerto Ricans in New York. In each instance, sudden bursts of new needs exist for language instruction, specialty foods, bilingual schools, entertainment, exchange banks, housing, and many other services.

The eminent financier J. P. Morgan had a gift of being able to recognize social and cultural shifts, and at the turn of the century he took advantage of these changes to build an extraordinary financial empire.²³ When Morgan was still in his 20s, the House of Rothschild was the dominant banking empire in Europe. The Rothschilds were financiers for the world powers, but it was J. P. Morgan who recognized the transatlantic migration and the tremendous need to provide financial services to these individuals and to underwrite industries that would employ them. Unlike the Rothschilds and most other financiers who served only the wealthy, Morgan served the blue-collar worker who transformed the United States into an industrial nation. He financed Alexander Graham Bell's telephone and helped create the first telephone company in the United States, underwrote Andrew Carnegie (and eventually bought Carnegie's steel mills, renaming the company U.S. Steel), conceived of, and pushed to implement, the Federal Reserve System, financed transcontinental railroads, and set up several immigrant banks.

Aside from these dazzling changes, shifts in population and the structure and composition of that population are continuous and easy to identify. For example, the demand for kindergarten facilities next year (or in four years) is established. The children who will be ready for kindergarten next year were born four years ago; they

exist and can be counted accurately. Entering college freshmen candidates for next year are known; they are high school seniors with qualifying grades. We can forecast with accuracy the number of people who will become doctors in the next few years, attain law degrees, start families, retire, and die. We know a lot about a lot of people.

Entrepreneurial opportunities occur whenever a gap exists in services or products for groups of individuals moving into new stages of life cycles, for groups coming into American society, for changes in families, careers, and incomes, and for "systems of needs" that arise from demographic shifts such as those addressed by J. P. Morgan. These opportunities may be on a grand scale, such as new banking systems, or localized, such as new housing construction.

Social and Cultural Changes

Social changes occurred at a snail's pace until the late 18th century. The pace quickened a bit during the 19th century, but as we look back over the 20th century, social changes reached an unprecedented quick pace. There is no evidence of a slowdown as we ready ourselves for the 21st century.

Think of the great historic eras. The Egyptian social order changed little during the 2,000 years preceding the Roman Empire. Rome revolutionized the known world with written language, transportation systems, administration processes, and legal systems. It remained dominant as a military and ruling power for about 500 years. Then the western world entered a thousand-year lull, the medieval era, a time when hundreds of small principalities, city-states, and feudal kingdoms slowly evolved into nations. Very few societies advanced beyond the Roman foundations that preceded them; few innovations occurred in any fashion. The Renaissance was a blossoming of youth, the beginning of modern nations, architecture, mercantilism, education, arts, and the recognition of common "cultures" among peoples with similar ethnic, regional, or religious characteristics.

The industrial revolution stimulated changes in how people lived, worked, spent their money, recreated, and worshiped. Men began working for wages rather than as farmers or in government service. Sailors became merchantmen. Craftsmen moved out of their shops and into factories. Adventurers put aside swords for plows and settled new worlds. These social changes brought new demands that inspired a faster rate of change in innovation. For example, while roads had been made of sand and stone for several thousand years, "industrial city traffic" (although limited to carts, wagons, and buggies) required sturdier materials. Macadam (a material fashioned from coal slag and oil that we know as blacktop) was developed in Scotland. The bicycle, also Scottish in origin, became a useful mode of transportation rather than a curiosity. "Systems" that we take entirely for granted now were major changes made to accommodate growing cities and industrial towns. Sewers, water systems, waste collection, police services, fire brigades, and schools began to evolve during the 19th century. Nevertheless, these thousands of years of innovation are more than matched by innovations that have occurred during the past 20 years. Nearly 70 percent of all scientists and engineers who ever lived were alive in 1980, and about 92 percent of all known technology was discovered or invented during the 20th century; half of that figure and a majority of the living scientists emerged after World War II.²⁴

This recent onslaught of innovation could not have happened without commensurate demand for products and services, and this demand has often resulted from social and cultural changes. The demand for timely and accurate information still outraces scientific efforts to provide telecommunications and computer applications. Mass transit systems are at best cumbersome alternatives to fender-bending traffic jams, and we have not yet devised a solution to crowded highways.

In practical terms, many entrepreneurs have found opportunities in such social changes as the increased numbers of dual-career families and working professional women. These changes opened doors for entrepreneurs to create new fashions, to develop educational seminars for career women, and to establish counseling centers for working wives, but entrepreneurs never seem to keep pace with change. Future problems yet unknown will certainly surface to propel the challenge.

► CHECKPOINT

Describe technological changes that lead to new products and those that lead to new processes.

Explain how economic and legal changes can occur to create new opportunities for industry.

Describe opportunities that arise from social, cultural, and demographic changes.

△ △ WINDOWS AND CORRIDORS

△ △

△ △

△ △

A window is a time horizon during which opportunities exist before something else happens to eliminate them. A unique opportunity, once shown to produce wealth, will attract competitors, and if the business is easy to enter, the industry will become rapidly saturated. Bicycles did not become viable commercial products until people needed them as transportation. When that need occurred, hundreds of bicycle manufacturers rushed to take advantage of the "window of opportunity." Literally every successful product and service has had an optimal period of time for commercialization. Those introduced too early have usually failed, and those introduced too late suffered from crowded markets.

A brief period of opportunity opened for electronic spreadsheets when microcomputers hit the fast growth curve. Several entrepreneurs entered the market with good spreadsheet products. The first, VisiCalc, was designed for the Apple PC. VisiCalc was quite successful, and later versions for MS-DOS systems were even more successful. But Lotus 1-2-3 and Microsoft's Multiplan and Excel programs forged into industry markets. By 1986, Lotus had set the industry standard, and today a handful of firms offering spreadsheets virtually control the market. Entrepreneurs, therefore, must not only recognize opportunities, but also take advantage of them while windows exist to be successful.

Another aspect of many successful ventures is called the *corridor principle*.²⁵ The corridor principle suggests that opportunities evolve from entrepreneurs being positioned in similar work or having had experience with related ventures so that when a window opens it is easy for them to move quickly into a new venture. A corollary is that as a venture becomes expert in one activity, related opportunities evolve, and many of them are more rewarding than the initial activity.

William Gates of Microsoft, for example, was first approached by IBM in 1980 to program an operating system for the PC; Gates turned down the offer. He had a fledgling software company and was "hacking" with minor programs he hoped to sell; the idea of a major software effort was inconceivable. However, he and several friends realized the opportunity and began working independently to create the MS-DOS system. His early efforts probably would have kept Gates in an obscure part of the software industry, but the brief opportunity to create the new operating system led to enormous success. Howard Head, the founder of Head Ski leveraged his "sports manufacturing" experience to create Prince Manufacturing and a revolutionary new line of tennis rackets.

The corridor principle is well known to scientists. For example, Wilson Greatbatch, the inventor of the Pacemaker for heart patients, was an electrical engineer and 41 years of age before the idea evolved from hundreds of other electrical ideas and gadgets concocted in his garage workshop. Probably a thorough résumé of most inventions and the entrepreneurs who commercialized them would reveal a series of closely related experiences that preceded success.

This does not mean that entrepreneurs must first work aimlessly and wait for a twist of fate to create opportunities. It means that entrepreneurs who are active and watching for changes are more likely to recognize opportunities when they occur. Few new ventures arise through "luck," which is one of the popular and inaccurate myths about entrepreneurial success we address next.

► CHECKPOINT

Discuss why a window of opportunity is critical for success.

Explain how a corridor influences the evolution of an innovation.

△ △ MYTHS—FANTASIES NOT FACTS

△ △
△ △
△ △

Folk heroes like Steven Jobs and Mitchell Kapor are beset by myths that they "stumbled into success" and got their ideas by accident. Not so. Several references have been made earlier to each of these popular individuals, but what may not be clear is that they spent several years striving for a foothold in their particular fields. Both men *made* success by creating their own brand of luck. There are other myths to be explored, but let's begin by expanding the notion of "luck."

Luck Is for Gamblers

Clearly, there are individuals who seem to have an uncanny ability to be able to spot and to exploit opportunities, and luck (both good and bad) plays a role in the outcome of many ventures. More often, successful individuals have been nourishing a concept for some time or working on closely related projects when a breakthrough occurs.

As noted earlier, Art Fry of 3M created the Post-it note as a result of trying to make nonslip hymn book markers. He spent several years working on the idea, and he also had to fight an uphill battle convincing 3M executives to manufacture his product. Compressing the story of the Post-it pads into a paragraph makes it seem as if Fry stumbled onto the idea, but the product's development, manufacture, and marketing required extraordinary work and commitment.

For John H. Johnson, the founder of *Ebony* magazine, success was the result of four decades of systematic development from a neighborhood newsletter to the publishing empire that exists today. Along the way, Johnson ran into more bad luck than good as an entrepreneur with little money facing a society not yet ready to endorse black business interests. Persistence and determination played greater roles in Johnson's success than luck.

Make or Break on the First Venture

Another popular myth is that entrepreneurs strike it rich with the first great "flash of genius," or, conversely, they fail miserably with the first venture. Entrepreneurship is not a "boom or bust" process, even though many new firms succeed brilliantly and others do not survive for long. The point is that too much distortion exists on both issues. Bankruptcy statistics suggest that of those who have gone bankrupt, 80 percent were in business for less than five years. That figure sounds terrible, but the qualifying point is that statistics are compiled on those firms who *do* go bankrupt. How many continue in business? How many are sold profitably, merged, or incorporated into larger organizations? How many evolve into new businesses through a corridor of innovation? Bankruptcy represents about 1 percent of the total number of new ventures established, whereas most other outcomes, successes and failures, are only vaguely studied.²⁶ Statistics can be misleading, and many new ventures evolve and change, generally going unnoticed on the grand scale of economic development. Several of these possibilities are shown in Figure 2-8.

Entrepreneurs Are Mavericks and Misfits

Evidence suggests that many entrepreneurs march to the proverbial different drummer. They are not always among the best students, and they tend to be restless in structured jobs. Consequently, they are likely to be unsettled wanderers. It is true that entrepreneurs prefer independence and can be rather rebellious, and both conditions can affect their performance in school and at work. Most successful entrepreneurs, however, are from the ranks of above average students, and they are relatively unlikely to have drug or alcohol problems or to run afoul of the law.²⁷ Entrepreneurs are mavericks in the sense that they instigate change and challenge the status quo, but they are not "misfits."

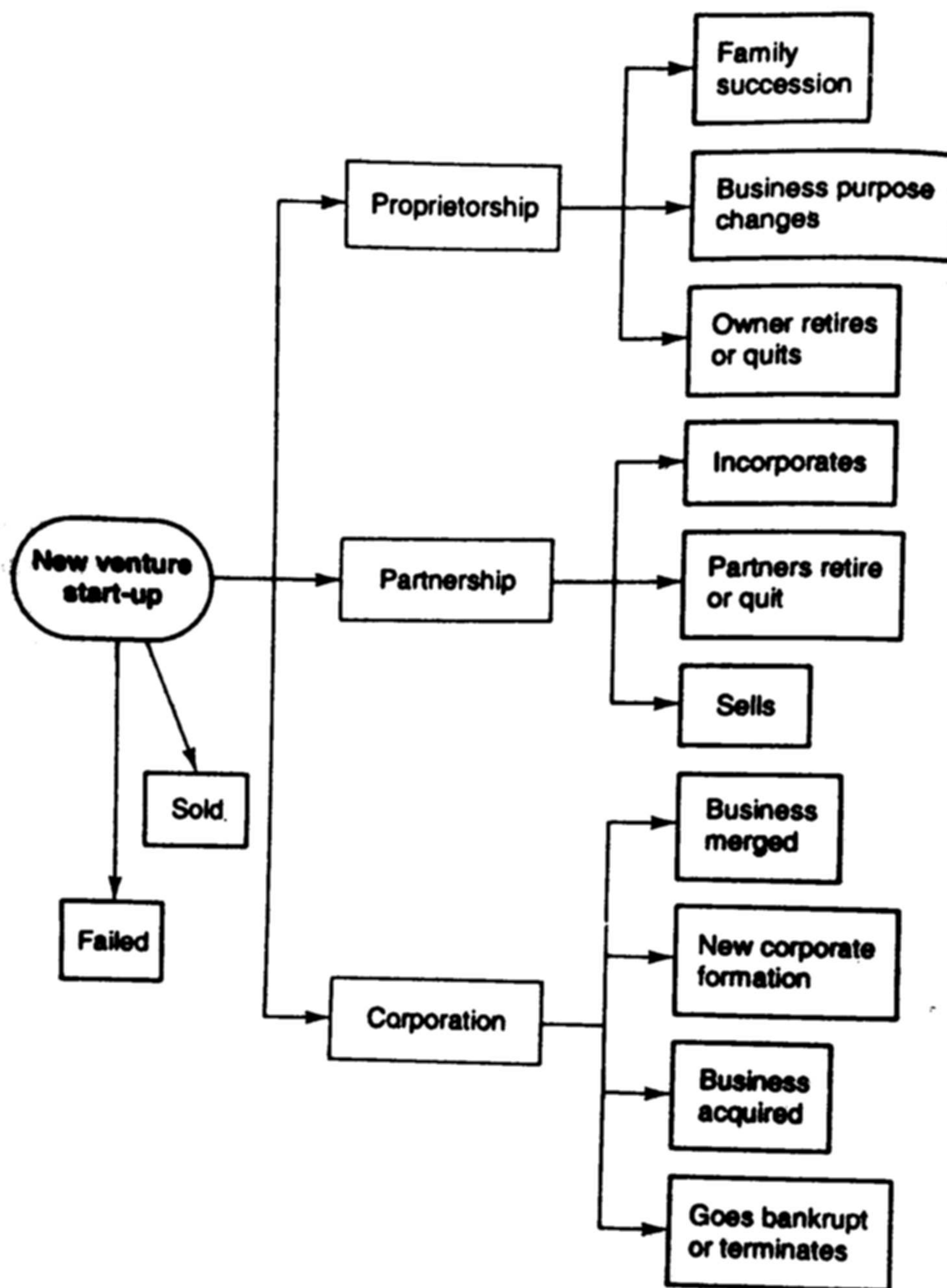


Figure 2-8 Possible Changes in New Venture Status

Are Entrepreneurs Born or Made?

A persistent notion is that most entrepreneurs are "born" with innate characteristics that prepare them for the often topsy-turvy life of new venture creation. Clearly, entrepreneurs have personal characteristics that lead to a more venturesome destiny. As noted in Chapter 1, successful entrepreneurs tend to be optimistic, have a keen sense of determination, are energetic, and often have an entrepreneurial parent. However, there is substantial evidence that entrepreneurial characteristics may be environmentally based. Firstborn children, for example, are often expected to take over parental businesses as heirs to established enterprises. One's childhood back-

ground often forges an entrepreneurial spirit as individuals from less-fortunate economic conditions have to find routes to success other than through traditional jobs.

Those who believe entrepreneurs are born conclude that entrepreneurship cannot be taught. This corollary myth would suggest that studying how new ventures are formed or how innovation takes place is of little value. If the environmental theme has credence, then learning as much as possible about the entrepreneurial process will better prepare students to succeed in business.

Other Myths and Misconceptions

Historic examples of inventors are used to illustrate success stories, and although these provide valuable insights, inventors are not necessarily entrepreneurs. Recall that we discussed earlier how entrepreneurs are less often inventors than astute businesspersons who can create an organization to bring new ideas to market.

A related misconception is that entrepreneurship must address whatever is called "high tech" at the time. Currently, information technology and biogenetic engineering are high-tech stereotypes. Twenty years ago it was communications, specifically color television and satellite transmission. Twenty years before that, just after World War II, it was the introduction of jet propulsion and new materials such as plastic. A hundred years earlier it was the telephone, petroleum fuel, and electricity. Entrepreneurship has always been associated with technological advances, but low- and no-tech enterprises remain very important.

For example, during the California Gold Rush period (1849 to 1860), everyone's attention was on gold mining; the "rush" to information technology and Silicon Valley has been compared to that era. However, lumber production in Minnesota produced nearly 40 times more revenue than gold did on the West Coast in the 1950s, and more money was made in lumber for homes, buildings, and ships than from the total gold-mining industry. The rush to information systems development today, although vitally important, is still eclipsed by basic food services and the housing industry.²⁸

An unfortunate myth that often accompanies failure is "all you need is money" to be successful. Even those with sufficient money to launch an enterprise find that entrepreneurship requires skills in marketing, manufacturing, planning, and managing human resources, to name a few. Money does not assure success, and in some instances it may be a problem because with excess capital entrepreneurs may encumber themselves with unnecessary assets and inefficient organizations.²⁹ Too little capital is, of course, a more serious problem to overcome.

► CHECKPOINT

Discuss the arguments for and against *luck*, *boom-or-bust*, and *all-you-need-is-money* perspectives of entrepreneurship.

Contrast the labels *maverick* and *misfit* often ascribed to entrepreneurs.

△ △ SUCCESS FACTORS FOR ENTREPRENEURS

△ △ Several success factors are apparent from research on innovation and entrepreneurship. We now have fairly solid evidence of what it takes to succeed in a new venture, and although there will always be exceptions, most new ventures succeed because their founders are capable individuals.

The Entrepreneurial Team

At the top of the success factor list is the "entrepreneurial team." The term *team* is used because, more often than not, entrepreneurs do not start businesses by themselves; they have teams, partners, close associates, or extensive networks of advisers. In major studies of entrepreneurs in the United States, Canada, and Europe, between 60 and 70 percent of all technology-based ventures were started by founders with at least one partner or cofounder.³⁰ Those in nontechnical enterprises (e.g., personal services or merchandising) were less likely to have partners or cofounders, yet they were well networked with associates or expert advisers.

An entrepreneurial team is usually headed by an individual who provides the critical profile of success. This focal entrepreneur typically has an above-average education, with about 35 percent of technical entrepreneurs holding graduate degrees. Most entrepreneurs started their businesses when they were in their 30s, and they had solid job experience. Also, nearly two-thirds of those studied in the United States had attempted a new venture before, and slightly fewer Canadians had made an earlier attempt. Of some interest, far less than half of those from Europe had previously tried to start a business.

Most technical entrepreneurs tend to start businesses closely related to what they did in previous career positions. Those in nontechnical areas often leverage their experience in marketing, merchandising, or a professional service area such as insurance or finance. We can infer that success is closely tied to a solid *knowledge base* and *substantial experience* in related fields of endeavor. They will also have well-developed social and business relationships, and therefore have a strong foundation for building a team or support network. This finding was reinforced in studies of Silicon Valley firms where researchers found entrepreneurs to have good relationships with vendors, potential customers, financiers, bankers, attorneys, and their competitors.³¹ Potential network relationships are summarized in Exhibit 2-2.

Venture Products or Services

Nearly all successful ventures start small and grow incrementally; few "gear up" with substantial organizations for a big-bang start. Incremental expansion of products and services also tends to stay within the bounds of positive cash flow. Products tend to have strong profit potential with high initial margins rather than small margins that require a substantial volume of sales to meet profit objectives. Service businesses retain good margins by effective cost controls and well-monitored overheads.³² In each instance, products and services tend to display a *distinctive competency*

Exhibit 2-2 Entrepreneurial Network Relationships

Business Relationships

Formal and informal liaisons with suppliers and wholesalers.

Contracts or informal relationships with subcontractors.

Existing contacts with potential customers or clients.

Potential contacts with clients or customers through networks established in prior employment.

Collegial relationships related to career specialty or through new membership in professional or trade societies.

Professional Relationships

Formal or informal relationships with bankers, security analysts, savings and loan managers, and investment fund managers.

Formal or informal liaisons with insurance companies, venture capitalists, or private investors.

Existing contacts with attorneys, public accountants, consulting organizations, import/export brokers, and realtors.

Organizational Relationships

Relationships with previous employers and universities.

Formal ties with corporations through new venture units.

Formal or informal ties with government agencies, state agencies, and local political organizations.

Social Relationships

Membership in local, state, or national professional associations.

Membership in or attendance at trade and professional conferences.

Relationships established through local or regional social clubs, community organizations, athletic clubs, and social events.

Other Relationships

Family relationships and friendship networks through family ties.

Ethnic, cultural, and religious affiliations.

Fraternal organizations, trade groups, or union membership.

Source: David H. Holt, "Network Support Systems: How Communities Can Encourage Entrepreneurship," *Frontiers of Entrepreneurship Research*, 1987, pp. 44-56.

in their industries. This is important because very few entrepreneurs start businesses in already competitive situations. This observation relates to an earlier point that we emphasized: Entrepreneurs must assure themselves of a niche for their services. A corollary to this rule is that successful entrepreneurs should "stick to their knitting" by concentrating initially on one distinct product or service, making it successful before diversifying.

From an investor's viewpoint, the product or service idea is secondary to the entrepreneur. A popular expression among investors is that they would rather "back a first-rate entrepreneur with a second-rate product than the other way around." This guideline does not mean the business concept can be weak, but it does suggest that investors must have considerable confidence in the entrepreneurial team before buying into the venture.

Markets and Timing

Successful entrepreneurs tend to have a clear vision of both existing and potential customers. A crucial aspect of planning is to have a well-documented forecast of sales based on sensible projections at each stage of incremental growth. A charismatic entrepreneur loaded with talent and a great idea will not convince investors that a venture is viable without valid market research. There are no shortcuts; innovation requires market demand, not simply a good idea.

Markets evolve, and as noted earlier, there are windows of opportunity that can lead to exceptional success. Misjudging those windows can result in dismal failure. Market potential is critically influenced by *timing* of new products or services. Timing pertains to when products or services are introduced, how they are priced, how they are distributed, and how they are promoted. We will pursue these points carefully in Chapters 8 and 9.

Business Ideology

From an entrepreneur's perspective, every venture has an ideology, a philosophy or rationale for existing. Although the ideology may be extremely difficult to quantify, it is nevertheless important. A business ideology is defined as a *system of beliefs* about how one conducts an enterprise. These beliefs include a commitment to providing customers with value, the ability to take calculated risks, the determination to grow and to control the fate of the business, the propensity to elicit cooperation among team members, and the perspective of creating wealth realistically. A business ideology may not be entirely defined by these notions, but failure is often blamed on one of them. For example, rarely do we hear that a business failed because the product was flawed, but more often because the firm lost track of its commitment to customers.

► CHECKPOINT

Describe the four primary factors associated with new venture success, and relate each to an example from the chapter.

AN ERA OF TRANSFORMATION

Given the perspective of how opportunities emerge, it is important to recognize that we are now in an era of transformation. Only a few years ago, *entrepreneurship* was a vague term occasionally used to explain bursts of economic activity. Today, the popular term *entrepreneur* occurs in television commercials, corporate annual reports, and political speeches. This transformation has had serious implications for business education and the way in which success is defined in the minds of young adults.

Before World War II, young people defined success in terms of a decent job with reasonable wages. After the war, they defined success as having corporate careers. During the past few years, more youthful graduates have been intrigued with independent business ventures. The average age of entrepreneurs who start new ventures is dropping, with more people in their 20s taking the entrepreneurial plunge. This trend is strongly evidenced by the extraordinary growth of the Association of Collegiate Entrepreneurs (ACE), founded in 1984 by a group of university students in a Boston pizza parlor. By 1991, ACE had attracted nearly 4,000 college students and more than 600 successful entrepreneurs still in their early 20s. The association has also established an honor roll called the ACE 100, representing millionaire members who, in order to qualify, must have at least \$2 million in annual sales and still be under 30 years of age; those at the top, however, have extraordinary sales.³³ Exhibit 2-3 is a recent ACE 100 list.

As we move toward the 21st century, it will be younger people who provide inspiration and innovative leadership. They are the entrepreneurs who will transform

Exhibit 2-3 The Top U.S. Young Entrepreneurs under 30 in 1991

1. **Michael S. Dell**, Dell Computer Corporation, age 26. Annual revenue, \$531 million.
2. **Neil Balter**, California Closet Company, age 30. Annual revenue, \$61 million.
3. **Jeff Bernstein & Brian Hinman**, Picturatel Corporation, ages 29. Annual revenue, \$37 million.
4. **Keith McCluskey**, McCluskey Chevrolet, age 30. Annual revenue, \$35 million.
5. **Silvano Digenova**, Tangible Investments of America, age 28. Annual revenue, \$30 million.
6. **Richard Kirshenbaum**, Kirshenbaum & Bond, age 27. Annual revenue, \$25 million.
7. **Teresa McBride**, McBride & Associates, age 29. Annual revenue, \$17 million.
8. **Jack Hertzberg**, Hertzberg Rare Coin Investments, age 26. Annual revenue, \$17 million.
9. **Jim Moseley**, The Moseley Group/Modern America, age 29. Annual revenue, \$16 million.
10. **David Goldman**, MacProducts USA & MacProducts Asia, age 25. Annual revenue, \$13 million.

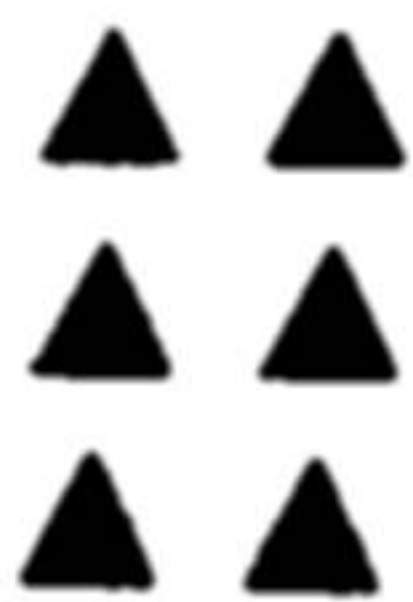
Note: Annual revenue is based on 1990 calendar year.

Source: "The ACE 100 for 1991," Association of Collegiate Entrepreneurs 1991 National Conference and Awards, St. Louis.

society. Just as in centuries past, in the 21st century it will be young entrepreneurs who determine the cadence for change.

► CHECKPOINT

Reflecting on information earlier in the chapter, discuss why this is an era of transformation. Are changes taking place today more than 20 years ago? If so, why? Why are younger entrepreneurs starting new ventures? What opportunities do you see for the future?



SYNOPSIS FOR LEARNING

1. *Explain the process of creativity.*

Creativity is defined as conceiving of something new. The process of creativity has five stages: idea germination, preparation, incubation, illumination, and verification. Germination is when the seed of an idea is implanted, arising from one's curiosity or interest in a problem or area of study. During preparation, a person embarks on research and a conscious search for bringing the idea to life. Although this search seldom produces results, a creative person becomes "prepared" by gathering information and knowledge related to the problem. During the incubation stage, a person "sleeps on the problem," often for years of periodic subconscious reflection on the idea or the problem to be solved. Illumination occurs when the idea surfaces through incubation, often seeming to have been a sudden flash of genius when, in fact, it was the culmination of conscious preparation and subconscious incubation. Once the idea becomes clear, a person will seek to verify it. Verification is the process of determining whether the idea has merit—whether it is useful and realistic.

2. *Describe how innovation is important as a dimension of entrepreneurship.*

Innovation is defined as the process of doing new things. Therefore, it is often the active translation of a creative idea into a new product, service, or technology. *Innovation* is different from *invention*. Invention is the verified result of a creative idea; innovation is the conversion of something new into useful goods or services. With that distinction in mind, innovation is perhaps the heart of entrepreneurship. Entrepreneurs may also be inventors, but they take the action necessary to redirect resources and convert creations into reality. They build organizations and systems needed to champion ideas and to exploit opportunities.

3. *Identify major changes that create opportunities for entrepreneurs.*

Entrepreneurs are often thought to be "inspired" people, and perhaps they are, but more important, they often recognize changes and opportunities that can result from a dynamic world. Scientific knowledge, one source of change, has been rapidly

advancing, and the combination of new knowledge often leads to exciting new innovations. This was the case for computers as a century of periodic changes led to artificial languages, mechanics, electronics, and combinations of technology to fashion new industries in semiconductors, computers, and software. Also important are rapid changes taking place in process innovations. "Processes" are the ways we accomplish tasks, and of course, computers have revolutionized office, manufacturing, and organizational systems, but processes such as the assembly line and petroleum refining resulted in far more pervasive changes in industrialized nations. Industrial changes occur for many reasons, including new knowledge and new processes, but also when there is new legislation or changes in society—for example, when airlines were deregulated or when AT&T was broken up. It occurs daily as new laws are passed to encourage trade, provide loans to businesses, and improve minority hiring. Market changes occur as new competitors enter industries, as social and economic shifts occur, and as cultural norms evolve. Markets also change as the demographic structure of a community or nation changes.

4. *Explain the concepts of "windows" and "corridors" for new ventures.*

A window is a time horizon during which opportunities exist. This can occur, for example, when a new change in technology takes place so that intrepid innovators rush to become early industry leaders. As opportunities for success become known, however, more competitors enter the industry, and the window rapidly closes with market saturation. A corridor is a route or an aisle down which a person travels, often beginning with one idea that leads to revisions and further innovations. It is not uncommon for a person to pursue a weak idea but, in the process, discover some new opportunity or new product that may not have come to light except through fruitless work on the original idea. Corridors also arise from the proximity of a person who is conducting similar work and is therefore positioned to recognize change more rapidly than others.

5. *Discuss popular myths of entrepreneurship and why they are more fantasy than fact.*

Perhaps the most prominent myth is that entrepreneurs are "lucky"; they were just in the right place at the right time. Perhaps in a few cases that assumption is true, but most entrepreneurs make their luck by working hard. They rarely stumble into new million-dollar enterprises but develop the marketing, manufacturing, and organizing skills needed to bring innovations to fruition. A similar myth is that entrepreneurs are "make or break" people; on the contrary, most ventures start slow and make incremental changes. Entrepreneurs are not misfits, as myth suggests, but they do "disrupt" the status quo. They alter the fundamental course of commerce, and in so doing, are clearly out of step with the rest of the parade. More accurately, they are leading the parade in a new direction. Whether entrepreneurs are "born" or "made" is an unresolved issue, but on balance, evidence suggests that most entrepreneurs are influenced to start new ventures through environmental factors and events encompassing their background, education, family, and careers. Finally, the myth that "all you need is money" to succeed has no credibility because few wealthy

people have pursued (or have needed to pursue) new ventures, whereas most successful companies have been founded by people with little money and few resources.

6. Describe the main factors that lead to success for new ventures.

Perhaps the most important factor is having a good entrepreneurial team. People transform ideas into useful innovations, and few new ventures grow beyond a preliminary start-up stage without a solid team of committed people. Financial backers rarely underwrite an individual but look for a strong team with the diversity of skills and the persistence to succeed. A second success factor is to have a well-planned enterprise that pursues incremental change and growth. It is essential to start with one distinct competency, one product or service, and firmly establish it. To succeed, therefore, a firm must maintain positive cash flow through controlled growth. A third factor is good timing. The most successful firms have timed the introduction of products or services to coincide with windows of opportunity. They did not take shortcuts or enter markets that were already highly competitive. Fourth, successful entrepreneurs have instilled in their companies a sense of purpose. They have created a business ideology to serve their customers, not to exploit them.

NOTES

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2. *Webster's Third New International Dictionary* (Springfield, MA: G&C Merriam, 1976).
3. Thomas J. Peters and Robert H. Waterman, Jr., *In Search of Excellence: Lessons from America's Best-Run Companies* (New York: Harper & Row, 1982), p. 206.
4. Frank Baron, "The Psychology of Imagination," *Scientific American*, Vol. 199 (1958), pp. 151-166. Also see John J. Kao, *Entrepreneurship, Creativity, and Organization* (Englewood Cliffs, NJ: Prentice-Hall, 1989), pp. 15-19.
5. "The Mad Idea," in *Communicating and the Telephone*, a biographical monograph by American Telephone and Telegraph Company, July 1979, pp. 4-5.
6. Kao, *Entrepreneurship, Creativity, and Organization*, pp. 55-56.
7. Hollister B. Sykes, "Lessons from a New Venture Program," *Harvard Business Review*, Vol. 86, No. 3 (May-June 1986), pp. 69-74.
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CASE 2-1

CareerTrack on a Roll

Entrepreneurs seldom march to the same cadence of others, and this "out of step" mindset often ends up costing entrepreneurs their jobs. Jimmy Calano had this experience early in a corporate career that ended at age 24. Together with Jeff Salzman, who left his job at age 28, the partners set up CareerTrack in 1982. Their corporate careers at an end, Calano and Salzman built an organization starting in Calano's bedroom that today has nearly \$50 million in sales and is the leading business seminar company in the industry.

CareerTrack offers more than 3,000 seminars annually in nearly 400 cities on three continents, and the numbers are rising. The success of CareerTrack is based on astute marketing and a clear picture of the firm's customers. By pricing seminars as low as \$45 rather than several hundred dollars per person, the company captured the market for women in emerging professional careers. "We gave more value at one-fourth the price," says Calano. "A lot of people price seminars according to their costs; we price our programs at what people can afford."

Among CareerTrack themes are "Image and Self-projection," "Getting Things Done," "How to Get Results with People." More than 500 seminar themes exist in the firm's repertoire, but when the business started, a deliberate effort was made to identify women in various career positions. Once established, CareerTrack diversified to provide on-site seminars for large corporations, including IBM, General Motors. Reaching \$25 million in sales, the entrepreneurs took aim at government agencies, including the IRS and the Department of Labor. Themes emerged for corporate and individual clientele, such as productivity

improvement, quality performance, creativity, and office system development.

Calano recalls that the company began with a vision of success that had little similarity to what it is today. "You have to understand that I was just out of college and still not entirely sure what my final grades were when Jeff and I decided to do it," Calano explains. "Jeff had been through several jobs in sales, and I had been working for a guy who did the Saturday-morning-you-are-gonna-get-rich seminars. Every Saturday we'd collect a couple of hundred bucks from 20 or 30 people eager to hear how to get ahead in real estate or stocks or something. I realized very quickly that nearly anyone could put on a seminar with a sexy message, and Jeff and I decided to do it right."

CareerTrack's first seminar for working women on "assertiveness training" was held in a Colorado hotel conference room. Calano and Salzman worked for several months researching the topic and putting the seminar together, then they decided on a \$40 fee and placed several ads, and the company was born.

"The concept was to provide a valuable seminar worth \$40," explains Calano, "and we felt good about what we were offering. The topic seemed obvious because no one seemed to be paying any attention to working women or their career problems. A half-day seminar on how to be more assertive in their jobs just seemed the ticket. But our so-called vision was just that—to offer one seminar to working women on assertiveness and hopefully make enough to buy tacos for a week or two. We had no idea of making lots of money, running courses for IBM, or hiring people like Tom Peters to lead seminars.

"Once we realized how many people

wanted quality seminars," Calano notes, "opportunities seemed to be everywhere. If we had mapped out a business plan then, it would have looked like a spider web with market opportunities in every direction. College students needed—and still need—practical information on writing résumés and getting jobs. Women still need help negotiating for promotions and being assertive about their careers. Men need stress management. And we all need to improve our careers, our self-images, and our knowledge of the world around us. If we had not created CareerTrack, someone would have, and, in fact, a lot of companies are doing the same thing now. All we had to do in 1982 was pick a direction and go. We are still doing that."

Today, Calano and Salzman spend their time on two distinct business activities. The first, and most consuming, is *market research*. The second is the actual development of CareerTrack training programs. Success, in their eyes, comes from first *understanding* the \$4 billion seminar and training industry, then *planning* carefully to address a distinct customer within that industry. The firm's products

evolve from a marketing base, that, today, includes films, videos, audiotapes, books, and seminars ranging in topics from "How to Survive Your College Days" to "The Masters of Excellence" by Tom Peters.

CASE QUESTIONS

1. Identify and discuss CareerTrack's window of opportunity. What social or economic changes occurred to create this window? Do you think the window is still open today? Explain.
2. Describe the corridor principle and how it seemed to propel CareerTrack from a Saturday morning seminar to a global business.
3. Put yourself in Calano's shoes today. What opportunities exist now and for the immediate future in a similar business?

Source: Interview with Jimmy Calano and staff at CareerTrack. Also Jimmy Calano and Jeff Salzman, *CareerTracking* (New York: Simon and Schuster, 1988), pp. 32-34, 95-96.

CASE 2-2

Stew Leonard—The Great American Milkman

Stew Leonard was a second-generation milkman with a home delivery route until 1968 when state highway construction forced him to relocate. Because of this change coupled with the realization that home milk delivery was going the way of buggy whips, Stew Leonard built a barnlike retail dairy store with glass viewing windows separating his customers and milk cows. The dairy plant provided milk so fresh that the only way to get fresher milk was to

own a cow. After 26 additions, the small barn has become an 8-acre complex with more than 600 employees in Norwalk, Connecticut.

In a White House ceremony in 1986, Leonard received the Presidential Award for Entrepreneurial Achievement from President Ronald Reagan, and Leonard was featured in Tom Peters' best-seller *A Passion for Excellence* as one of America's best-run companies. Featured in the television special "In Search

of Excellence," Stew Leonard was heralded as one of the nation's most innovative companies alongside Disney, McDonald's, and Apple.

The genius of Stew Leonard is making customers happy through quality service and innovative marketing. His "Rock of Commitment" credo is "Rule 1: The customer is always right. Rule 2: If the customer is ever wrong, reread Rule 1." Leonard says he wants to make customers say "Wow!" and then return—again and again. A trip to Stew Leonard's store is an experience that reinforces his credo and his policies. Disneylike farm characters play music, perform, and mingle with customers. Live farm animals give children up-close encounters with egg-laying chickens, milk-producing cows, friendly rabbits, ducks, geese, and other domestic animals. On any given day, there is likely to be a live band, free gifts, and ice cream for youngsters. Stew Leonard and his family will be there every day, talking with customers, soliciting suggestions, and managing the business with one clear objective: Make customers happy.

His success is dependent on the sincerity of his policies and the attention to planning that result in what Leonard calls "action-based policies." These include "If you wouldn't take it home to your mother, don't put it out for customers"; "Only happy customers come back"; "A customer who complains is our best friend because we get the opportunity to improve"; "When in doubt, throw it out"; "Do it right the first time"; and "If you're training someone to be even better at your job than you are, then you're one of the most valuable people in our company."

Leonard often generates ideas from customers who are involved in his weekly creative brainstorming sessions. About a dozen customers are chosen at random and invited to sit down with Leonard's family and staff to explore ideas for the store. Meetings can last for several hours, and the results are often quite stunning.

A complaint about strawberries always being prepackaged so that customers could not see whether they were getting their money's worth led to an open-bin arrangement where customers could pick and choose. The result was that, on average, customers bought more strawberries, and total sales nearly tripled. Another suggestion was that friendly cashiers be openly rewarded. Leonard started a daily program of "stopping the line" to announce and reward the best cashier in a fanfare manner. Customers periodically win free shopping sprees. There are two fish counters—one with prepackaged seafood and another with "morning fresh" seafood on ice. Leonard conducts classes through his employees for customers on cooking, and he periodically hires specialists in nutrition and diet control both to train employees and to guide customer purchases.

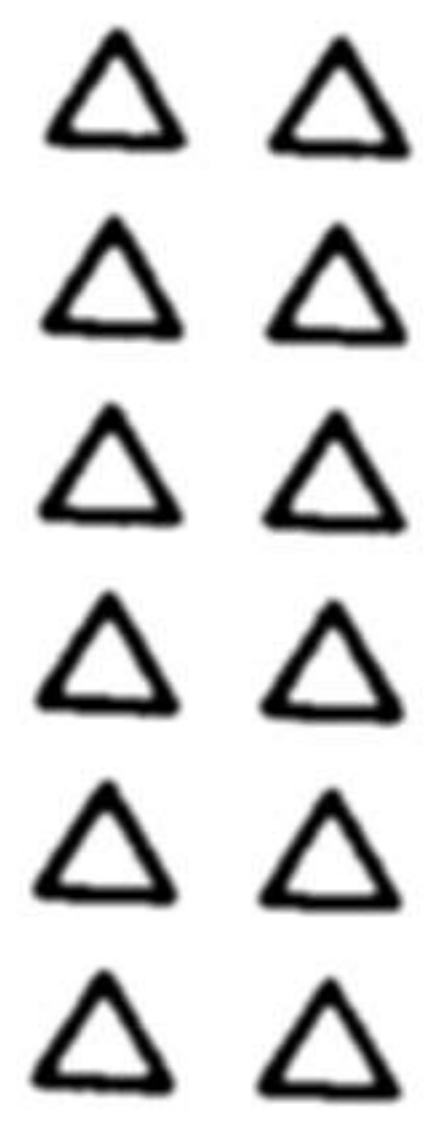
In Leonard's view, creativity is "listening" to others and building a business around the total environment rather than just a merchandise line. Consequently, his store sells more than food and more than service, it sells the idea of food preparation as a fun concept. Customers are on his organizational chart as participants in the store and its environment.

Success is reflected in more than 100,000 customers a week and more than \$100 million in annual sales, making Stew Leonard's the largest retail dairy in the world. In fact, he sells more of each item that he stocks than any other store in the world, including 10 million quarts of milk, or about 18,000 quarts per hour. Annual sales also include 100 tons of cottage cheese, 800 tons of salad, 1,000 tons of hamburger meat, 1,800 tons of poultry products, a million ice cream cones, nearly 3 million quarts of orange juice, 250 tons of butter, 5.6 million bananas, and 7.8 million ears of corn. These are a few of Stew Leonard's 800 record-setting products epitomizing a record-setting family business.

CASE QUESTIONS

1. Describe how Stew Leonard's methods compare with a prescribed process of innovation.
2. Selling groceries is hardly a new type of business, and it is far from "high tech," so explain how Leonard found "new opportunities" in this business.
3. Identify the main success factors of Leonard's business and tell how they relate to similar factors described in the chapter for successful ventures.

Source: Courtesy of Stew Leonard, June 1988.



Small Business and Corporate Entrepreneurship: Contrasting Enterprises

OBJECTIVES

1. Describe the environment of small business and how it is changing.
2. Identify the most common causes for small business failure.
3. Explain the important success factors for small business enterprises.
4. Describe corporate entrepreneurship.
5. Discuss the major approaches to corporate entrepreneurship.
6. Describe emerging ways corporations are encouraging entrepreneurship.

Fundamental concepts of entrepreneurship, creativity, and innovation were introduced in the first two chapters. We also provided a framework of definitions on which we can build more thorough discussions. In Chapter 3, we explore in more detail "small business" and "corporate entrepreneurship" as two highly contrasting approaches to new venture creation. Small businesses are as essential to the American economy as successful large corporations are, and both contribute to the high quality of life that we enjoy in the United States.

Small business will be examined in terms of the many services, local professional practices, and merchandisers that all of us rely on. Without the clothiers, shoe stores, convenience stores, restaurants, laundries, gas stations, and many other small enterprises, we could not function. Without accounting firms, dentists, pharmacies, and attorneys, we would lack important services. Without music stores, florists, photography shops, candy stores, theaters, beauty salons, and bookstores, life would be bland. On the other hand, without larger firms to support economic development, jobs, major product development, and communication systems, utilities, and energy resources, the country would be little more than a wilderness.

In terms of entrepreneurship, small business is a very personal approach to creating new enterprises. Small businesses usually have limited growth opportunities and operate in a community atmosphere. Corporate entrepreneurship encompasses major innovations and organizations that can leverage their massed resources to provide systems of technology, products, and services on national and global scales. This chapter examines how entrepreneurial activities occur in both sectors.

THE ENVIRONMENT OF SMALL BUSINESS

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The environment of small business is often defined by the type of business or service rendered, and in most instances the opportunities for small business are defined by the characteristics of a community. To emphasize the role of small business, it is important to recall the introduction in Chapter 1. Small business comprises many local enterprises, service companies, and professional organizations that constitute more than half of all nonfarm employment in the United States. This profile of small business is remarkably similar among most free-market nations. Small businesses include merchandisers to which we turn for a significant amount of our daily purchases. It also includes "practices" and "personal service" enterprises of doctors, accountants, tailors, interior designers, and many others to whom we turn for personal needs.

There is also a substantial number of small manufacturers, wholesalers, distributing companies, and vendors who focus on specialized niches to provide everything from local bakery goods to space telecommunication equipment. Many of these entrepreneurs are small *by choice*. They probably have opportunities to expand into new markets or to develop into larger organizations, but they prefer the autonomy of a small business and subsequently avoid rapid expansion. The entrepreneurial profile on Dan Bricklin is illustrative.

Franchises, owned and operated by independent businesspersons, provide us with local products and services that range from fast foods to microcomputer services. These independent businesses represent an extraordinary range of activity that has given us a high-quality life-style. A short list of these would include quick printing services, auto parts and repair services, gift shops, personnel placement services, fashionable men's or women's clothing shops, gourmet candy stores, video rental outlets, yogurt shops, and travel agencies.

For nearly all phases of domestic construction, we rely on small business enterprises, including prime contractors, plumbers, electricians, and other craftsmen. Community radio stations, newspapers, and cable operators help keep us informed and entertained. Our recreation needs are often met through small business endeavors that include golf courses and pro shops, tennis clubs, boating facilities, ski shops, health clubs, and many more.

Opportunities in Small Business

Business students, as well as most business school curricula, focus on careers in the corporate world, but an exceptional number of career opportunities exist in smaller

PROFILE △

Dan Bricklin: Small Is Not Bad

Dan Bricklin was the pioneer of computer spreadsheets who created the first commercial software company for microcomputer applications. He was also credited with the first business software that propelled Apple Computers to prominence, and his innovations became the models for Lotus Development Corporation software. Bricklin graduated from MIT and Harvard Business School, then teamed up with Bob Franston in 1978 to program the first spreadsheet. The result was VisiCalc, a program that swept to prominence five years before Lotus introduced its first product. Apple Computer, and most other computer manufacturers, rapidly adopted VisiCalc, and Bricklin's company grew to a multimillion-dollar industry leader.

By 1983, Bricklin's VisiCalc had expanded to world markets, his staff had expanded to hundreds of employees, and anxious bidders were offering huge sums to purchase the company. Then IBM set a new standard with its PC, and the MS-DOS operating system came to prominence. Lotus 1-2-3 pushed aside VisiCalc, and the VisiCalc family of products eventually faded from the market. Bricklin did not fade away, however, and in addition to being a consultant to Lotus Development Corporation, he set up another software company and quietly (and profitably) closed down the VisiCalc business.

Instead of rebuilding as a major software developer, Bricklin resolved to keep his new company small. Avoiding corporate growth, marketing hype, and global expansion, Bricklin chose to remain independent. By 1989 he had developed several award-winning programs, sold or licensed proprietary software to several major manufacturers, and made an undisclosed but "enormous" amount of money while remaining almost totally anonymous. Bricklin likes the idea of being "small" and keeping his business "lean as a bone." In his view, building a large organization may give a founder honor and glory, but remaining small satisfies his life objectives to be innovative, successful, and independent. Growing a company can be fun, Bricklin admits, but he has no intention of spending a decade organizing and guiding a high-growth enterprise.

Source: Dan Bricklin, "My Company, My Self." Reprinted with permission, *Inc. Magazine* (July, 1989). Copyright © 1989, by Goldhirsh Group, Inc. 38 Commercial Wharf, Boston, MA 02110.

42% of U.S. GDP
 58% of U.S. GDP

enterprises. Of the nearly 19 million businesses in the United States today, about 97 percent, roughly 18 million, are in the small business sector.¹ Although researchers continue to debate the definition of "small," there is a preponderance of evidence that most new jobs are created through new and smaller enterprises. Nearly 42 percent of all sales and 38 percent of the U.S. gross domestic product are derived through small business activity, and more than four times as many new innovations are

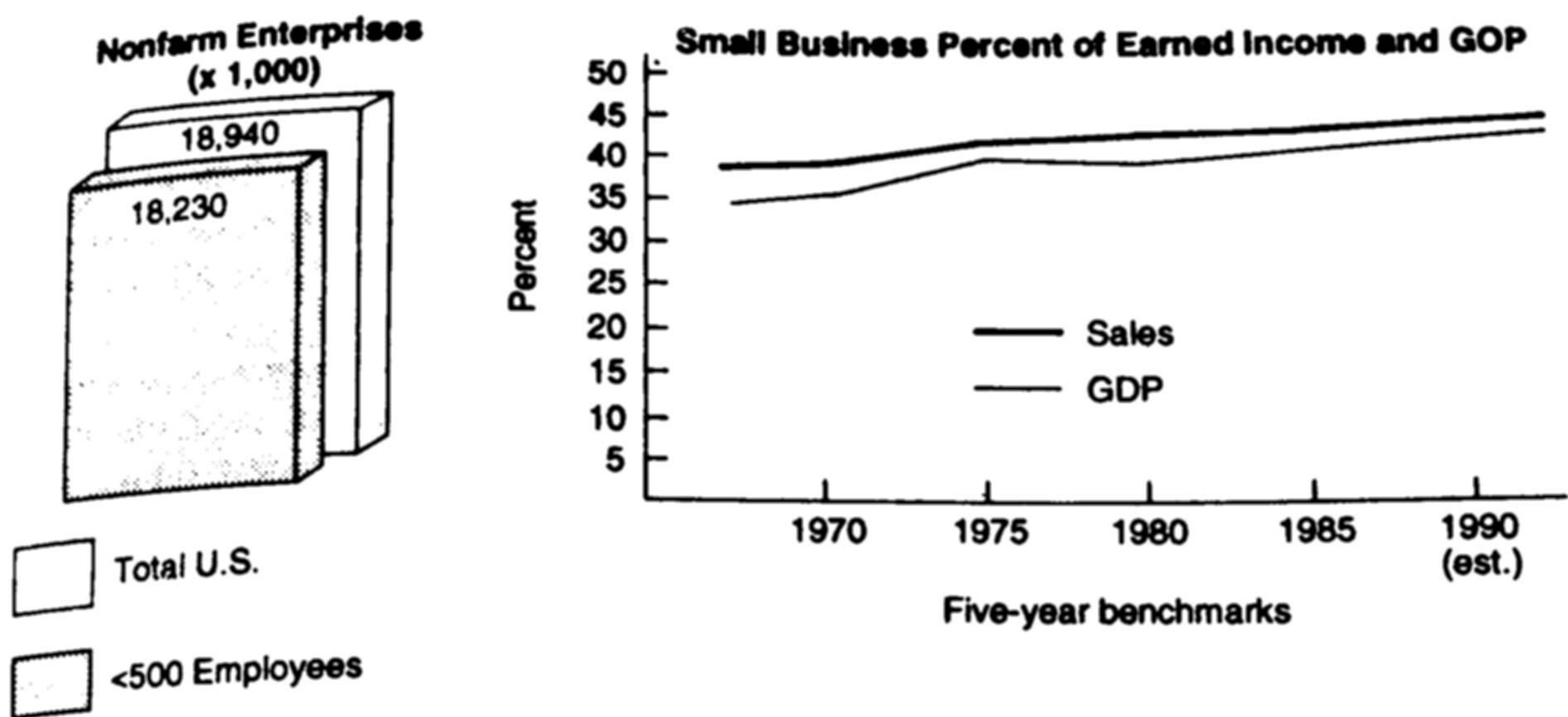


Figure 3-1 Contributions of Small Businesses to the U.S. Economy

developed through small enterprises as through large corporate endeavors.² Several trends are shown in Figure 3-1.

Opportunities in small business are distinct from those of *high-growth* enterprises. Recall from Chapter 1 that we characterized **small businesses** as those started by individuals who seek *income substitution* and who serve a local constituency. Therefore, most small business owners are not concerned with changing the world, finding a cure for the common cold, or setting industry on its heel with some marvelous new invention. To the contrary, they are concerned with filling immediate needs of their customers and clients within the scope of well-defined markets. Opportunities arise from business niches and local shifts in consumer demands, but these often constitute enormous transformations in commercial activity. For example, the city of San Diego, California, grew from a population of barely more than a half million persons in 1960 to approximately 3 million by the late 1980s, creating an eightfold increase in demand for retail merchandisers. In Sun City, Arizona, once an isolated and small retirement community, there are now more than a quarter million residential homes and 50,000 businesses supporting an extensive suburbia near Phoenix.³ Population increases throughout most of the United States, in particular the southern sunbelt regions, have stimulated an explosion of small business activity.

Opportunities arise from any change that fosters an unfulfilled need. Something as simple as the construction of a new highway off-ramp will create an influx of travelers in search of gasoline and fast food. If the area is scenic, opportunities may be forged by entrepreneurs to provide recreation, lodging, and tourist shopping. As these businesses develop, a network of support businesses is needed to serve them. More houses will be built, groceries and convenience stores will emerge, retailers will become established, schools and churches will appear, and, in turn, these will cause even greater needs to surface. This is not, however, an ever-widening circle of activity. If travel recedes, demand for goods and services may collapse. For example, "The Colonel" Harland Sanders was thriving on his unusual chicken recipe

and a good restaurant business in Kentucky until the U.S. Interstate Highway System bypassed his town during the 1950s. Sanders was virtually broke within a few months of the highway opening, and he might have quietly retired on social security had he not been determined to find a way to regain his losses. Instead, he conceived of restaurants located in small communities where the new Interstate System would have off-ramps, and when he licensed his chicken recipe to small restaurant owners, Kentucky Fried Chicken was born.⁴

In this age of global communications, small businesses may no longer be severely restricted to local or community endeavors. International trade, export brokerage of products, and instantaneous communications are opening new venues for small businesses. For example, nearly every country in the free world has import and export quotas for products ranging from canned nuts to automobiles. In 1990 the export quota for American eggs to be imported to Hong Kong was set at 26.7 million dozen. The U.S. government noted a shortfall of over 3 million dozen eggs scheduled for export and issued a notice to Americans that a bonus would be paid to fulfill the quota. Individual farmers are unlikely to have the connections to pursue these types of opportunities, but "export brokers" do. Operating out of midwest offices, small companies such as McCall Saunders Marketing monitor government reports, and armed only with a fax machine and telephone, they fill orders from hundreds of independent farmers. McCall reacted to the government report within hours to register export sales of 27,000 dozen eggs.⁵ Weekly reports by government agencies throughout the world list thousands of products needed overseas, and a growing number of small businesses are becoming involved in exporting. Perhaps more businesses are involved with importing. The United States is an affluent society, the marketplace of the world, and imported products range from toothpicks to oil tankers.

International business opportunities are growing rapidly, and although we will be attentive to global business throughout this book, small business is most commonly represented by the merchandisers and service firms in a community. Being a small businessperson also shares several characteristics with the role of an independent business owner.

The Small Business Role

The independent businessperson has a role quite different from that of a high-growth entrepreneur or corporate business manager. As a risk-taking owner of an entrepreneurial venture, innovation and growth require the organizational abilities to gather resources and establish new venture teams. Corporate managers become professional specialists, focusing on specific tasks or responsibilities, such as tax accounting, design engineering, or advertising. Small business owners must wear many "professional hats" at once. They may hire a few people, but they behave more as an autonomous owner than as a professional manager. The owner will also assume the risks associated with financing and operating a new business, but those risks are seldom related to innovation development. Some of the many responsibilities of business owners are summarized in Figure 3-2.

Small business owners often keep their own books and do their own taxes, but

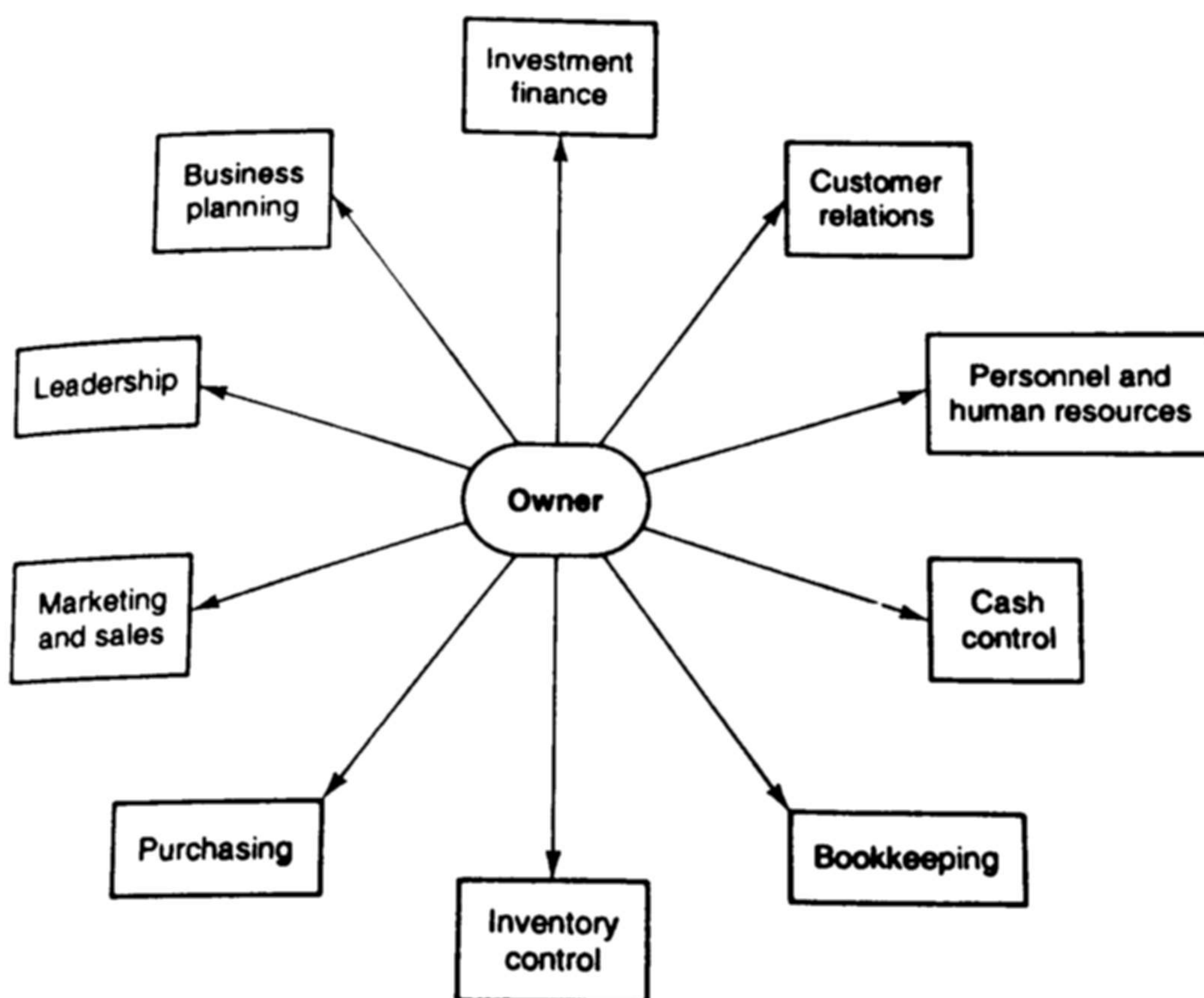


Figure 3-2 Role Responsibilities of Small Business Owners

most neither have the time nor the inclination to become expert in tax accounting. They may use personal computers to track inventory and do a bit of word processing, but they rarely care about "knowing computers" or programming. As managers, they must motivate a team of employees, and although this activity is important, weighty theories in leadership will be of little interest to them. They will think strategically but not develop strategic plans, and be concerned about market demand but not engage in market research. In most instances, they do things required to survive tomorrow and to compete next week.

This sense of immediacy coupled with a disregard for management concepts at once helps illustrate the nature of small business and shows why it is important for aspiring small business entrepreneurs to become better educated in business matters. The small business role is complex, encompassing all the activities required to be in business, yet lacks the depth necessary to become specialized in any particular aspect of management. In most instances, the business owner is *technically* competent, perhaps an expert in merchandising, accounting, medicine, engineering, or export brokerage, but often this technical orientation dominates business decision making, further reducing the ability of the owner to deal with management issues such as planning, organizing, leading, and controlling the enterprise. Most business failures are attributed to the incompetency of the owner, and broadly interpreted, this gen-

eralization means that independent businesses are often operated in a technically sound manner but managed pathetically.

Management issues will be addressed throughout this book, but not in a "how-to" manner; there are several excellent books and courses specifically designed for that purpose.⁶ Understanding why small businesses succeed or fail, however, can forewarn aspiring entrepreneurs about the risks.

► CHECKPOINT

Describe local markets, competition, and types of products or services that constitute the small business environment.

Explain how opportunities arise locally and globally for small business.

△ △ / RISK AND FAILURE

△ △

△ △

Failure can be thrust upon an entrepreneur through external conditions or fabricated by the entrepreneur through personal shortcomings. Small business owners are particularly vulnerable to both situations because they are usually preoccupied with the immediate needs of survival. External conditions, such as inflation, threaten us all, and we can be consumed by them. Fabricated failure, unfortunately, can usually be traced to an owner's arrogance or simple lack of management acumen.

External Factors of Failure

Every business is affected by *externalities*: economic business cycles, fluctuating interest rates, interrupted supplies, labor market trends, inflation, government regulations, and unstable financial markets. A general rise in consumer prices will detract from sales. A similar rise in producer prices will inflate costs. However, the smaller enterprise is far more susceptible to these forces than a large firm. For example, IBM has access to capital resources to ride out a recession, but a local contractor may run out of cash quickly and go under. A major toy manufacturer may be able to find alternative financing when interest rates soar, but the local toy store may watch its profits evaporate in precipitous debt obligations.

From a financial standpoint, most small businesses rely on commercial loans tied to premium interest rates. Small changes in economic conditions result in huge changes in profits. Smaller businesses that are relatively debt free still operate in a more intense, price-sensitive environment. Most cannot afford to trim prices, nor can they substantially reduce costs. On the other hand, many smaller firms are isolated from "macro" economic variables. Inflation, for example, rarely affects two communities in exactly the same way. During the early 1980s consumer price levels were very high on a national scale, but there may have been a 10 percent general price

Exhibit 3-1 Pressing Problems for Small Business

- Payroll taxes, contributions to unemployment insurance, disability, and compliance costs often exceed small business margins.
 - Estate taxes and a tax program lacking in investment incentives have combined to divert money away from small businesses.
 - Changes in institutional credit and investment alternatives have biased lending toward larger companies and publicly traded securities.
 - Because small businesses tend to use more debt than larger firms, rising interest rates weigh more heavily on small business than on any other economic sector.
 - Government limitations for backing sponsored programs, mainly those administered through the Small Business Administration, have made bank lending less attractive to small start-up enterprises.
 - International competition has stiffened, opening opportunities for small businesses in export markets, but the economic power of foreign competitors operating at home and abroad threatens small businesses.
-

increase in New York and only a 3 percent increase in Charleston, South Carolina. Likewise, the extraordinary increase in housing costs in California came when housing costs in Buffalo were falling. In effect, local businesses are often insulated from problems that plague national corporations. In 1988, Houston was in a recession, and there was a general "sell-off" of assets.⁷ Bargains abounded in housing, commercial property, cars, computers, and other hard assets. Employment was down and wages dropped drastically, yet this oil-related recession in Houston had little effect on business in Washington, and while Houston was staggering, San Diego was booming with a full-employment economy.

Consequently, smaller enterprises are more susceptible to changes in the external environment, but success or failure is often a result of phenomena peculiar to a community or to a well-defined industry. Small businesses usually operate in an environment composed of local competitors. Still, capital for investment and loans come from institutions that are influenced by national or regional trends. Therein lies the crunch, and too often the small businessperson cannot reconcile these contradictory forces. Even the most astute business owner is preoccupied with the two external issues of financing and taxation. The National Federation of Independent Businesses (NFIB) noted these issues as pressing problems during the 1987 White House Conference on Small Business.⁸ Exhibit 3-1 elaborates on these points.

Personal Factors of Failure

Just how many businesses fail because of uncontrollable external factors and how many fail owing to personal factors is debatable. However, Dun and Bradstreet statistics attribute about 52 percent of all business failures to "management issues," and as much as 90 percent of small business failures to incompetent managers. Specifically, D&B cites the inability of small business managers to control purchasing costs (inventory), to control capacity (production or operating costs), to generate

customers (lack of marketing expertise), or to manage financial assets (feeble cash control being the primary issue).⁹

Inexperience. Too often, entrepreneurs launch their enterprises without having sufficient experience to succeed. Inexperience can be translated to mean a lack of technical skills or management acumen. Each of these shortcomings can lead to disaster, but they also can be overcome by an individual willing to make the commitment of time and energy to learn about business. Not too long ago, for example, an experienced nurse created a medical newsletter for retirees in north Florida. The idea was sound, there was a good market, and her editorial content was excellent. Six months after her first issue, however, she was bankrupt. Her problems stemmed from lack of experience in publishing (the real nature of her business), not in the medical field. As a result, she had purchased expensive desk-top publishing equipment and produced huge runs of newsletters that stacked up in her garage unsold. At about the same time in 1987, a nurse in Virginia started a similar health newsletter for truckers that focused on safety and stress. She too got into trouble by going to market without solid experience, but she sought advice from small business counselors, took training courses in desk-top publishing, and worked briefly as an intern with a printing firm. She made a second start, and her business is doing well.

Experienced managers often make the mistake of assuming that since they are reasonably successful in a salaried position, they can transfer that knowledge to an independent business. Personnel specialists may feel confident when they strike out on their own to open an executive placement agency, only to find that the "agency" requires marketing expertise, not just knowledge in corporate personnel. Engineers launch their own firms to pursue the manufacture of innovative products only to find that they know practically nothing about production. Each of these individuals may be "experienced," but the kind of expertise they bring to their enterprises has limited value.

In other instances, capable individuals start new enterprises within their respective fields but cannot manage their resources or provide leadership for their employees. An engineer who starts a consulting firm with excellent credentials, yet who ignores employee needs, risks losing the primary resource essential to succeed. A clothier who is a fashion expert but cannot control inventory costs could easily "buy" into oblivion.

Arrogance. Many small businesspersons—particularly inventors and innovative entrepreneurs with new products—become egocentrically engrossed in their ventures. They become consumed with their own brilliance, convinced beyond reason (often without market research) that their bright idea will change the world—it's got to sell! Their arrogance will not allow them to take advice from others. They will shun all innuendo of failure. Such arrogance is often needed to succeed, and there are many fine examples of those who have defied the odds, yet for each success story, there is a legion of failures.

An extraordinary example of success born of this singular-minded arrogance is King Gillette. At the turn of the century, men everywhere had to go through the

PROFILE Δ

King Gillette

At the turn of the century, shaving was a painful ordeal. Few men really got the hang of using a straight razor, and barbers were expensive. King Gillette was one of those men who were more likely to shave off skin than whiskers, and he set out to solve the problem. His idea for a safety razor was jeered by engineers and barbers who told Gillette his idea was impossible. It took a while to catch on, but during World War I, the safety razor became a standard item in every soldier's field kit, and soon after, the Gillette Safety Razor Company was manufacturing enough replacement blades each year to circle the globe.

Source: *The Entrepreneurs: An American Adventure* (Boston: Enterprise Media, 1987), Film No. 3.

agony of shaving with a straight razor. This was not an easy task, nor a safe one, and it was expensive to be shaved professionally by a barber. Gillette conceived of the safety razor with replacement blades, but as a merchandising salesman, he wanted expert advice about his invention. King Gillette went to engineers at the Massachusetts Institute of Technology who said it couldn't be done. He talked with experienced manufacturers who laughed at the idea. In the end, Gillette was sure he could create the safety razor and did so. He remarked that he was grateful for not being an "expert" or he too would have realized that the safety razor was impossible to make.¹⁰

Examples of failure are more subtle. In most instances, the entrepreneur was an independent businessperson who simply focused too intensely on one aspect of the enterprise. This is a case of being tied to an infeasible idea, and then "riding the tiger until consumed."

Mismanagement. Humble entrepreneurs steeped in experience can still go under simply through mismanagement of resources; they simply make bad decisions in critical situations. Given the competitive nature of most small businesses and the volatility of profits, business results are quite sensitive to small errors. Several categories of management mistakes are critical for small businesses to avoid.

→ **Overinvestment** in fixed assets is common. When starting or expanding a business, it is tempting to buy facilities and equipment rather than lease or subcontract. For example, we noted earlier that a nurse in Florida had started (and quickly ended) a health newsletter for retirees. One of her mistakes was to purchase \$40,000 worth of desk-top publishing equipment. She did so to avoid the high variable cost of paying for commercial printing. She had a good product and could have used her cash and credit to underwrite several years of activity. Perhaps that would have been sufficient time to establish a market. Instead, the \$40,000 created a heavy debt burden requiring

a huge sales volume to break even. Everyone likes to own assets, but greater investment in fixed assets means less flexibility to adjust to adverse conditions. Of course, there are conspicuous spenders who buy BMWs, join country clubs, and lease Lear Jets before opening day. They are usually doomed to a few wonderful days in fantasy land before the crash.

Poor inventory control threatens the success of nearly all retail enterprises. Inventory is the critical cost factor for most stores. Purchasing too much inventory increases the risk of low turnover and obsolescence. Having too little inventory undermines customer selection and sales. Buying the wrong inventory, or buying at the wrong time, evaporates cash. In each scenario, the business ties up high-powered cash in nonearning assets, and inventory items can rarely be disposed of for more than a fraction of their costs in an emergency. The result is that a business "purchases" itself into insolvency.

Purchasing errors and lack of good inventory management are critical problems for any business. Manufacturers typically have more than 40 percent of their money tied up in raw materials and supplies, and the problem is compounded by those who "build to inventory" (i.e., make products to stock in warehouses), thereby tying up even more capital in finished goods.¹¹ Many companies build to market (i.e., coordinate production to meet shipping schedules with minimum finished goods). Differences in overhead costs between companies that build to inventory and build to market are shown in Figure 3-3.

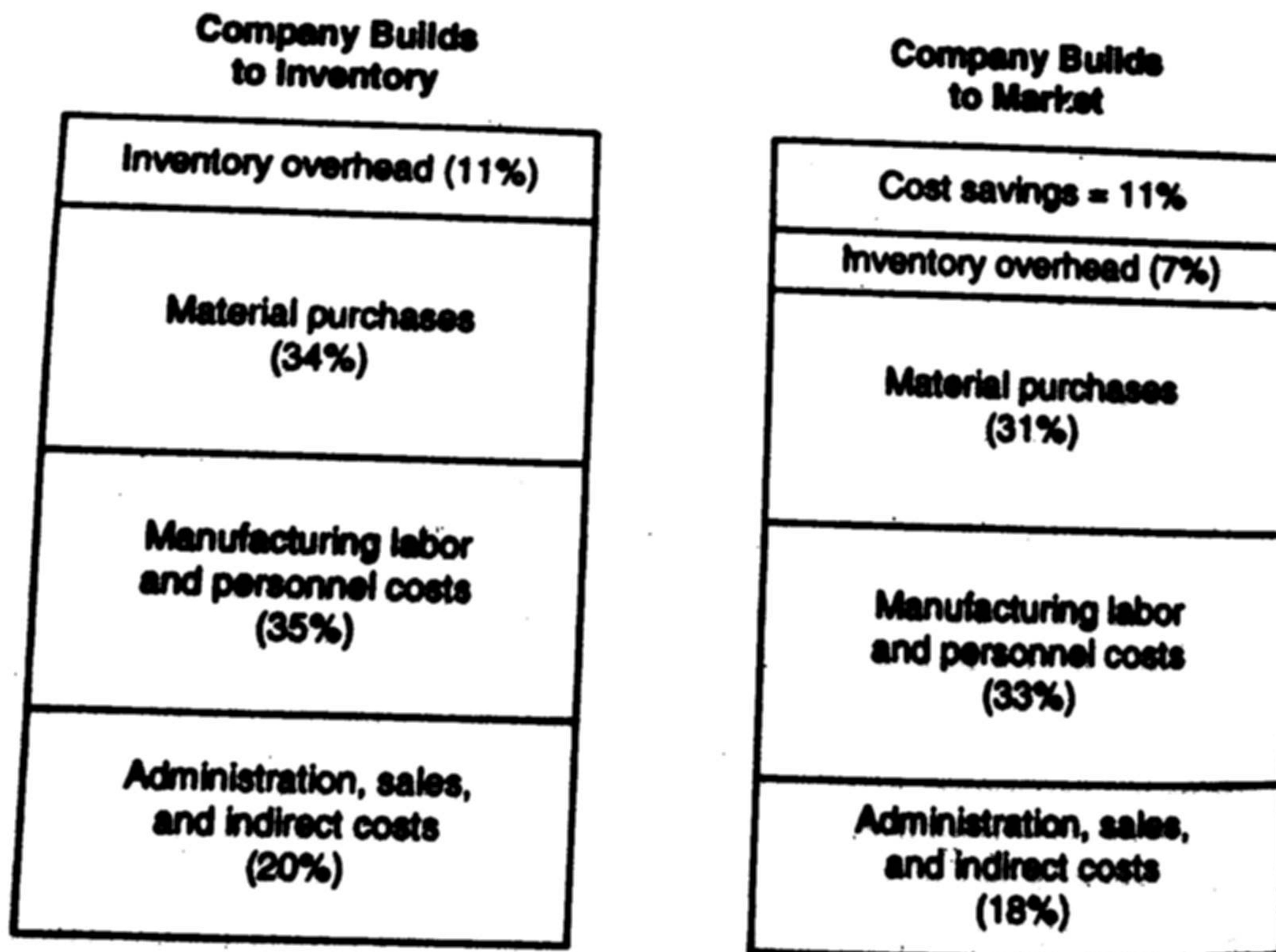


Figure 3-3 Relationships of Inventory Costs to Total Costs. (Source: Adapted from Richard J. Schonberger, *World Class Manufacturing* (New York: Free Press, 1987), Chapter 1; and *Annual Survey of Manufacturers* (Washington, DC: U.S. Department of Commerce, 1989).)

Poor financial control is a fatal flaw for most small businesses. Even for those firms with excellent inventory management, good leadership, solid markets, and a reasonable capital structure, cash-flow problems persist. Many entrepreneurs simply fail to realize that "income" does not mean "cash flow." A record-setting month of perhaps \$100,000 in sales is *cash* only to the extent that customers paid in hard money at the point of sale. Most businesses extend substantial credit to customers, and some accounts may remain unpaid for months. The average collection period in retail department stores is 24 days, and it commonly runs to 52 days during slack seasons. In the electronics and computer industry, the average collection period is 40 days, running to 60 days for many hardware firms.¹²

Assuming no "bad credit" and only a few bounced checks or bogus credit cards, small business managers will have to manage credit policies very closely to assure a positive cash flow. Cash problems arise on the "payables" side of the ledger as often as through delayed receipts. Specifically, most inventory purchases require advanced payments (or at least partial payments on receipt). For young enterprises without a track record, inventory purchases may be strictly on a cash-and-carry basis. It follows that cash is needed in advance to underwrite sales; cash from sales may be months away. Meanwhile, loan payments, lease payments, utility costs, telephone bills, and payroll expenses occur with monotonous regularity. Sales do *not* occur regularly. In fact, most sales for most firms in almost every industry have substantial seasonal variations. Income generated from sales during a brief Christmas season may have to underwrite expenses for the next five slow months. Summer sales in recreational sportswear may have to pay bills for a nine-month "off season." And many manufacturers must purchase materials months before they actually create their products, which are in turn sold on credit months before they can expect payment from customers.

Financial problems also arise simply through sloppy bookkeeping. It is not surprising that most small business entrepreneurs see their roles "on the firing line" as marketers, engineers, technicians, or merchandisers and, in the process, forget to attend to "back-shop" books. Others who do attend to the books simply do not know what they are doing. It is rather easy to miss payments to vendors and destroy the company's credit rating (or worse, lose the source of inventory). It is just as easy to overdraw a bank account and nullify loan sources.

Poor Business Philosophy. An unfortunate aspect of many business failures is that too often individual owners' priorities get in the way of sound business practices. In the least obtrusive way, entrepreneurs may not be fully committed to the long hours required to make a venture successful. Working only 40 hours a week is out of the question, particularly for small business retailers. The new venture is a mistress requiring long hours and constant attention, and most retail establishments are expected to remain open 12 to 16 hours a day, seven days a week. The early stages of starting a business require intensity of effort, sacrifices, and the ability to endure at high energy levels without becoming overextended to the point of exhaustion. As the business stabilizes, the challenge is to hire good employees who can manage in the owner's absence.

A more sinister side of business failure is a blatant disregard for customers. The principal success factor of all business is to "create a satisfied customer," and as Peter Drucker explains, "to be of value to society by providing a needed, useful, and safe product or service."¹³ This is the essence of the *marketing concept*, and it means that business managers will succeed when they can generate satisfied customers by providing quality goods and services. Too many individuals, however, exploit customers to make a fast buck. Commitment to quality is replaced by a commitment to use the cheapest materials, to pass on marginally safe or defective products, and to serve customers only reluctantly. Cheating and deception exist in small businesses just as they do in large enterprises, but probably to no greater extent than in American society in general. The small business owner, however, will feel the brunt of public reaction much quicker. Customers typically have other options for car repairs, computer services, clothes, professional services, and most other products and services offered by local businesses. If they feel cheated, they will spend their money elsewhere. For that matter, there are usually enough choices that something as simple as a frowning sales clerk will alienate customers.

Lack of Planning. Research shows that less than half of small business owners had formal plans prior to going into business.¹⁴ Many engaged in formal planning soon after starting their businesses, but one-third could not recall ever having a formal business plan. Little research exists to determine the extent of planning in failing businesses. This lack is understandable because few of those who failed are around to be interviewed. However, research supports a strong case for well-developed plans with clear objectives prior to starting any venture. It is nearly impossible to acquire capital, obtain loans, or solidify vendor contracts without documented sales forecasts, financial statements, market analyses, and a clear statement of the business purpose.

Exhibit 3-2 Planning Considerations for Ventures during Start-up and Early Growth

Prior to start-up:

- Establish the purpose of the venture and define major objectives.
- Plan the market with attention to a well-defined market niche.
- Forecast sales and translate sales data into resource requirements.
- Document financial requirements and resources.
- Plan with attention to maintain positive cash flow.
- Consciously approach planning as a feasibility study.

During initial business operations:

- Create a clear marketing strategy.
 - Position products or services in appropriate growth markets.
 - Establish an inventory management plan.
 - Plan growth consistent with resources and limitations; rapid growth can create problems in cash flow and financing.
 - Adapt plans made prior to start-up; initial assumptions are often found to be flawed.
 - Do not allow events to just happen—plan conscientiously to control events and to prevent mistakes.
-

Plans are guidelines for action, and as businesses evolve, they must be continuously upgraded to reflect changes in the business environment. Too often planning stops after loans and investment capital are acquired. Growth is allowed to occur rather than be managed. New products may be added to a line without clear evaluation of how they fit into the existing business or serve customer needs. Several important planning considerations are noted in Exhibit 3-2.

Many fatal problems emerge from lack of appropriate planning. These include poor business locations, overextended capital requirements, unrealistic sales projections, and nightmarish legal entanglements brought about through poorly conceived partnerships and business naivete. Rather than dwell on the point, understand that a primary objective of this text is to emphasize *conscientious* planning to avoid the mistakes that often lead to failure.

► CHECKPOINT

Describe external factors that can threaten small businesses.

Identify and discuss the internal factors that threaten small business, and discuss why "immediacy" can affect good business decisions.

△△ RESOLUTIONS FOR SUCCESS

△△
△△

The question of how to dramatically improve the chances for success in small business has a prescriptive answer: *plan well*. This may sound like a hollow platitude, but planning includes careful analysis of the external environment and honest appraisal of the enterprise and its owner's capabilities. As noted earlier, being unprepared for externalities, oblivious to internal business problems, and unaware of personal shortcomings represent a majority of the reasons for failure.

Planning is therefore important, but it is not a panacea for all business ills, and just as important, small business entrepreneurs must protect against overplanning; it is possible to become paralyzed by "preparation," thereby leaving little time for "doing." Because so few businesses plan well, business advisers emphasize planning responsibilities, and perhaps the correct answer rests with a cautionary note to plan well, but to do so with a sense of what is needed in a particular line of business.¹⁵

Reversing the Factors of Failure

There are several positive steps in addition to planning that business owners can take to improve a firm's chance for success. From the discussion about factors of failure, we can conclude that a proper *attitude* is important to ensure a customer orientation for quality and service; the owner must have a purpose for being in business and

want to provide customers with value for their money. We also can conclude that having a variety of basic business skills is important, such as the ability to keep accounting records. During the critical early years of a new business, it is vital to manage cash flow, avoid undercapitalization, and avoid unnecessary acquisitions of fixed assets. If the business relies on performance of good employees, leadership skills will be paramount. As a team leader, a business owner must be capable of influencing others to do quality work, and as an owner-operator, one must be able to set standards for ethical business behavior.

By understanding why businesses fail, as described earlier, entrepreneurs can discover ways to tilt the scales toward success. Better merchandising, for example, requires effective inventory control and purchasing. An aspiring entrepreneur's lack of experience can be overcome by working in a related business before starting a venture. Many business owners update their skills and knowledge through seminars and training programs. Others return to school to take formal courses in such topics as accounting or marketing.

When an owner recognizes a personal shortcoming, it may be necessary to build a business team or join in partnership with someone with complementary skills.¹⁶ Consequently, if a technically competent individual wants to open a computer service center but has no aptitude for marketing, a wise decision would be to bring into the business a capable marketer. In turn, if neither of these people has an aptitude for finance, a third team member might be essential, one who can handle "back-shop" numbers. Better control and improved management can be achieved in nearly every instance by "taking the blinders off." This means simply to realize personal limitations and seek help without being too arrogant.

Understanding the Purpose of Being in Business

Business owners should have a clear understanding of the business and the environment in which their firms compete. This *clarity of purpose* is another benefit of planning, and its importance cannot be overstated. If a person intends to produce a health newsletter, the nature of the business and the competitive environment is in publishing, not health counseling. The owner of a computer franchise outlet has to understand that he or she is solving information-related problems for clients, not peddling inanimate hardware.

While the purpose of being in business is never just to make money, the result of knowing why you are in business and then developing a *distinct competency* around that purpose will dramatically improve the likelihood of profits. For example, a computer franchisee committed to solving information-related problems for business clients has *clarity of purpose* beyond the notion of selling computer hardware, but the owner may find even greater rewards by creating a competency distinct from competitors. Such a distinction may be a focus on office networking systems. In a given community, one computer store may emphasize educational systems while another makes a market in business accounting systems. Several options for computer retailing services are shown in Figure 3-4. This reflects classic *niche marketing*, but businesses can differentiate in many ways. For instance, carving out a clear geographic

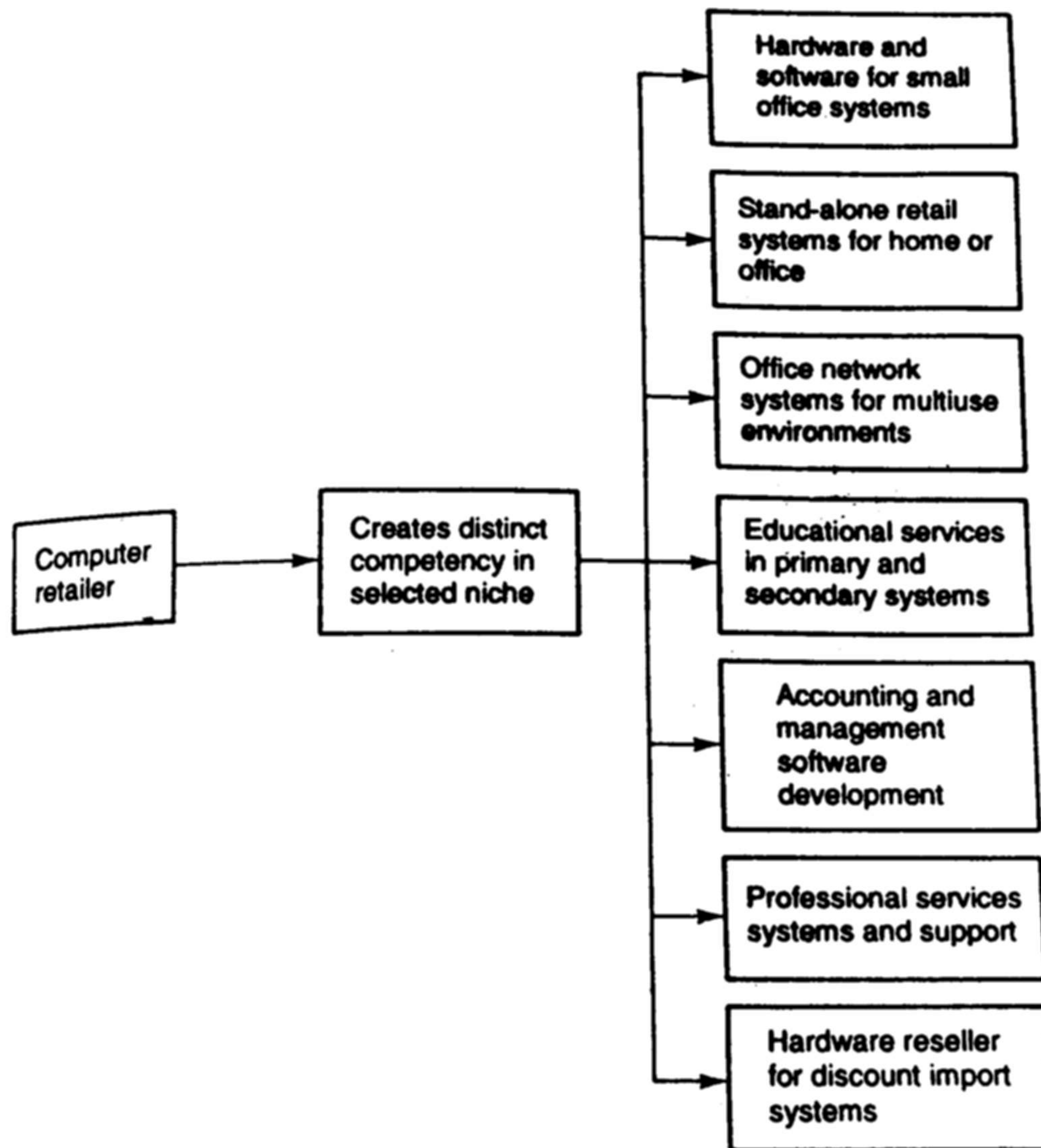


Figure 3-4 Niche Markets for Computer-Related Retailers

area for a service such as selling "upmarket" home furnishings in a suburban community will demand an inventory and image different from those of a home furnishings store in a retirement community. Atmospheres can be developed for bookstores emphasizing discount prices or perhaps rare books. The former will have large inventories requiring a rapid turnover in book sales, and the latter may have few books but provide snug reading corners where customers can sip gourmet coffee.

Most business owners intuitively try to distinguish their enterprises, and those who succeed are usually far more successful than those who try to sell everything to everyone. Of course there are huge discount stores and outlet malls that literally do try to sell everything to everyone, but they too have a distinction that attracts customers; they hold out a general perception of numerous bargains with deep no-frill discounts.

Clearly, these few insights cannot hope to encompass all the relevant issues, and as we turn our attention to corporate entrepreneurship, it may be valuable to

emphasize that most suggestions for small business owners are equally applicable to corporate enterprises. The small business owner is differentiated by having limited growth objectives, and many are family enterprises, but good business practices apply to all new enterprises.

► CHECKPOINT

Explain the planning role, and tell why it must be a pragmatic process.

Describe why it is important to understand business failures, and discuss several ways to improve the probabilities for success.



CORPORATE ENTREPRENEURSHIP—INTRAPRENEURSHIP

The world is still groping for a single label that captures the nature of "corporate entrepreneurship," and a number of popular terms are being used in books and advertisements. Several already have been introduced. "Intra-corporate venturing" has an academic flare; "intrapreneurship" has achieved a certain degree of popularity; and a term that has recently emerged in the hallways of Washington bureaucracies is ICE, an acronym for intra-corporate entrepreneurs. Whatever the term, the implication is that entrepreneurial activities are explicitly supported within established organizations, provided with organizational resources, and accomplished by company employees.¹⁷

Just as there is no consensus on a label for corporate entrepreneurship, there is no clear definition for a corporate entrepreneur. There is a sense of understanding, however, that innovative employees disrupt the company in constructive ways to instigate new products or services. These individuals often work independently, or with some degree of autonomy, and although they are given the latitude to explore new ideas, there is no presumption of business ownership apart from the mother organization. As we shall see, recent initiatives by a few corporations do provide opportunities for ownership, but this is an exception to prevailing practices. More often than not, entrepreneurial employees find themselves at odds with their companies and leave to pursue their ideas.

Focal Distinctions

Corporate managers who create something new within the context of their jobs seldom have the commensurate responsibility of taking a personal stake in their creations. There is no assumption of personal risk, no assumption of profit, and no assumption of loss. In fact, entrepreneurship is *not taking place* at this point. Hans Schollhammer, an ardent researcher in this area, suggests that employees stop being "employees" and start being "entrepreneurs" when they are charged with the responsibility of

PROFILE Δ

John D. MacEachron

After 21 years with Xerox Corporation, John D. MacEachron took the entrepreneurial plunge, forming LeaseAd, a company that develops master data files of real-estate lease and rental properties. MacEachron developed his real-estate software system for Xerox as part of his job to solve corporate property management problems. However, he also recognized the value of the software as a commercial product and proposed that Xerox package and market it. His superiors reprimanded him and said it was a pointless idea that did not fit with corporate development plans. As a career "company man" with a record of accomplishments and promotions, he was a successful manager headed for an executive position, but MacEachron was so frustrated by his treatment that he left Xerox and started LeaseAd. Today, his company sells custom software data systems and grosses \$10 million in annual sales.

Source: Paul B. Brown, "The Last Company Man," *Inc.*, July 1987, pp. 19-21.

championing their innovations. More precisely, these individuals are expected to create an entrepreneurial team that could evolve into a new operating division or a formal subsidiary.¹⁸ The corporate entrepreneurs often still have no direct investment and bear no financial risk. Consequently, they seldom reap rewards beyond bonuses and promotions, but they do behave as if they are giving birth to new enterprises.

A Matter of Perception

Gifford Pinchot, who wrote the somewhat controversial and best-selling book *Intrapreneuring*, gave us the term "intrapreneurs" and also gave these intrapreneurs a mantle of heroism. In Pinchot's view, intrapreneurs are much like corporate commandos, and he says, "These courageous souls form underground teams and networks that routinely bootleg company resources or 'steal' company time to work on their own missions."¹⁹ In Pinchot's view, they make things happen, creating new commercial successes in spite of stodgy corporate policies and a glacial pace of bureaucratic decision making.

Two important points to emphasize are, first, that entrepreneurs are viewed as disruptive mavericks prone to shatter the status quo and replace "what is" by "what might be," and second, that very few entrepreneurs are motivated by money as much as by the pursuit of a vision to provide something of value. Wealth may come to those who succeed, but the pursuit of wealth is not itself a primary goal; money is simply one way to measure progress. With this in mind, Pinchot describes the corporate entrepreneur as someone who violates policy, ignores the chain of command, defies

established procedures, and, perhaps, comes up with a great new product for the company. Successes may garner bonuses for their champions, but failures can end in shattered careers. This perspective assumes that "courageous souls" are at odds with their organizations, so much so that there is no tolerance for failure and only reluctant rewards for success. In many organizations, this view is probably accurate. The challenge of corporate management is to create a supportive environment that attracts, motivates, and retains intrapreneurs—to instill a culture of innovation where renegades are empowered to pursue dreams and to fail without retribution.²⁰

If organizations provide these support systems, and also provide the entrepreneur with a safe salary, there should be no reason to start independent ventures; innovative employees would have the best of both worlds—income security and opportunity without risk. Few companies, however, provide all these support systems; they are more likely to discourage independent initiative. Consequently, many new ventures are started by restless employees who have been frustrated by corporate straitjackets. It is not unusual to trace the careers of successful entrepreneurs and find that they left good corporate positions.²¹ Sometimes they were fired by inept managers who strangled their creative spirit.

One more important insight can be gained from the corporate scenario that distinguishes *small businesses* from *growth-oriented ventures*. A majority of small businesses are *not* born of controversy and innovation; they are largely focused on providing established products or services in local markets. The primary incentive for opening a small business is the independence gained from personal control over one's life. In contrast, a growth-oriented venture is determined to expand through the commercialization of a new idea. In this sense, the growth-oriented entrepreneur and the intrapreneur are similar, and they are set apart from small business owners by their philosophies of doing business.

Classifications of Corporate Entrepreneurship

Hans Schollhammer provides five classifications of what he calls *intra-corporate entrepreneurship*, each one having an unusual strategy for corporate sponsorship and a distinct role for the innovator. Each classification implies a supportive environment and a cooperative endeavor within an organization that benefits not only the corporation but also the innovative manager.²²

Administrative Entrepreneurship. Traditional research and development (R&D) is closely approximated in the administrative model. Here, the firm simply moves a step beyond formal R&D projects to encourage greater innovation and commercial development of new inventions. The distinction that makes R&D entrepreneurial is a philosophy of corporate enthusiasm for supporting researchers while systematically providing extensive resources for making new ideas commercial realities. Personnel in R&D will be only partial contributors, implementation relies on contributions from many other departments (marketing, production, and finance, among others), as well as from an entrepreneurial team led by a champion who will

set the cadence for team members who are enthusiastic about the innovation. The Sony Walkman resulted from an R&D breakthrough at Sony Corporation, but it was an integrated marketing team that designed the Walkman system, introduced it, and set the industry standard.²³

Opportunistic Entrepreneurship. Formal structural ties are loosened in this model as champions are given the freedom to pursue opportunities both for the organization and through external markets. For example, commercial banks have begun to give managers profit-and-loss responsibilities for investing funds in unusual high-risk, high-yield opportunities. The investment bankers do not report through existing management hierarchies but enjoy a semiautonomous work environment, report to a highly placed executive, and manage their own budgets. Quad/Graphics, Inc., the company that prints *U.S. News & World Report, Inc.*, and *Newsweek*, among others, has taken opportunistic entrepreneurship a step further.²⁴ When printing technology began to change rapidly with computers, Quad/Graphics challenged its engineers to design state-of-the-art equipment. They did so, but they also convinced management that the technology itself was marketable. Quad/Graphics then created a separate subsidiary, Quad/Tech, and gave its engineers executive control and the autonomy to sell technology openly to anyone. The parent company is still the customer of choice, but Quad/Tech management is not expected to shut out the world. They are compensated according to profit performance, and although isolated from the parent, they have significant support for innovation.

Acquisitive Entrepreneurship. Moving even further from traditional R&D models, the acquisition concept is one of corporate managers in search of external opportunities such as other firms and entrepreneurial start-ups that can enhance the corporate profile through mergers, acquisitions, joint ventures, and licensing agreements. In recent years, this trend has led to almost frantic merger and acquisition activities in virtually every sector of the economy. Rather than develop ideas internally, corporations actively court other firms that have proprietary knowledge or promising products. Major companies such as General Motors, IBM, and General Electric have created joint ventures or new subsidiaries, or have added innovative product lines to their portfolios through acquisitions. Similarly, CitiCorp, Transamerica Corporation, and Sears have extended their services through acquisitive strategies. Kodak and Campbell Soup have infused their companies with innovative marketing through acquisitions.²⁵ Options for acquisitive strategies are shown in Figure 3-5.

Imitative Entrepreneurship. Sometimes bordering on corporate espionage, imitative entrepreneurship takes advantage of other firms' ideas and simply brings to bear the weight of corporate muscle to control markets. The Japanese have suffered this label for years, perhaps rightly so, as in many instances the Japanese have studied American products, found ways to improve on those products, produced them at lower costs, and exported them to American markets. It can be argued that this is the essence of free enterprise, but others suggest it is espionage. The controversy



Figure 3-5 Acquisitive Strategies for Portfolio Development

notwithstanding, the fact remains that if a company (regardless of nationality) provides consumers with valuable products or services, consumers are not really interested in how it all came about. Imitators abound in all cultures; imitation is a way of "shaking out" less efficient producers as more capable firms take the initiative. Society is often the benefactor because many inventors simply cannot get their products off the drawing board, but imitators can often make them commercially viable.

Incubative Entrepreneurship. When new ideas materialize, whether developed in-house, acquired, or imitated, they must be developed to the stage of feasible commercialization. This "incubative" process is necessary for any corporate endeavor, and the pattern for this activity has been to create project teams charged with high-impact implementation programs. These teams are expected to put an innovation through its paces, to enthusiastically subject the idea to torture, to test market prototypes, and then to either kill the project if warranted or push for implementation. Few projects are successful, and project teams are seldom responsible for failure, nor are they rewarded for success.

As a result, the incubative process has rapidly evolved toward a pattern more reflective of risk-oriented entrepreneurship. In this instance, a team is established as a semiautonomous *new venture development unit* that often has seed capital, access to corporate resources, freedom of independent action, and responsibility for implementation from inception to commercialization. This represents a major change in the way corporations approach innovation, and it is important enough to merit more attention.

► CHECKPOINT

Discuss the often conflicting viewpoints on corporate entrepreneurship.
Identify and discuss the major approaches taken by established companies to encourage corporate entrepreneurship.

CORPORATE NEW VENTURE UNITS

The term **new venture unit** is one of convenience used to capture the notion that teams are formally developed within corporate walls to instigate new ideas, to nourish them through the necessary stages for commercialization, and often to continue as the management cadre in charge of the venture.²⁶ In many instances, this last criterion becomes the payoff for team members who achieve executive status in autonomous operating divisions. In a few corporations, employees have the opportunity to "buy into" their new ventures through stock plans. These opportunities will become apparent as we describe ways in which new venture units evolve. In general, companies either encourage *spontaneous* team effort or create *formal* venture teams.²⁷

The Spontaneous Team. If an organization has no policy for empowering developing venture teams, a "bootlegging" atmosphere may evolve. This leads to informal relationships among a few close associates working on new ideas. Pinchot identified four stages of spontaneous team development. These are illustrated in Figure 3-6 and described as follows:²⁸

Stage 1: The first stage is the "solo phase" in which a single innovator cautiously nurtures an idea to the point where he or she has sufficient confidence in the project to confide in one or two close associates. During the solo phase, innovators are likely to be reclusive, slipping into laboratories after hours, working at home on weekends, and very quietly fleshing out their ideas.

Stage 2: The second stage evolves as innovators reach out for advice and support from friends, experts, or sponsors who can find resources to back ideas. This is called the "network phase," and it is a process of gaining allies and sponsors.

Stage 3: The third stage is the "bootleg phase" when an informal team begins to take shape. The innovator is no longer isolated in the endeavor, and team members actually do work of a substantial nature such as helping to develop a prototype, gathering market information, lining up production resources,

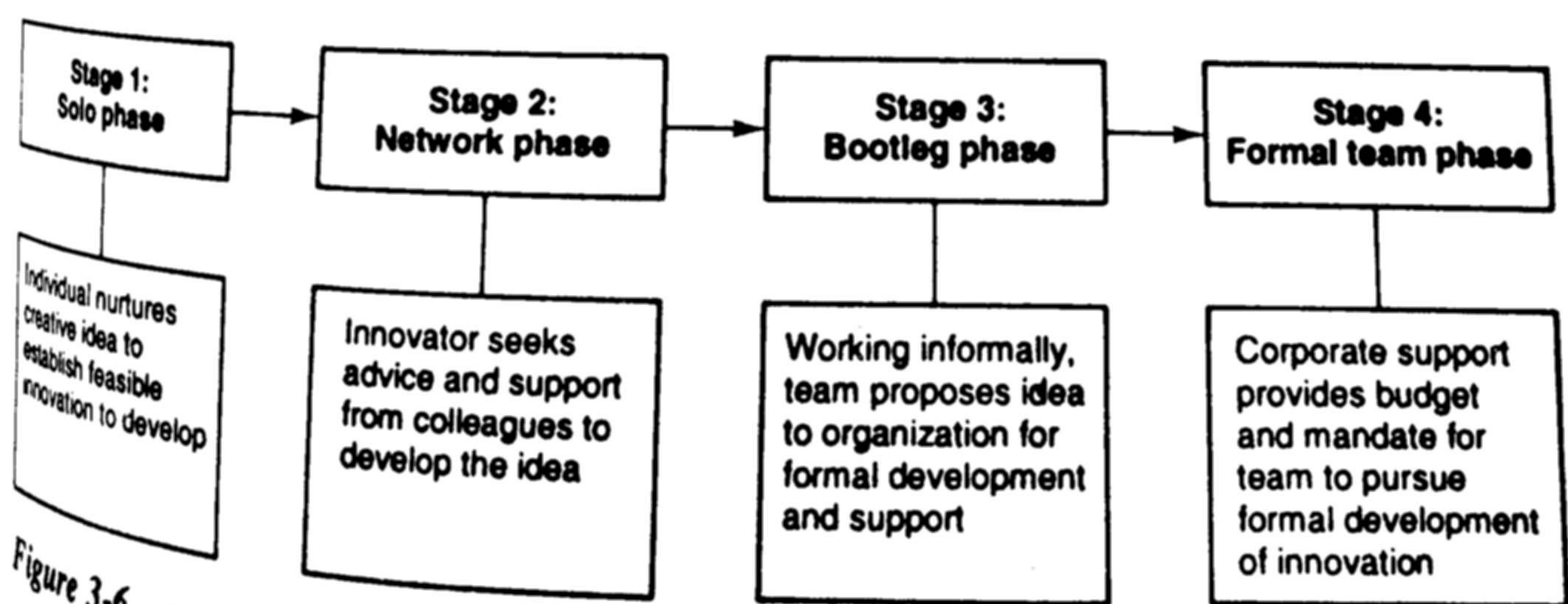


Figure 3-6 Four Stages of Intrapreneurial Team Development

and gathering essential information needed to *write a proposal*. The proposal is the "business plan" in corporate terminology, and it is almost exactly the same documentation that an independent entrepreneur uses to attract investors. In this instance, the proposal is taken to corporate management to secure support and formal recognition of the project.

Stage 4: When corporate support is given, the final stage is launched. This is the "formal team phase" where team members are given authority to manage the project, budgets are allocated, and resources are lined up for a well-defined commercial development process.

Formal Venture Units. Farsighted organizations have had formal mechanisms in place for years. These allow adventuresome individuals to create legitimate teams at the beginning of an innovation process. The team-building process does not evolve among corporate shadows or with bootlegged resources. In this environment, innovators will still endure a "solo phase" of incubation until they can put enough substance into their ideas to make a feasibility proposal to management, but this proposal will not resemble a formal business plan. It may be little more than draft sketches and notes, just enough to indicate to management that there is a feasible idea that should be given a reasonable level of support. Obviously, a polished proposal with supported data will enhance the likelihood of a green light and budget support.

Once formal recognition has been achieved, an entrepreneurial team is established to take the idea to a predetermined stage of development. This process may result in prototypes, initial market research, testing, and a cost-and-profit analysis. Organizations usually have review committees that track these efforts or, alternatively, a sponsoring manager to whom the venture team reports. The team will have a first-stage budget called seed capital, and the corporate commitment is to allow the team to operate autonomously (within a budget). If the idea fails, the seed money is written off as a necessary investment to encourage creativity. If the idea has merit, recommendations are put forward for various degrees of support. The decision to fund a second stage rests crucially on a rather extensive business plan. This second round of support typically has a development budget that allows the team to take a product to limited production and to introduce the product to a select market.

Results are gathered, the team refines its proposal once again, and a corporate-level decision is made either to kill the project or to support its implementation. Every firm will have a method of launching projects, but the following three approaches stand out:

Innovation transfer is accomplished by integrating the new product into existing operations. Integration is spearheaded by the new venture team, which has formal management authority for operational control. This control can extend to research and development, production, marketing, logistics, and most other operational functions. Merck & Company, ranked as America's "Most Admired Firm" by *Fortune*, has recently instigated a program of innovation transfer as a strategic alternative to traditional R&D to encourage corporate entrepreneurship.²⁹ Merck's efforts are a reflection of top management com-

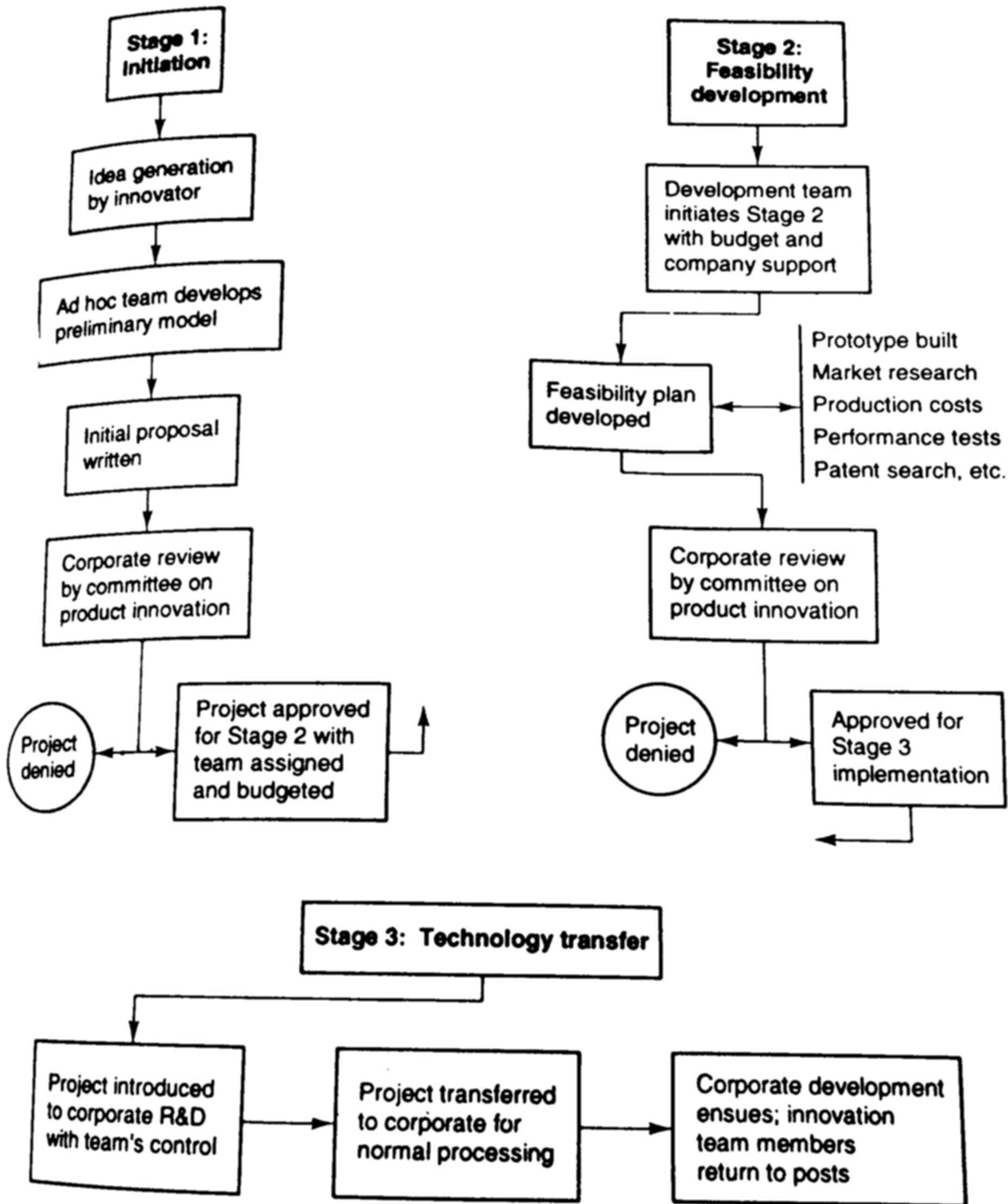


Figure 3-7 Merck's Technology Transfer Process

mitment, and this was demonstrated in 1987 when the firm granted a young research biochemist a leave of absence to formulate a strategic plan for developing new venture teams. The biochemist, Robert Pengelly, was awarded a corporate grant to pursue his research, and in 1988 he introduced Merck's "innovation transfer" program, which is widely used today. The Merck model is presented in Figure 3-7.

New division status is the second approach achieved through a corporate mandate to solidify a project into a formal operating division. Unlike the innovation transfer approach, this option typically results in a new organization within the parent company, a horizontal extension that allows diversification without disrupting other operations. Companies that are organized through horizontal "stacking" of divisions can implement this decision easily. The new venture team will most likely become the new division's management core, and although ownership resides with the corporation, team members' careers will shift to the new unit. An excellent example is AT&T's American Transtech, a division formed in 1983 to manage the stock transfers resulting from the parent company's forced divestiture of operating divisions. American Transtech grew into a separate operating division that now handles stock transfers, paralegal work, and service development systems for AT&T, Bell South, and NYNEX. The subsidiary has autonomous operations, budgets, research, and compensation systems.³⁰

Spin-offs may also be formed. These are new business entities created through the venture team, and they can take the form of corporate subsidiaries or autonomous corporations. Team members often enjoy stock options and significant ownership positions in the spin-off. The mother company typically retains a strong equity position, and although there is no set pattern of equity underwriting, companies such as Tektronix and General Electric have encouraged their venture teams to move toward a complete ownership position.³¹ This is called a spin-off for obvious reasons, and it goes beyond the boundaries of being a corporate subsidiary. Team members actually share in success and risk the burden of failure as principal investors. It is the classic free-enterprise scenario of opportunity, rewarding those who bring an idea to fruition.

In new venture units, and specifically in spin-off situations, the parent company appears to relinquish control and give away potential profits, but evidence suggests that the corporation prospers. It does so for several reasons. First, team members are beneficiaries of the parent company's generosity, and that goes a long way in solidifying commercial relationships in which the parent company becomes a prime customer (or supplier), a sponsor, and a strong ally. Second, enlightened managers recognize that fast growth can best be achieved through a lean-and-mean young company. Moreover, if a corporation does not provide a way for team members to take part in developing their ideas, they may leave to set up their own firm or move to a competitor thereby alienating the corporation from its infant offspring.³²

There also is a certain recognition that corporate mavericks who instigate venture units are highly motivated by their own achievement orientation; they tend to be anxious about seeing their ideas through from incubation to full commercial development. If a subsidiary is developed with majority interest held by the parent company, the team, in effect, is little more than a subordinated division or "preferred vendor." If the product or service is not proprietary to the parent company, new external markets are likely to emerge; the team, as principal investors, will more tenaciously pursue those markets. The new venture has few limitations, and whatever investment the parent company holds will be enriched by rapid acceleration into new markets.

PROFILE Δ **IBM Looks toward Innovation**

International Business Machines was founded on innovative thinking and the entrepreneurial spirit of Thomas Watson Sr., who built IBM from a struggling small company making mechanical office equipment to the world's largest and most successful computer products corporation. During a "lull" in its innovative history during the 1970s, IBM became more bureaucratic and less adaptive as an organization, allowing the microcomputer industry to develop without IBM's participation. Then, in 1981, IBM's Entry Systems Division, spearheaded by a few employees, created the company's first personal computer, and IBM regained its sense of innovative purpose. Looking to the future, IBM executives are implementing incentive programs, bonus systems, and grants to foster new technologies for the 21st century.

Source: "Akers Looks Ahead to IBM's Future Strategies, Principles," *Computer Reseller News*, April 3, 1989, pp. 44-46.

The Changing Environment for Corporate Entrepreneurship

This chapter has provided a brief glimpse of corporate entrepreneurship, but it should be apparent that there are ample opportunities in most organizations for innovation. A few stale bureaucracies linger in the shadows, but they will disappear unless they instill in managers a spirit of entrepreneurial endeavor. The ultimate challenge for corporations is to attract, nurture, and retain disruptive mavericks who can rejuvenate growth through successful innovations.

Society has extravagant rewards for those who can spearhead new ventures, and although corporate managers often leave their corporate positions to pursue those rewards, many farsighted corporations are helping employees realize their potential through new venture teams. Part of the equation for success is to match rewards with dreams that bear fruit. The entrepreneurial impulse, until recently, has been unleashed only through individual initiative, but amazing success stories have begun to appear as major corporations embrace the entrepreneurial spirit. Far beyond the boundaries of California's Silicon Valley or Boston's Route 128, firms such as AT&T, 3M, Merck & Company, General Electric, and IBM have instigated unusual corporate innovations through new venture teams.

The best known of these efforts may be IBM's Entry Systems Division, and it was an autonomous research group located in Boca Raton, Florida, far from IBM corporate halls, that created the IBM Personal Computer. To encourage development of the PC, IBM acted only as an investor with arms-length mentoring.³³ However, IBM recognized the value of motivating people through company development programs. During the past few years, IBM created research grants, bonuses, and rec-

ognition awards through its IBM Fellow Program, and the company has made more than a hundred awards to employees amounting to several million dollars.³⁴

The fundamental structure of corporations in the United States may be changing in response to this entrepreneurial surge. Large companies are becoming smaller and more streamlined, and big "rational" bureaucratic organizations are quickly being replaced by decentralized organizations with smaller operating units. The growth of so-called high-tech firms, particularly those in microelectronics, led us into the 1990s with more than half of the emerging *Fortune* 500 firms drawn from "instant successes"—the small entrepreneurial firm turned large through rapid growth and innovation. The new "large" companies, however, are small compared to those of the 1960s. Most have fewer than 5,000 employees, yet they generate sales that match companies four times their size. This trend, called the atomization of America, is partially the result of improved technology and partially the result of a shift in leadership emphasis, away from structured controls toward self-direction for operating units.³⁵

There is little doubt that smaller operating units that can respond quickly to market changes and new technologies are reshaping corporations. Rational bureaucracies—corporations with layered functional divisions and narrow specializations—are quickly being replaced by smaller corporations, or by larger ones that have "downsized," streamlining their organizations.³⁶

► CHECKPOINT

Describe the benefits associated with spontaneous and formal new venture units.

Identify and discuss the various approaches taken by established companies to sponsor formal new venture units.

A CONCLUDING PERSPECTIVE

As a conclusion, it is important to reflect briefly on entrepreneurship as it relates to small business and corporate endeavor. The small business sector is growing, not only in the number of new enterprises, but also in the markets they serve. Once thought to be the realm of "shopkeepers" and "mom-and-pop" stores, small business has evolved to include high-profit companies with extensive sales domestically and overseas. Most people who start small businesses will continue to do so because they seek an alternative life-style away from the corporate environment, and they will continue to focus primarily on community endeavors. Nevertheless, they continue to represent nearly half of the U.S. GNP while providing employment for more than half the total nonfarm work force.

From a corporate viewpoint, innovative models of entrepreneurship have only recently begun to surface. Current students of management and entrepreneurship will most likely be the leaders who implement these changes in a pervasive way as the 21st century unfolds. Perhaps the corporate environment will change in such a way that substantial opportunities will emerge for innovative managers. These may be particularly enticing for those who understand challenges such as the creation of new venture units as potential career opportunities.

SYNOPSIS FOR LEARNING

1. *Describe the environment of small business and how it is changing.*

Small businesses comprise a large majority of enterprises in the United States, and although they are individually small, they account for a significant portion of GNP and slightly more than half of all nonfarm employees. Small businesses typically provide goods and services to local markets; however, there has been a growing number of small businesses involved in global trade. The environment of small business is described by local or regional conditions. Thus national trends such as unemployment may not have a direct effect on local companies. Small businesses are vulnerable to some national phenomena, such as financial changes, because they often have heavy debt requirements; swings in interest rates rapidly consume a firm's cash flow. Although "macro" factors are important, small business owners are more concerned with "micro" problems. These include short-term cost and price changes, immediate competition, and managing the small business team. Often small business owners are caught up in this sense of "immediacy" and fail to account for threats that arise from externalities.

2. *Identify the most common causes for small business failure.*

A broad and inaccurate statement often heard is that small businesses fail because of "poor management." That begs the question, because businesses are often fragile and particularly susceptible to external influences. These include changes in debt availability, interest rates, local demand for goods and services, regional employment trends, production prices required by larger companies, and government regulations. Slight changes in tax laws, for example, can quickly turn a profitable small business into an unprofitable enterprise. More important, small business owners must wear many hats, and although they are usually technically competent, they may not be adept at marketing, managing employees, controlling cash flow and finances, or strategic planning. One reason for these shortcomings is lack of experience. Another is that many small business owners are arrogant; they simply refuse to acknowledge that they cannot do everything well; consequently, they allow their business to falter. One important "mismanagement" symptom is lack of a clear business philosophy. Many small businesspersons work with blinders on, seeing only the short-term potential for profits without understanding that they must create a lasting organization capable of satisfying customers with quality goods and services.

3. Explain the important success factors for small business enterprises.

One of the most important ways to improve the odds for business success is to improve planning. Because so few businesses are planned well before opening, counselors and mentors have been adamant that owners should develop systematic and thorough business plans. Recently, however, advice has been more guarded. Business owners are encouraged to plan pragmatically, giving due diligence to business issues supported by adequate market research and well-developed objectives, yet avoiding paralysis caused by overzealous planning. In addition, probabilities for success can be improved by reversing the factors of failure. Therefore, understanding why and how small businesses fail is crucial to safeguarding against failure. Inexperience and personal shortcomings can be offset by creating a team with skills that complement those of the entrepreneur.

4. Describe corporate entrepreneurship.

Corporate entrepreneurship, also called intrapreneurship or intra-corporate entrepreneurship, is the process of encouraging innovation within existing companies through motivated employees who are supported with company resources. An exact definition is lacking, but various perceptions exist. At one end of a spectrum of opinion are those who view corporate entrepreneurship as a contradiction in terms; that is, entrepreneurship does not exist because salaried employees who innovate take little or no personal risk in the process, and they seldom reap rewards for their achievements. At the other end of the spectrum, corporate entrepreneurs are cast in heroic terms as corporate commandos who alter the course of their companies through tenacious innovation. They are called courageous souls who risk their careers for little compensation, championing new ideas as mavericks bent on smashing the status quo. However, they behave this way while they are protected in their jobs and have access to corporate resources.

5. Discuss the major approaches to corporate entrepreneurship.

Four approaches to corporate entrepreneurship have been described. First, administrative entrepreneurship describes the traditional R&D process, but with the distinction that researchers who create new ideas become key players in commercializing them. Second, opportunistic entrepreneurship suggests that large companies are positioned to commercialize ideas generated elsewhere. Thus smaller companies and individual inventors may have brilliant innovations but lack the resources or marketing power to develop them. Larger firms with these advantages can prosper by adopting their innovations. Third, imitative entrepreneurship implies industrial espionage (or liberal borrowing of another's ideas). Large companies with relatively more resources and lower costs can take an existing innovator, make it cheaper, finance it at a lower price, and market it more efficiently than smaller firms. Fourth, incubative entrepreneurship suggests an intensive in-house effort to establish new methods of innovation. Venture units, project teams, and systems of "spinning off" companies based on innovations developed by company employees are among the ways corporations are trying to encourage entrepreneurship.

6. Describe emerging ways corporations are encouraging entrepreneurship.

Corporate venture teams, also known as new venture units, have become a popular way to encourage employees to develop new commercial ideas. Some of these teams evolve spontaneously as champions "bootleg" product development on company time and resources, creating feasible new ventures that the parent company can reconfigure into divisions or subsidiaries. Formal venture teams are those sponsored by companies to pursue research and development, and they can take several forms. Some large companies, such as Merck, sponsor programs of innovation transfer in which incubative behavior is supported. Teams are given resources and corporate approval to pursue ideas, systematically evolving toward new internal business ventures. Other companies, such as General Electric, set up new venture units with division status, complete with budgets, resources, and entrepreneurial teams. Team members are often given the opportunity to invest in ventures or to share profits, thereby giving them incentives to succeed. Spin-off ventures can also be created whereby parent companies become major investors in separate companies specifically created to pursue innovations.

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CASE 3-1

Her Own Boss

Katherine Magrini is one of many women who own their own businesses, and her experience is not very different from others who must contend with being a mother, spouse, and family cheerleader in addition to owning and operating a business. Magrini is more successful than most women (or men). She turned her first million at age 28, and ten years later she is on a \$10 million annual roll.

Katherine Magrini is owner and president of Gardner Spring & Wire Company, a Chicago corporation that markets industrial springs and spring assembly hardware. She bought the company in 1978, hocking everything she had and borrowing more than a million dollars, and although this was her first business, she had worked for Gardner (and had become its president) several years earlier while she was still in her early 20s.

Magrini grew up in Drumright, Oklahoma, with five brothers. With her brothers, she started working for the Oklahoma Spring Company in sales. Her brothers eventually bought that company, expanded, and bought Gardner Spring & Wire Company. Katherine Magrini was sent to Chicago to help out there, and she took the fledgling division with only \$50,000 in sales to more than \$400,000 in sales by opening accounts with the federal government and chains such as Ace Hardware. She recalls that she was the first woman ever to call on Ace Hardware, and during the 1970s when this growth occurred, most of her clients could not understand that a woman could sell industrial hardware.

The combination of her brothers' manufacturing business in Oklahoma and her fast-paced marketing in Chicago was so successful that the family sold the business for an undisclosed but "nice" sum. With the sale, Kath-

erine felt she had lost part of herself, and subsequently bought back the Gardner company. During her rise to success and while recreating her independent business, she managed a family, stayed involved with school and community affairs, and after a divorce remarried to pursue a happy life-style. She does not speak much about her family except to say that the television show *Dallas* held no surprises for her.

In Katherine Magrini's mind, there is nothing more exhilarating than owning your own business, and for her, the fun is in the challenge of making the firm grow from a small business struggling for a foothold. Today, more and more women are making this choice rather than pursuing traditional careers. The SBA notes that for the past ten years, the number of women starting new ventures is three times as large as the number of men. There are several good reasons for this trend. Some women find that owning a business is the only way to combine a decent wage with time for their children by having the flexibility to control their schedules. Others see themselves as unlikely corporate managers, and recognizing the gender problem that exists for achieving success, they choose the entrepreneurial route. Still others see entrepreneurship as a way of controlling their lives, pursuing interests that would be impossible in corporate jobs.

There are prices to pay that many men do not have to consider. The dual roles of mother and business owner often conflict, and husbands and wives tend to develop separate career tracks that often cannot be reconciled. In Magrini's case, the price was divorce, and although failed marriages are not uncommon in America, business pressures played a significant role in dividing her loyalties. Women can

also find it lonely in a business world, especially if business clients are predominately men; this too was a problem for Magrini. Many women, however, have businesses that fit well with their interests and with women customers. These include services in beauty care, women's clothing, nutrition, education, and entertainment. Nevertheless, being in business often exacts a double price for women, yet for those with determination like Katherine Magrini, the rewards can increase at an exponential rate.

CASE QUESTIONS

Describe the nature of small business ownership, and tell how Katherine Magrini fits

- the profile of an independent entrepreneur.
- Discuss problems facing small business owners and entrepreneurs in family businesses. Contrast these with the case and discuss possible issues that women entrepreneurs like Katherine Magrini face.
- Identify and describe opportunities that women might find rewarding as business ventures. Also discuss the advantages and disadvantages of unusual enterprises such as the industrial spring hardware business in the case.

Source: Susan Ochshorn, "I Am My Own Boss," *Venture*, July 1986, pp. 46-47.

CASE 3-2

Corporate Adventures, New Units, and Tiger Teams

Corporations are turning to a form of "venture" creation in an effort to revive their organizations. The objective is to emulate the behavior of smaller, lean and mean, entrepreneurial ventures that are innovative and nimble. Many of these efforts are highly successful, but corporate executives find they cannot always change their behavior. Several examples are noteworthy.

Bausch & Lomb, the multinational medical instrumentation and optics company, has created "tiger teams." These are autonomous groups of scientists given resources and freedom of action to develop new products. Each team has a budget and can assemble its own members from any corporate discipline. When their ideas become marketable products, they share in profits and receive bonuses of cash and stock options, but B&L employees stay within

their corporate positions working mainly on projects a few hours each week in special meetings and through R&D departments. Over a period of several years, B&L has introduced several innovative products, altered distribution systems, and marketed improved models of Inter-Plak, the home oral hygiene product.

At Texas Instruments, innovations are encouraged by any employee or company group. If an idea has promise, TI backs the idea with resources and allows employees to form an ad hoc division to pursue it. Once developed to the stage of successful test marketing, the product is brought on line through one of TI's primary divisions. A notable success is the Speak & Spell family of products.

Colgate-Palmolive Corporation created a separate company for innovation development. It is called the Colgate Venture Company, and

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its mission is to help any corporate group identify and start new businesses related to Colgate's consumer products industry. The venture company underwrites individual projects and helps corporate teams create "spin-off" subsidiaries or separate businesses. This policy has resulted in several new business units, including a retail branch with the initial location in Long Island called Clean Street USA. Colgate venture units also launched the Maniac line of teen personal care products.

On the down side, many corporate efforts to emulate entrepreneurial ventures have failed, but few companies make these failures public. Exxon Corporation wasted more than \$10 billion several years ago developing its Exxon Office Systems division, which purportedly was to become the leader in office information systems ahead of IBM. Exxon failed, largely because corporate oil executives were expected to lead the venture, spearheading innovations in computer technology and information marketing.

More recently, Weyerhaeuser Company decided it could put its billion-dollar muscle behind a new disposable diaper to compete with Kimberly-Clark and Procter & Gamble. Weyerhaeuser had been marketing a low-priced product under generic labels for several years. The new diaper was developed by a new venture unit and resulted from careful consumer research. Called UltraSofts, Weyerhaeuser's diaper had unique features that included cushy waistbands and patented cuffs to stop leakage. UltraSofts were made with clothlike covers and used superabsorbent pulp material. Initial consumer reaction was very good, and UltraSofts were proclaimed by Weyerhaeuser as the world's best diaper.

The company's executives decided that UltraSofts were so good that rather than market through generic brands and settle for a small market share, the company would go after a national market, competing head-on with Kimberly-Clark and Procter & Gamble. In early

1990, UltraSofts were introduced through an unprecedented campaign. Samples and discounts were mailed to 50,000 shoppers in the launch area of Rochester, New York, and a blitz of television ads, video promotions, magazine features, and newspaper specials were used to announce UltraSofts. Pricing was also set 10 percent below the competition, and the company employed top market research and consumer affairs consultants to tailor presentations for hundreds of retailers. Sales exceeded expectations, and executives of the corporation envisioned sharing the \$3.8 billion diaper market equally with its two primary competitors.

Success lasted a few months, but UltraSofts disappeared from the market in less than ten months. Weyerhaeuser executives blame failure on poor planning and uncoordinated operations that drove costs up too high to compete. In addition to the huge corporate marketing budget that was never absorbed by sales, the company's new venture pilot plant experienced breakdowns, fires, labor problems, and snarled production. The plant was not geared up to meet production schedules created by corporate fiat, and although it had operated efficiently as a small production unit, just the weight of activity created a series of disasters. Prior to the big push, the diaper unit had marketed products designed for the private brands of supermarkets, and these were manufactured and distributed in small batches; the system was cost-effective and allowed favorable private brand prices for retailers. Under mass-production and mass-distribution mandates, neither costs nor prices would be maintained.

CASE QUESTIONS

1. Explain each of the examples in terms of different approaches to achieving corporate entrepreneurship.
2. Describe the advantages and disadvantages of the different approaches taken by each

company to encourage innovation or to introduce new products.

3. Examine the problems, real or perceived, of Weyerhaeuser's effort to position its diaper product against major competitors. What do you see as critical mistakes or problems that led to failure?

Sources: Louis Therrien, "Bausch & Lomb Is Correcting Its Vision of Research," *Business Week*, March 30, 1987, p. 9; Barrie M. Spelling, "Colgate Ventures into New Territories," *Marketing Communications*, December 1987, pp. 17-21; and Alecia Swasy, "Diaper's Failure Shows How Poor Plans, Unexpected Woes Can Kill New Products," *Wall Street Journal*, October 9, 1990, pp. B1, B13.

A Model for New Ventures: Feasibility Planning

OBJECTIVES

1. Discuss the concept of a planning paradigm for new ventures.
2. Describe the four-stage growth model of entrepreneurship.
3. Discuss the fundamentals of a good feasibility plan.
3. Explain the major components in a feasibility plan.
4. Explore planning responsibilities and ways in which entrepreneurs can get assistance.

Just as there are no absolute answers on how to succeed in business, there are no absolute answers on how to develop a successful new venture. There are no undisputed "models" of entrepreneurship, but there are similarities among the leading ones that suggest a *paradigm*, a general pattern of how to progress from an abstract idea to achieving sustained sales. This chapter provides a paradigm in which the sequence of activities starts with the initial idea and ends with an established enterprise positioned for growth.

The model, or paradigm, encompasses a feasibility plan. This is a pragmatic business plan reflecting the philosophy that entrepreneurs should do the planning necessary to ensure the feasibility of a venture without becoming overwhelmed in the process. The planning outline presented here is a foundation for more detailed chapters in the remainder of the text.

THE CONCEPT OF A PLANNING PARADIGM

Karl H. Vesper, a leading educator in the field, concludes that there are perhaps a half dozen leading models that describe the entrepreneurship process. He also notes

that these models suggest more than a hundred different sequences for creating new ventures, each sequence having variations according to the unique characteristics of individual ventures. As a result, entrepreneurs can follow one paradigm only with the understanding that it provides a framework—not a mandate—for required activities.¹ This point is illustrated by the experiences of two successful entrepreneurs who established their businesses through entirely different sequences of events.

Called the Cowboy Capitalist (H. Ross Perot), founder of Electronic Data Systems Corporation (EDS), may be one of this century's most unpredictable and successful entrepreneurs. Perot started EDS in 1962 with \$1,000 and an idea for using computers as integrated systems. He envisioned computer terminals connected through telecommunication systems and information processing that could link operations instantaneously on a global basis. We take these things for granted today, but they were revolutionary in 1962, when critical technology such as integrated circuitry, microcomputers, and telecommunication software were years away from being developed. Nevertheless, Perot had the vision, and he created EDS to accomplish the feat. Planning was incremental, starting with systems designed for office use, expanding to factory controls, then to companywide integration. Perot hired the best designers and planners possible, established a remarkable market research team, and focused EDS always on possibilities five or ten years into the future. Perot relied on instinct but made informed decisions based on astute strategic plans developed by his staff. As a result, EDS was compared to a tank that could be put into low gear and roll over anything. The company was sold to General Motors in 1984, but Perot is doing it all again with Perot Systems, and looking into the next century as a planning horizon.²

In contrast to Perot, Michael Dell began as a premed undergraduate student who, at the age of 20, turned a hunch into the quarter-billion-dollar Dell Computer Corporation. The hunch came to him while working part-time selling IBM PCs near his campus. Through his job, he discovered the huge price markups on computers, and he was convinced that the world was ready for a low-cost "clone" of the IBM PC. To test his idea, he assembled his own PC in his apartment from parts purchased by mail order. It worked, and the total cost was well under \$1,000, so he made a few more to sell to friends. The hunch turned into a business, and he called his system the PC Limited. Word spread about Dell's computers, and he began taking orders over the phone. Demand was extraordinary, and his apartment-based business soon turned into a direct sales organization. Planning evolved only as sales growth pushed Dell to make decisions, but his success formula was entrenched by circumstances; build a clone computer at the lowest cost possible and market it directly through an army of salespeople with telephones. Planning became essential to establish purchasing systems and a nationwide distribution system, but planning was done reluctantly process. Nevertheless, it was accomplished by dedicated staff, and the corporation expanded to more than \$200 million in sales. Although many of his ideas changed as the business evolved, Dell retained the core strategy of direct sales and low-cost clones.³

H. Ross Perot and Michael Dell represent two ends of a spectrum of planning activities, and their businesses evolved through entirely different sets of sequential activities. There is no way to say whether either would have been more or less

PROFILE △*Ready, Aim, Fire, Fire, Fire, Fire*

After selling Electronic Data Systems Corporation (EDS) to General Motors for \$2.5 billion, H. Ross Perot is starting all over again. His new company, Perot Systems, is in the building stage, but Perot promises to make it as successful as EDS. Perhaps more important, he has positioned Perot Systems to compete with EDS, the company he founded in 1962 and took to nearly \$4.5 billion in annual sales.

Perot served on GM's board as part of the EDS deal, and while there, he became one of GM's most outspoken critics. Convinced that GM was a huge machine buckling under a mired bureaucracy, Perot condemned management practices as lacking imagination, drive, and innovation. Perot left GM and began an ardent attack on American bureaucracy in general. As one of the country's most successful entrepreneurs, he characterized large corporations—and GM in particular—as paralyzed by inactivity. Paraphrasing a military action, Perot said, "The gunner's command at GM . . . was 'Ready, aim, aim, aim, aim.' " In contrast, the EDS approach was characterized as "Ready, aim, fire, fire, fire, fire."

Perot has been described as an extraordinary thinker with finely tuned instincts, yet a leader who inspired strategic action based on exceptional preparation. Not only was EDS well planned and well staffed, but it was also strategically positioned to make revolutionary changes. Perot Systems promises to be no less dynamic, and H. Ross Perot is positioning his company for 21st-century technology.

Sources: Bo Burlingham and Curtis Hartman, "Cowboy Capitalist," *Inc.*, January 1989, pp. 54–62, 66, 68–69. Ross Perot, "How I Would Turn Around GM," *Fortune*, February 15, 1988, pp. 44–46.

successful had they behaved differently. Dell could have planned his business in detail and perhaps been paralyzed by it; or perhaps his business would have doubled in size. Perot might have relied entirely on intuition to stumble into systems technology; he also could have failed miserably. In both instances, however, there was a logical pattern of activities that evolved, planned or not, that led them toward success.

This logical pattern is recognized today as the general paradigm for new venture development. It is called the *four-stage growth model*, and it will be the model, or paradigm, that we use throughout the remainder of this book.

► CHECKPOINT

Discuss the concept of using a model for planning new ventures.

Explain why planning is important for a start-up enterprise.



THE FOUR-STAGE GROWTH MODEL

The **four-stage growth model** consists of categories of distinct activities essential for a new venture to progress from an idea to a substantial enterprise. The four are *pre-start-up*, *start-up*, *early growth*, and *later growth* stages. Figure 4-1 summarizes activities related to each stage.⁴

Pre-start-up Stage

During this initial phase, ideas evolve from a creative process to the point of being consciously perceived as commercial endeavors. Entrepreneurs have already begun to believe that their ideas are feasible, and they become fascinated by visions of their enterprises. As noted earlier, many of them will haphazardly plunge into business, following a popular adage that entrepreneurship is simply a manner of "finding a gap and filling it." As we noted in Chapter 2, however, this lack of preparation too often leads to early failure. Having a gap and filling it are important, but seldom sufficient, for success.

More astute entrepreneurs will begin by asking questions about the actual potential of their products or services. They will try to answer questions about production, operations, markets, competitors, costs, financing, and potential profits. And they will try to resolve questions about their own abilities to start businesses. Depending on the complexity of the proposed enterprise, the range of pre-start-up activities can be quite extensive, but there are four activities common to all new ventures. These are shown in Figure 4-2.

Business Concept Identified. Entrepreneurs must first conceptualize their businesses. This conceptualization may occur as a natural extension of the creativity process in which new ideas are shaped into visions of useful products or services. It

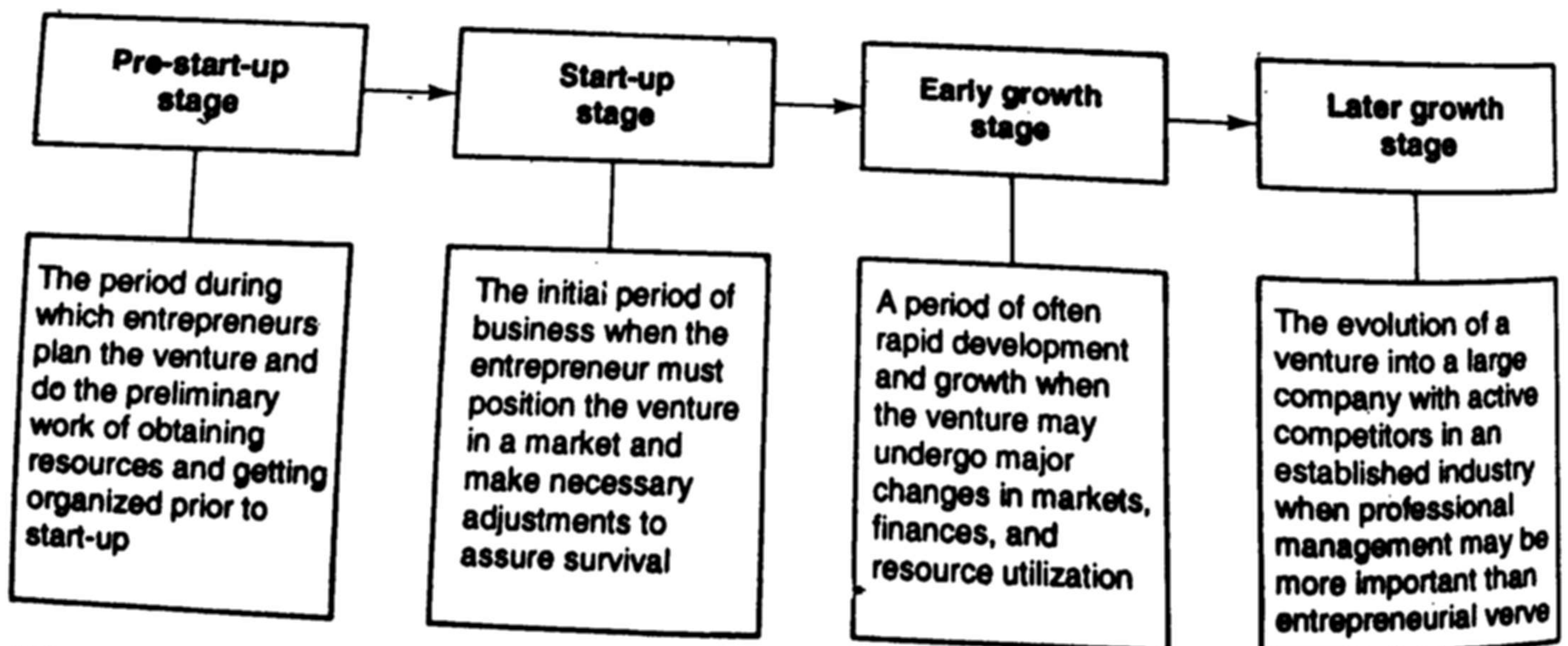


Figure 4-1 The Four-Stage Growth Model

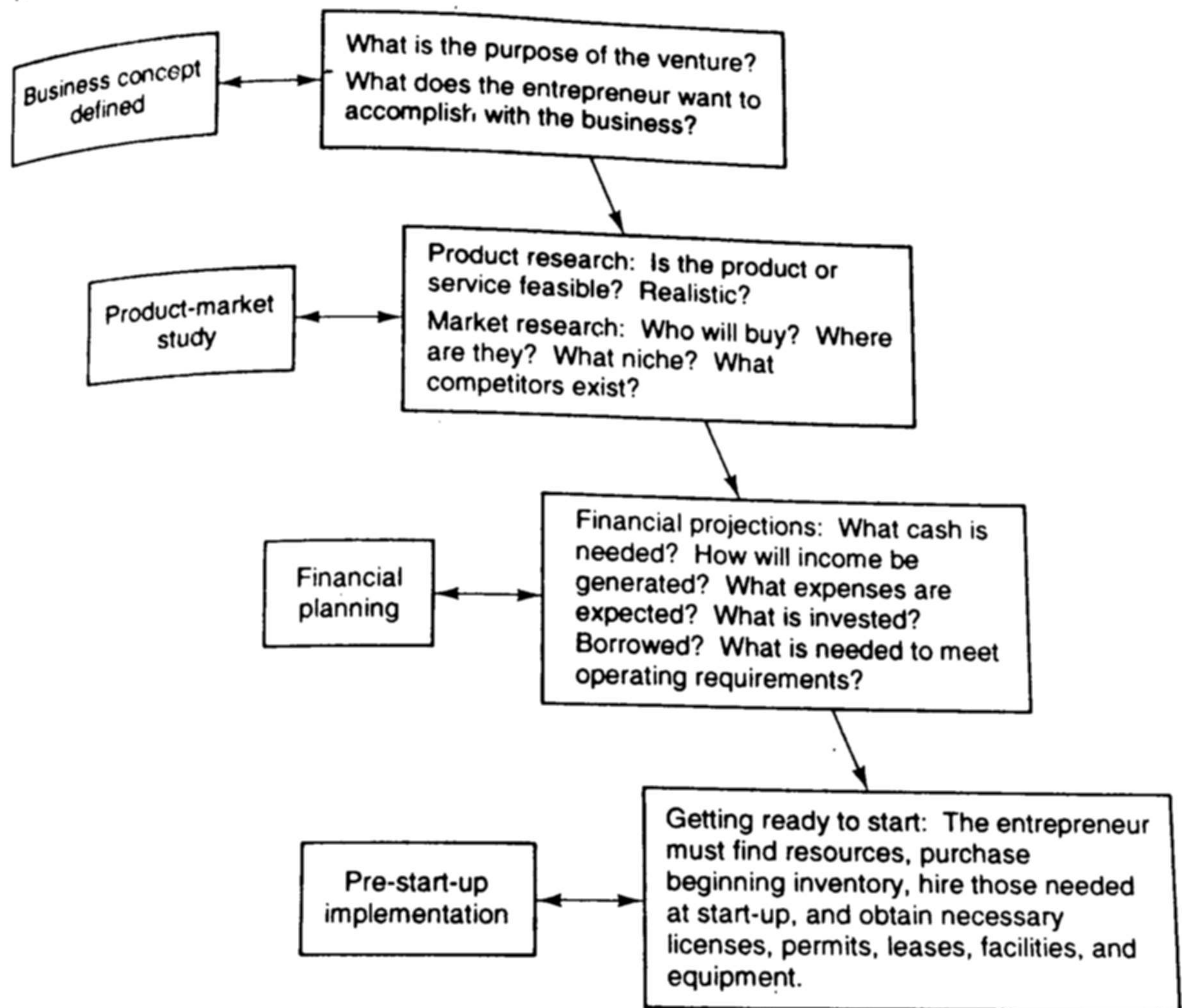


Figure 4-2 Pre-start-up Activities

also may occur in a conscientious plan developed around a perceived "gap" that an entrepreneur might "fill." The critical question to be answered is "What do I want to accomplish with this enterprise?"

To illustrate the point, consider how Steve Kirsch developed the concept for his electronic "mouse," a common accessory today for computer systems. Kirsch was an MIT student working in a computer lab where three very expensive machines were all crippled because the mechanical mouse each machine used was broken. He said that it was a sad situation, "like having a Ferrari with only three wheels on it."⁵ Kirsch set about designing a reliable electronic mouse, formed his company, Mouse Systems, Inc., in 1982, and now has clients that include most major manufacturers of microcomputers and scientific workstations. He had no preconceived notion of becoming an entrepreneur, but the idea "glared out at him" when he built a reliable mouse for himself. The idea of a business evolved over a period of several months when he realized the market potential. Kirsch's *innovation* was not his business concept; he could have sold or licensed the idea to IBM. Kirsch chose to subcontract production, create a marketing company, and position his business to sell mouse

accessories. His business concept was to design and market high-quality mouse accessories at premium prices.

Many rapid-fire questions jump into an aspiring entrepreneur's head the moment an idea begins to take shape. A few of the important questions are these: Does this thing exist already? If it doesn't, can it be made? Who would buy it? Why would they want it? Where are these customers? Am I the person to make this thing? Am I the one to sell it? Anyway, why would I want to do this?

The business concept may not be fully developed until most of these questions are answered. For instance, Kirsch initially had no intention of establishing his own venture; he wanted to sell the mouse design. When he was turned down, he offered to license his product. Turned down again, he thought of manufacturing, but realizing that he knew very little about production, he decided to focus on designing and marketing mouse accessories.

Product-Market Study. Once an entrepreneur has determined that a product or service is feasible, and that he or she might be capable, the next set of activities involves pragmatic research. This is crucial because entrepreneurs often jump to early conclusions based on intuition that, under close scrutiny, reveal fatal flaws in their plans. Research is necessary in at least two areas: product development and marketing.

Product research should include patent searches to uncover existing products. It is not unusual for dreams to end in the U.S. Patent Office when a half dozen similar product ideas are discovered. Some may be in production, some may be registered but never brought to market, and some may have never worked in the first place. If the search reveals a similar product in production, the proposed new venture usually ends there. If a product was patented but was also a commercial failure, understanding what went wrong could help avoid similar mistakes. It may be necessary to contact the original inventor, talk with the company that made the item, or search for out-of-circulation products in closets. If the product never worked in the first place, its flaw might be discovered, encouraging the entrepreneur to design a successful one.

Product research also requires actual R&D to design the item, investigate development costs, evaluate materials, and explore methods of manufacture. The questions to answer include the following: Can it be done? Can it be done at a cost that could generate profits? How is it to be done? Who will do it? As we shall see later, these questions are addressed in a special section of the feasibility plan, but product research must be *initiated* during the pre-start-up stage.

If the business is concerned with services, such as setting up a travel agency, "product" research in the sense of technical R&D does not exist. However, a travel agency will delineate its range of services, including types of tours offered, destinations, airlines served, travel associations with which to affiliate, and so on. This range of services defines "products" for the travel agency, and the business concept will depend critically on the blend of travel services devised through pre-start-up planning. Similarly, a retail merchandiser must devise an inventory plan. This will define the store's business concept through its product line, cost structure, image, and merchandising strategy.

Market research is the process of answering such questions as these: Who will

buy the product or service? What will they be willing to pay? How can I attract them to my business? If this venture is a big success, what will prevent competitors from overwhelming me? Who are my competitors? Can I establish a niche in the market? What are my options for long-term growth? These questions are critical to pursue in concert with product research efforts for several important reasons. First, the product itself is usually modified by feedback from initial market research. Second, how a product is marketed often determines how it is designed, manufactured, and packaged. Third, a product is often commercially viable only when markets can be protected against strong competitors.⁶

The initial stage of marketing research is often rudimentary. Typically, entrepreneurs will confide in close friends or family members to get reactions to their ideas. This feedback is useful but often misleading. Friends and family members seldom want to hurt the feelings of someone close, so feedback is often a cautious nod of approval rather than an objective evaluation. Then too, there is the chance of caustic rejection—again, often without objective evaluation. Ted Turner's father, an entrepreneur himself in the advertising business, seldom found anything worthwhile in his son's ideas. Father-and-son arguments between the Turners were notorious—father wanting son to "do something useful" with his life, and son wanting to "do something different."⁷

Entrepreneurs occasionally seek professional help from market researchers, university centers, and experienced mentors. Unfortunately, most entrepreneurs do not ask enough people enough questions. They seldom ask customers for their opinions, yet when they do, they often gain valuable insights about their ideas. Successful entrepreneurs will try to reach as many people as possible in a systematic manner before making start-up investments. Formal market research, however, can be complicated and expensive, so during the pre-start-up stage, the process is usually *informal*. Specifically, entrepreneurs will personally research industry data, study competitors, and seek advice from people they know and trust.

During pre-start-up planning, informal market research is a minimum requirement. Entrepreneurs must be able to find satisfactory answers about their potential markets and competitors. They also must have some reasonable idea about pricing, promotions, and distribution. Chapter 8 addresses these issues thoroughly.

Financial Planning. The third set of pre-start-up activities relates to money. Although new ventures are usually underwritten by personal savings and cookie-jar money, cash infusions are needed as the business begins to grow. Early cash flow is usually acquired through a combination of short-term loans, home mortgages, and family investments. As the venture evolves further, more cash is needed, and entrepreneurs have to attract capital through sophisticated loans and knowledgeable investors. Attracting capital requires careful planning and documentation about products, services, markets, and the entrepreneur's expectations.

Financial planning during the pre-start-up stage will not necessarily be extensive, but it does have to be based on verifiable information. For example, if an entrepreneur projects a million dollars in sales during the first year, there should be more than intuition behind the forecast. Using product and market information, the entrepreneur

should be able to justify cost-price relationships, how sales were estimated, and what will be required in overhead expenses. Using this information, the entrepreneur can forecast profits and cash flow, the two major pieces of information required by bank loan officers and investors.

The type of capital needed will dictate requirements for financial documentation. Most ventures will need seed capital during the pre-start-up and start-up phases. Seed capital is the cash needed for product development, market research, and initial operating expenses before sales revenue can begin to offset business expenses.⁸ Capital requirements are addressed in Chapter 13, but seed capital can range from a few thousand dollars for a simple barbershop to several million dollars for a complex biotechnology business.

During the pre-start-up stage, entrepreneurs seldom need extensive seed capital, with one exception: When the nature of the business is to create new products through research, the venture may spend years in development without creating anything to sell. As a result, an infusion of substantial capital is needed that far exceeds the concept of seed money. The biotechnology industry exemplifies this phenomenon. Genentech Inc., a biotech company that manufactures lab testing enzymes and experimental medicines, spent more than three years and \$20 million before announcing its first commercial product.⁹

If we stay with a general model of a simple business, financial planning activities are not complicated during the pre-start-up stage, but they require diligence. Investors and lenders want to see financial projections based on reasonable initial research, and they require accurate documentation. They also require financial statements that show how the venture will perform during its first few years of business. Entrepreneurs also will have to clarify their stake in the business, investments by family members or partners, and their personal financial capabilities outside business interests.

Pre-start-up Implementation. If we define the pre-start-up stage as a period that precedes any attempt to generate sales, then it is a stage similar to that of an Olympic sprinter preparing for a race. The sprinter, like the entrepreneur, plans, trains, develops strategies, and gets physically and mentally prepared to run. Just before the race is to begin, the sprinter gets into the starting blocks to await the gun. Like the sprinter, an entrepreneur must commit to action and do certain things before the event.

Entrepreneurs must establish vendor relations with suppliers, establish a business location, hire essential personnel, arrange for initial promotions, and set up administration systems. These activities vary widely with the nature of the business, but they are all essential. If the venture is a new retail store, the premises will have to be leased and renovated (or perhaps a store built). The store will need starting inventory, so advanced purchasing must be accomplished. Sales clerks may be needed on opening day; therefore, they must be hired and trained. Public relations, advertising, and a grand-opening event should be arranged. Finally, administrative systems must be in place, including inventory and cash controls, credit card subscriptions, a merchandise replenishment system, and a payroll system.

If the business is in manufacturing, the pre-start-up stage is much more complex. It will include those activities already noted plus equipment leases (or purchases), performance checks on equipment, engineering, and initial production of starting inventory. In addition, marketing systems must be in place, and the entrepreneur may have to comply with regulations by agencies such as the Food and Drug Administration, Environmental Protection Agency, Equal Employment Opportunity Commission, or Occupational Safety and Health Administration. Service ventures, such as restaurants and realtors, must comply with state and local licensing laws. Attorneys, public accountants, physicians, and other professionals will have to meet criteria established by regulatory agencies and professional licensing associations.

These activities are best accomplished well in advance of opening, not at the eleventh hour; however, some things may be postponed until the last minute. These include signing leases and hiring employees, because they create expenses that cannot be recovered until the firm begins generating revenue. Therefore, the *pre-start-up implementation phase* constitutes a set of well-timed activities that must be accomplished. The entrepreneur is stepping into the sprinter's racing blocks.

Start-up Stage

The **start-up stage** is the initial period of business. For companies with products or services to sell, it is the first foray into revenue-generating activity. The start-up stage has no definite time frame, and there are no models to describe what a business does during this stage; however, there are two benchmark considerations. First, entrepreneurs want to meet operating objectives, such as satisfying revenue and cost targets. Second, they want to position the venture for long-term growth. These objectives are summarized in Exhibit 4-1.

Exhibit 4-1 Start-up Operating Objectives

Sales	To attain monthly sales volume as projected at prices projected in feasibility plan. To achieve projected sales mix of products and services as summarized in feasibility plan.
Revenue	To achieve cash flow within budget based on sale volume and price projections.
Growth	To meet targets above variable costs with appropriate operating margins. To realize incremental growth within seasonal pattern of forecasts.
Position	To maintain balance of growth with ability to underwrite inventory, materials, and human resources. To solidify a long-term position in appropriate markets as a result of adaptation during start-up. To identify market strategy for niches or opportunities in new products, services, or markets during start-up.

Meeting Operating Objectives. Ideally, the venture will generate projected sales, or do slightly better. If sales are significantly below projections, the venture risks running out of cash and closing. If sales are substantially higher than projections, the firm may find itself equally in distress and unable to either finance growth or replenish inventory. This risk is often overlooked because most people automatically assume that a higher sales volume means higher profits. Unfortunately, the only time this assumption is true is when an entrepreneur sells everything for cash and has an unlimited supply of inventory. Both conditions are rare.

More often, a business has an established inventory that requires time to replace and cash to acquire. If the business sets records on opening day, it may have nothing to sell on day two. One answer to this dilemma is to buy more inventory through rush orders, paying a premium for goods. If the company has large margins, added costs may be easily absorbed, but usually it is the other way around—premium costs absorb cash and profits.

This process is precisely what happened to Osborne Computers.¹⁰ During its first year of operations, Osborne became the fastest-growing corporation in the United States. The company's founders had conceived of the first portable computer in 1980, several years before Compaq and IBM did so, but they had estimated sales at less than a third of the \$80 million in orders achieved during the first few months in business. Because most sales were to distributors who had 30-day credit terms, Osborne accumulated huge orders, but without cash receipts. The company acquired debt financing to meet manufacturing costs, shipped computers around the clock, and within a few months was hopelessly in debt. Creditors called in Osborne's debts, and investors quickly liquidated, leaving the company debt ridden but with extraordinary sales orders. Unfortunately, orders could not be filled.

Meeting operating objectives does not necessarily mean making a profit. To the contrary, most new ventures operate at a loss for several years. They "break even" only with carefully monitored controls, but they should be able to structure the business so that variable costs are covered and cash flow is positive. If either condition cannot be met, the enterprise is not viable. Specifically, when variable costs cannot be met by sales revenue, by definition the company will go deeper into a hole with each sale. In addition, there will be no income to contribute to fixed costs or pre-start-up expenditures.

Maintaining a profitable blend of products and services is also important. For example, a retail bicycle shop may have been planned to generate 60 percent of gross revenue from bicycle sales, 30 percent from accessories, and 10 percent from repairs. It may turn out that 60 percent of total revenue is derived from accessories, 30 percent from bicycles, and 10 percent from repairs. In this situation, the shop owner will have idle inventory in bikes (money tied up in slow-moving inventory) while accessory inventory is depleted. Moreover, unless the cost-price differential is exactly the same for bicycles and accessories, income projections will be seriously distorted. This sequence of events is precisely what happened to Spokes Etc., a bicycle shop located in Alexandria, Virginia.¹¹ Fortunately the store's owner, Jim Strang, recognized the shift in sales early, quickly adjusted his operations, and avoided catastrophe. Good pre-start-up planning helps reduce these problems.

PROFILE Δ

Jim Strang

With two locations in northern Virginia, Spokes Etc. is a successful bicycle business founded by Jim Strang, a 1985 college graduate who spent his first two years after earning his business degree in the fast-paced world of corporate sales for Lanier Corporation. Life in the fast lane lost its luster when Strang had to give up biking and his independence; however, he enjoyed the challenge of business and sales. By opening his own bicycle shop, he satisfied his desire to stay close to biking and to pursue a business career. His bicycle stores have the latest equipment, accessories, and clothes, and he has a team of mechanics who share his enthusiasm for biking. Everyone in Spokes Etc. is a competitive rider and eager to share their knowledge with customers. In Strang's view, the business is a "living, personal extension of our philosophy to have fun and help others have fun. If we grow any larger, that could get lost in the shuffle. . . . I like it the way it is."

Source: Personal interview with Jim Strang, August 1989.

Positioning the Enterprise. Every successful business starts with a preconceived business idea. As noted earlier, this includes a concept of the product or service, markets, and growth potential. Entrepreneurs often find, however, that reality is quite different from what was envisioned. Two considerations are important. First, the business must *survive* in the short run, and second, the business must be *positioned* to achieve long-term objectives.

From a survival viewpoint, the start-up stage is a crucial period when adjustments are made. The entrepreneur who "opens" and smugly waits for sales to occur may not be open for long. Needless to say, some enterprises are so well developed before opening day that customers are lined up with cash in hand. This is not usually the case; more often this stage is a period of acid tests when many things go wrong. The product simply may not work, not sell, be introduced at the wrong time, or be positioned in the wrong market. The entrepreneur may not be capable of running the business. Costs may exceed expectations. Prices may not be low enough to attract customers. Investors may back out. And so on. Consequently, entrepreneurs must make quick adjustments to survive. These may include simple decisions such as adjusting inventory to eliminate slow-moving items, or complex decisions such as restructuring the company's debt when cash flow becomes thin.

From a long-term perspective, the business concept must coincide with realistic prospects for growth. This means that the enterprise must be *positioned* to take advantage of growth markets. Products are positioned by placing them for sale in particular market niches. For example, Michael Dell positioned PC Limited to sell to small businesses and as stand-alone systems through a factory-direct marketing

process. He could have positioned his products for home use, education, scientific work, or office networks, each with different distribution systems. Other companies are positioned in these markets. Sun Microsystems, for example, sells mainly to organizations with engineering applications. Hewlett-Packard is strong in scientific research, and Apple Computer is strong in education markets.

Positioning of services is the process of organizing the enterprise to provide expertise to a particular clientele. Hyatt Legal Services, a consortium of independent attorneys, targets family clients with services that include drafting of wills, handling probates, representing clients in divorce suits, and litigating casualty claims. Other attorneys will specialize in criminal law, patents, corporate legal services, or labor relations. Retailers can finely tune their markets for young professionals, married women, single men, children, wealthy clientele, bargain hunters, and so on. Ideally, positioning will be planned during the pre-start-up stage, but even the best plans change soon after the venture opens, and positioning—or *repositioning*—is essential.

Early Growth Stage

Once the venture is positioned, successful enterprises will experience a stage of early growth. This is a period of intense monitoring, and growth can occur at different rates along a long continuum, ranging from slow growth through incrementally higher sales to explosive growth through quantum changes in consumer demand. This continuum is illustrated in Figure 4-3.

At the low end of the continuum, entrepreneurs find that they compete in slow-growth markets. New parcel-delivery systems and mail outlets such as the franchised Mail Boxes Etc. are successful, but they compete in local markets against UPS, Federal Express, and the U.S. Postal Service. As a result, they can achieve immediate success by attracting clients who seek alternative mail services, but annual growth rates are typically less than 5 percent because each store must persuade new customers to change their methods of handling mail.¹² Most highly specialized businesses, particularly those in food and agriculture, will experience slow growth. These include cheese shops, specialty garden farms, dietary consulting, ecology research, organically grown wines and vegetables, and specialty foods like tofu.¹³

At the high end of the continuum, two companies that experienced high-growth sales were Osborne Computers and People Express Airlines. As noted earlier, Osborne

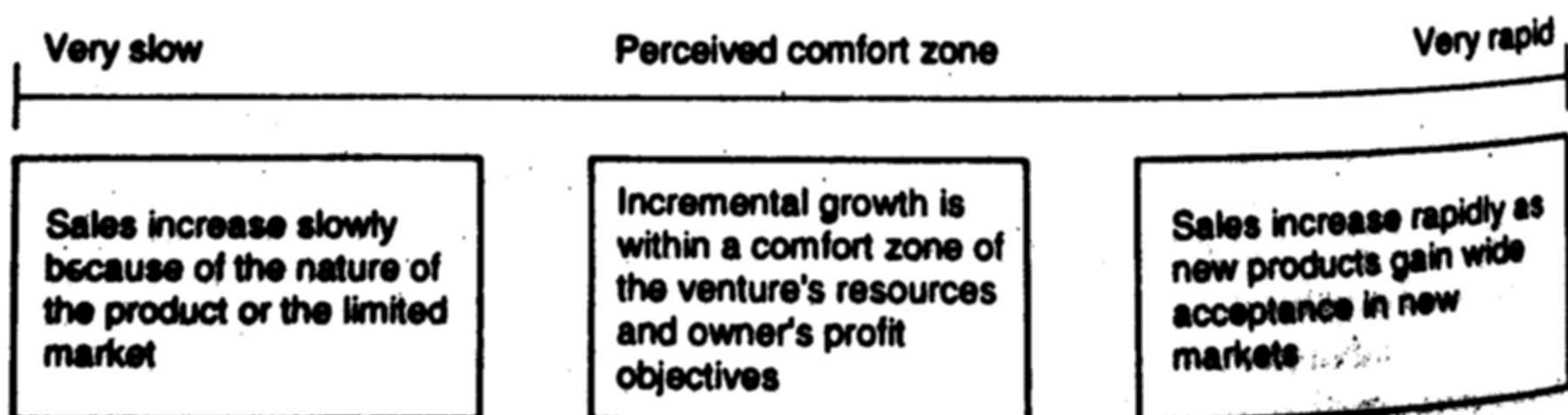


Figure 4-3 Continuum of Early Growth

grew so rapidly that it outran its ability to finance expansion. People Express, once listed as the nation's fastest-growing company, also outran its underwriting. Plagued by high expenses and a huge debt burden for aircraft, People Express filed for bankruptcy protection in 1987. However, there is nothing wrong with rapid growth as long as it is managed. For example, Karsten Solheim, a Norwegian immigrant, developed his first Ping putter as a hobby while working for General Electric. He positioned Karsten Manufacturing Corporation to manufacture a full line of golf clubs during the early 1980s when demand for golf equipment was expected to increase exponentially with rapid growth in new courses. Karsten's firm grew at nearly 200 percent annually, and by 1989, Karsten's Ping clubs were leading the market; Ping putters were used by more than half of PGA touring pros. Today, Ping produces 12,000 clubs a day, grossing \$100 million annually without being able to meet demand for customer orders.¹⁴

Between these extremes, a majority of entrepreneurs find a "comfort zone" of expansion. Their ventures may have growth potential, but founders restrain expansion to coincide with personal objectives. Jim Strang, founder of Spokes Etc., quickly succeeded in his first bicycle store, and within a year he opened a second store. Both stores are successful, with annual growth near 20 percent. In 1989, Strang was urged to open a chain of franchises but refused, preferring instead to own and control his own shops. At the same time, Garry Snook founded Performance, Inc., a bicycle business with inventory similar to Strang's. Snook, however, decided to pursue rapid growth. He leveraged the business, created a franchise system, and by 1989 had ten stores in four states and more than \$40 million in sales. Snook expects to open 50 stores by 1992.¹⁵ Snook's business is growing more rapidly than Strang's, but not at the frantic pace set by Osborne or People Express. The important point is that both Strang and Snook are meeting their *personal* objectives, staying within their "comfort zones."

Interesting things can happen to a new venture during this stage. If the entrepreneur has a unique product or lucrative patent, the business may be actively courted by larger firms. Such courtships can result in very profitable buyouts or licensing agreements. Mergers are also common, as companies with complementary strengths combine to form a new company positioned for more rapid growth. Many businesses also experience early growth but find that the enterprise has severe limitations. In this case, an entrepreneur may simply recognize that the future holds little growth potential and reposition the venture as a small business.

Later Growth Stage

If the enterprise proves successful in the early growth stage and has momentum, it can find itself in competition with larger companies. This is the later growth stage, when the rate of growth may be slower and the industry has attracted competitors. Companies reaching this stage often "go public" with stock offerings. Family fortunes turn into corporate equity positions, private investors convert their holdings into publicly traded securities, and management teams replace the entrepreneurial cadre. In many instances, founders lose the personal identity they had with their firms, and

if they are not ready to adapt to corporate management, they leave (or are ousted). Those who do adapt enjoy the benefits of corporate management and the profits of being major stockholders. For example, Jim Jaeger, founder of Cincinnati Microwave, Inc., the company that makes the Escort radar detector, reached a sales plateau in 1984. The market was still strong for radar detectors, but competition required infusions of new products. He developed a complementary product called the Passport, and sales surged. Jaeger found himself heading a \$77 million company with hundreds of employees. This growth required a transformation in the company to restructure its equity capital and to establish a professional management team. Jaeger accomplished both, and his company continues to prosper.¹⁶

A few ventures become large without losing control or going public. Their founders continue to manage their corporations, finance growth through earnings, and avoid the complexities of publicly traded stock. The Du Pont family controlled its chemicals and plastics empire for generations, and today, the Mars family still owns and manages its global company in candy and convenience foods. Perhaps one of the most interesting companies is Mrs. Fields Cookies, a company started in 1978 by Debbi Fields at the age of 22, and now jointly operated by Debbi and Randy Fields. Their business has more than 500 stores spanning five countries and grosses \$100 million annually. The business is not franchised; all stores are owned by the company, which is managed by a staff of about 120 people.¹⁷

Consequently, the later growth stage does not necessarily mean emulating IBM or General Motors, but most ventures outgrow their founders and earlier methods of raising capital. As we shall see in Chapters 13 and 14, there are significant differences between the various stages of development with regard to financing and managing companies.

Understanding the Four-Stage Growth Paradigm

Sequential stages of new venture development represent intervals that focus on different sets of circumstances. During the pre-start-up stage, the focus is on product, service, and market planning. The start-up stage requires entrepreneurs to focus on implementation and early positioning. During the early growth stage, they are concerned with rapid changes in sales and resources. And during the later growth stage, they must make a successful transition from personally managed enterprises to professionally managed companies.

Few companies, however, experience all four stages of growth. As noted earlier, many new ventures simply do not survive long enough to continue past the start-up stage. Others will be started by entrepreneurs who have no intention of expanding beyond a "comfort zone" of operations. Still others will embrace rapid growth, but their founders may not be able to make the transition to professionally managed companies.

The feasibility planning scenario presented in the following pages focuses on the pre-start-up and start-up stages. In the process, we address implications for the early growth stage, but planning for the later growth stage is omitted as a topic more appropriate for management and business policy courses.

► CHECKPOINT

Describe the four stages in the growth model and how they differ.
 Explain five sets of activities essential during the pre-start-up stage.
 Define the growth continuum and contrast new venture activities at the polar extremes. What is a "comfort zone" in the continuum?

FUNDAMENTALS OF A FEASIBILITY PLAN

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 In Chapter 1, we defined a *business plan* as a comprehensive set of guidelines for a new venture. We also cautioned that entrepreneurs can become entangled in their plans, and although planning is essential, it must be done in a reasonable manner. Therefore, the term *feasibility planning* is used as a way of moderating the concept of a comprehensive business plan. A feasibility plan encompasses the full range of business planning activities, but it seldom requires the depth of research or detail expected for an established enterprise.

Every new business is unique. Each will have something that sets it apart from others, even if it is no more than the personality of an entrepreneur. For that reason, no plan is going to provide an absolute prescription for success. A feasibility plan is an outline of *potential* issues to address and a set of *guidelines* to help an entrepreneur make better decisions.

Developing a Good Plan

Feasibility plans usually are written for investors and lenders, and being aware of this audience often leads to overoptimistic presentations by entrepreneurs who "hard sell" their business concepts. Occasionally this tactic may attract investors and help secure loans, but it will have little value as a management tool for the founder. Writing an *honest* plan with *well-supported* information will benefit everyone.

A well-written plan should be succinct, clearly identifying products, services, markets, and the founders. A feasibility plan does not have to be "slick," but it does have to be prepared in a quality manner. The plan should be easy to read, complete, and accurate. There should be no misspellings, improper grammar, or mistakes in data. Effective plans avoid emotion-packed phrases like "This can't miss!" or "Everybody needs this!" They also avoid abstract language. Entrepreneurs who know how to write a good plan will avoid saying they "think" there is a market or they "believe" a product will work. Instead, they will use facts to support their assertions.

Protecting the Business

Since business plans are used to attract investors and lenders, many copies are circulated. Wide circulation can be dangerous if the plan contains sensitive infor-

mation. Consequently, it is wise to include a strong "nondisclosure statement" on the cover page that states information in the plan is proprietary and cannot be copied, disclosed, shared, or otherwise compromised. Many entrepreneurs also assign an index number on each copy in addition to a signature line for each recipient. This constitutes an agreement on the nondisclosure terms and provides a reference number for documenting circulation. Although this procedure may not always protect entrepreneurs from having their ideas stolen, it can be a strong deterrent.

Making the Plan Readable

A thorough business plan often has more than 50 pages, but many plans based on easily understood business concepts may be less than 20 pages long. Plans for complex enterprises requiring extensive documentation are much longer. If there is a choice, keep it short. Potential investors and lenders receive many proposals, but they rarely read more than the first few pages. If the concept is intriguing, they spend more time probing financial data. It can be quite disturbing to an entrepreneur who has spent months writing a good plan to watch a loan officer spend five minutes reading the front page and skimming projections. Therefore, it is even more important to be convincing in the opening pages.¹⁸

For those few enterprises that capture an investor's attention (or get past the junior loan officer), there is a more complete study. This means that an entrepreneur must be very careful to capture a reader's attention early, yet provide thorough information for a detailed analysis that occurs later.

► CHECKPOINT

Explain how a feasibility plan is used and why it is important to entrepreneurs.
Describe the elements that go into writing an effective plan.

THE FEASIBILITY PLAN

The composite feasibility plan presented in this section was developed by comparing 26 different published versions. All of the plans included eight common elements that are contained in the feasibility model summarized in Exhibit 4-2. This model is generally adaptable to most types of new ventures.

Executive Summary

The opening section, called the **executive summary**, is a synopsis of the proposed enterprise. It is the "tickler" that either captures an investor's interest or kills all incentive to read further. Usually no longer than three pages, it addresses five subjects noted in Figure 4-4.

Exhibit 4-2 Eight Common Elements in a Feasibility Plan

Executive summary	Venture defined, products or services identified, market characteristics summarized, founders introduced, and financial structure profiled
Business concept	Purpose of the venture and the major objectives of its founders; description of the distinct competency of the firm
Product or service	Function and nature of products and services, proprietary interests, attributes, and technical profile
Market research and analysis	Customer scenario, markets, venture's niche, industry structure, expected competition, and sales forecast
Market plan	Market strategy to compete, pricing, promotion, distribution, service and warranties, and sales leadership
Manufacturing or operations	Facilities, location, inventory and materials needed, human resources, operational processes, technology, security, insurance, and safety
Entrepreneurial team	Profile of founders, key personnel, investors, and management roles
Financial documentation	Financial statements for income and expenses, cash flow, assets and liabilities, break-even projections, and start-up underwriting needed

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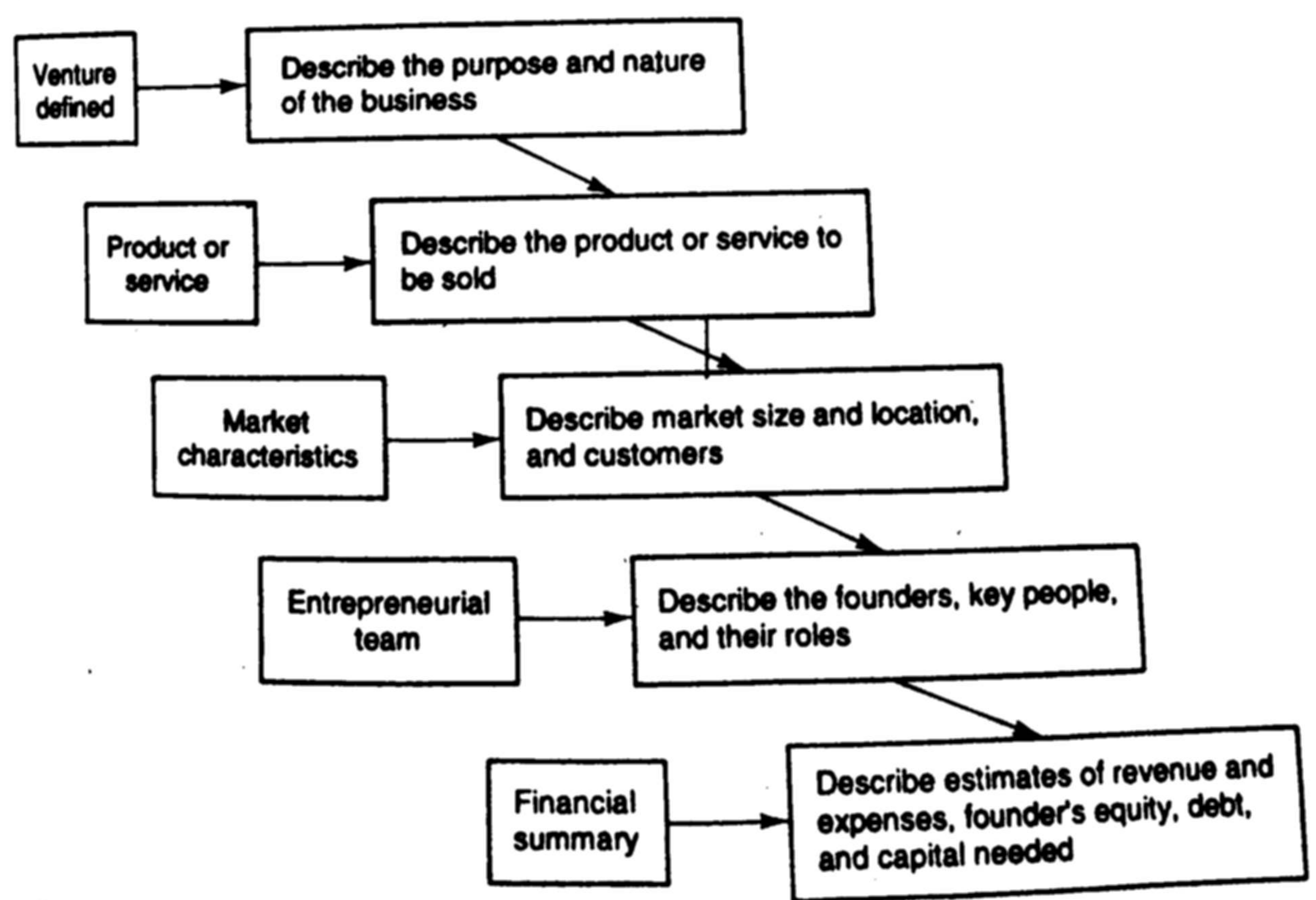


Figure 4-4 Six Key Elements in the Executive Summary

Venture Defined. The company must be identified to include when it was formed, by whom, and for what purpose. The most important requirement is to explain the purpose of the new venture. For example, a venture's purpose can be described as manufacturing microelectronics, merchandising women's clothes, or publishing children's books. In each instance, the entrepreneur should briefly extend the definition to explain how the enterprise is unique. Mrs. Fields Cookies, for example, could be described as a chain of confectionery shops, but that description would be superficial. Elaboration is needed to explain the business concept of selling high-quality cookies made from a proprietary recipe. Similarly, a women's clothing store could be described as an upmarket boutique merchandising petite-sized fashions. The definition should also include its legal formation, identifying it as a corporation, partnership, sole proprietorship, or other form of business.

Product or Service. The entrepreneur must describe clearly what will be sold. If there is a proprietary interest (patent, trademark, or copyright), this fact should be stated. The executive summary should briefly describe how far the entrepreneur has gone to develop the product or service. For example, a new product may be in the research stage, design stage, prototype stage, or advanced engineering stage with limited production. Most services are described in terms of customer value. An advertising agency, for instance, might be described as providing mass media promotional programs for professional sports teams.

Products and services should also be described in terms of quality image, pricing, and distinguishing characteristics that might demonstrate a distinctive competency. For example, a business formed to provide computer software training is not distinctive, but a business designed to provide "computer-based retail inventory control training" indicates specific services that can be evaluated.

Market Characteristics Existing and potential markets must be briefly described in terms of size and geographic characteristics. The plan must provide a summary of data to validate projections. If an entrepreneur is going to open a women's clothing boutique with petite sizes, then it will be important to estimate how many women in the market area are likely to need petite-sized clothes. Such an estimate may also require a *brief* description of market demographics, such as changes in local population or data on women in various age groups. Market potential should be estimated over a reasonable period of time (i.e., number of sales or dollar sales for the first three to five years). Summaries of data on growth projections, such as regional trends in specialty merchandising, may be required.

The plan's reader must be convinced that a viable market exists and that the business has a reasonable opportunity to serve this market. However, the executive summary is an overview of market data, not a complicated presentation of detailed market research.

Entrepreneurial Team An entrepreneurial team may include only the founder, but usually there are other key personnel essential for the firm's success. Individuals must be identified, and their skills and talents must be described. If the business requires individuals with unique qualifications,

these should be emphasized. For example, a restaurant may require a chef skilled in preparing French gourmet food, or a health club may require an experienced aerobics instructor.

The executive summary emphasizes strengths of team members and their qualifications, but without "hype." Exaggerations permanently undermine the entrepreneur's credibility, and no matter how exciting the product or service, investors look first to the character and ability of the entrepreneur.¹⁹

Financial Summary. Critical financial considerations must be summarized to include start-up estimates of revenue, costs, cash-flow requirements, and profits or losses. These should be extended in annual increments for at least three years. A good plan will identify the break-even point in sales volume or sales dollars (i.e., explain when the venture turns profitable). Most important, it will be clear about the financing needed. The plan will establish what is needed and what is being sought from investors and lenders. For instance, a venture may be seeking \$400,000 from investors with an established equity base of \$100,000 from the founders, or it may be seeking a loan of \$200,000 and \$200,000 of new investment equity. This summary may be oversimplified, but it indicates to potential investors how much capital is needed, how much the founder has invested, and how much has to be borrowed.

Business Description

Following the executive summary, the plan will provide detailed sections on each major topic. The first section is a thorough description of the business. Essentially the same points covered in the executive summary are covered here, but they are covered in far greater detail. For example, rather than simply naming the business and why it was founded, the entrepreneur should carefully describe evolutionary steps that led to the business formation. It is not unusual to find that a proposed enterprise evolved from an earlier business or from the efforts of an individual who has been working on an innovative product for years.

An interesting example is Wilson Greatbatch, the inventor of the Pacemaker. He had worked alone in his garage for several years engineering the Pacemaker, and, initially, he attempted to do his own marketing.²⁰ However, he was shunned and ridiculed by doctors until he collaborated with a New York cardiologist who formed a team of specialists to further develop the Pacemaker. The enterprise that evolved was based on the team and its research, not solely on Wilson Greatbatch's invention. Greatbatch established another, separate business that evolved from the Pacemaker research. His venture manufactured an innovative line of batteries required to power Pacemakers. Without having a complete background on the Pacemaker's development, an investor would have only a superficial idea of the importance of Wilson Greatbatch's battery-manufacturing enterprise.

An important area to address is the nature of market demand. Is the firm responding to an established demand, or is it trying to establish a new product or service in untested markets? The Pacemaker was developed in response to a critical problem, and today about one of every 500 Americans relies on a Pacemaker to live. However, the first microcomputer marketed by Apple Computer Corporation was a

PROFILE Δ

Wilson Greatbatch

At the age of 41, Wilson Greatbatch left his job as an engineer to work alone in his garage. He was convinced that he could create a device that regulated the human heart. With a meager savings and an assortment of spare parts and simple tools, Greatbatch invented the Pacemaker. For several years, he traveled in western New York and Pennsylvania showing his "mechanical metronome" to doctors who thought the idea was absurd. Eventually, a cardiologist in Buffalo listened, and the Pacemaker was introduced to medical science. Now applauded for his work and among a select few scientists to be in the Inventor's Hall of Fame, Greatbatch considers his invention a minor one. In his view, the real contribution was power supply technology that he developed with batteries that would operate inside the human body—an environment, he notes, that is far more complex and hostile than the depths of an ocean or outer space.

Source: *The Entrepreneurs: An American Adventure* (Boston: Enterprise Media 1987), Film No. 3.

shot in the dark. Some people saw it as a gimmick, and IBM initially ignored the microcomputer as nothing more than a fascinating toy.²¹

The entrepreneur also needs to explain the nature of the business by clearly defining how the firm will operate and what the founders intend to accomplish. For example, MedCon, Inc. has the singular purpose of disposing of infectious waste products from hospitals, clinics, and medical laboratories.²² MedCon was licensed in 1987 by the state of Texas after rigorous federal tests showed that a patented disposal process would not release potential carcinogens into the air. Larry Dunham, one of the firm's founders, clearly stated the nature of the business as safely disposing of infectious waste products using a patented process. Although there is a potential world market for this service, MedCon has set out clear near-term objectives for plant sites in Texas and New Jersey.

Finally, a firm's *technological profile* should be explained. This may include a description of equipment such as robotic manufacturing. It may require a description of wholesale networks. It may even require an explanation of foreign licensing agreements. For example, toy makers who import inventory manufactured in Taiwan and Singapore should identify import-licensing arrangements that are vital for the business to succeed.

Product or Services

One requirement of every plan is to explain the *product or service concept*. To examine this, however, it is important to recognize that the product or service models

do not consistently place this topic immediately after the "business description." A slight majority of business plans treat market issues before providing details of the product or service, but those models require a thorough description of the product or service in both the executive-summary and the business-description sections. For an easily defined concept, such as a specialty clothing store, a brief description early in the plan may suffice. As a general rule, the plan must provide an accurate description of a product or service before attempting to explain how it will be marketed.

Essential information required to describe a product includes distinctive characteristics of the product itself, how it works (or is used), materials, costs, methods of manufacturing, proprietary protection (patents, trademarks, or copyrights), and potential competing (substitute) products. Most new products also will require validated testing, and many will require approval by regulatory agencies. If the product is a new dental instrument, for example, it will have to be approved by the U.S. Food and Drug Administration (FDA). Most services must have licensed owners or employees (cosmetologists, securities brokers, CPAs, real estate brokers, and so on). Restaurants and medical testing laboratories often have to meet state health and safety requirements. Day-care centers, preschools, and counseling centers are required to meet educational credential standards and to comply with state and local regulations.²³

An important part of this section is to describe how a business is *staged* during the start-up and early growth periods. **Staging** refers to the manner in which products or services will be introduced. It also explains diversification plans and prospects for incremental growth. When Unimation introduced its first commercial robots during the 1960s, they were little more than punch-tape-driven machines, not robots as we know them today. However, Unimation had a *staged development plan* that spanned ten years and three changes in robotics technology. Numerically controlled machines were introduced during start-up, then three years later, bidirectional computer-aided robots were developed, and within ten years, the company planned an integrated robotic system for automated manufacturing. Unimation did not meet the schedule as planned because, after ten years, the microelectronics industry had not yet developed the technology needed for computer-aided manufacturing. Unimation did succeed within 16 years, and Volvo, Chrysler, and Toyota were quick to restructure their auto assembly lines using robotics during the early 1980s. The rest of the automotive industry quickly followed.²⁴ The critical point is that in 1960, researchers at Unimation envisioned what robotics would be capable of in the 1980s, yet building a plan on that vision would not have attracted investors. Instead, the company presented plans for products that were commercially feasible at that time. These included numerically controlled machines and robots with simple functions.

Market Research and Analysis

The objective of *market research and analysis* is to establish that a market exists for the proposed venture. This may be the most difficult part of the plan, but it also may be the most important. Entrepreneurs must provide a credible summary of potential customers, markets, competitors, and assumptions about pricing, promotion, and

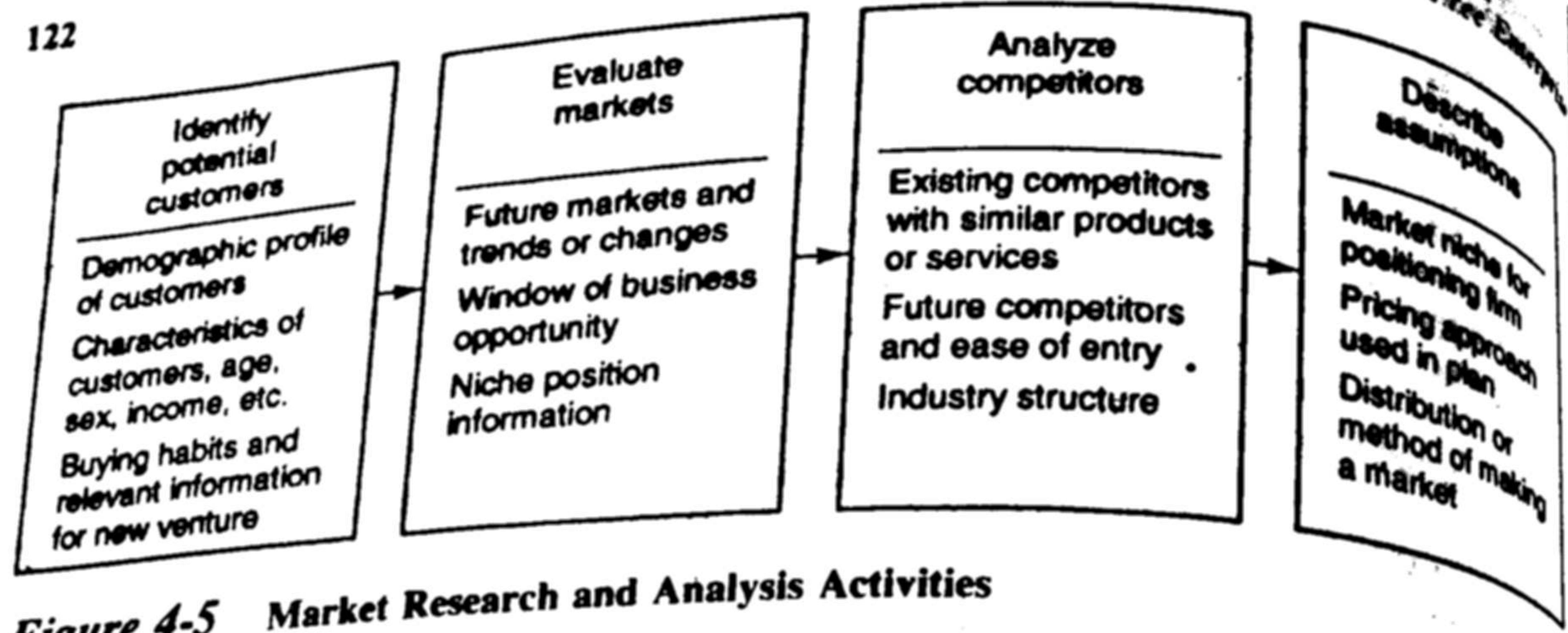


Figure 4-5 Market Research and Analysis Activities

distribution. Figure 4-5 summarizes these points. Each must relate to the future period of operations, not merely describe what exists at the pre-start-up stage.

Potential Customers. Research should describe a **customer profile** that includes demographic information such as age, sex, family income, occupation, and location of potential customers. For example, a firm that intends to market micro-computer systems to doctors should provide information on the number of doctors' offices in a marketing area, their ages, gross business income, types of medical services they offer, and how many currently have systems in place. Each bit of information helps to explain the market size and the likelihood of generating sales. To illustrate with just the "age" characteristic, if most physicians in a market area are young, they are probably more likely to consider investments in new technology than older colleagues with established practices.

Customer profiles can include many characteristics, but entrepreneurs should be guided by reason to provide *relevant* information that could affect sales. Consequently, including data about business income for doctors helps to establish their financial ability to invest in new technology, but information about their families and country club memberships would not be relevant to purchasing office computer systems.

Markets. A market exists only when there are qualified buyers, but the entrepreneur must remember that the feasibility plan is a forecast of *future* markets, not merely those that exist. Therefore, *market trends* are important to identify, including, when possible, a window of opportunity for introducing the new business. For a venture positioned to sell computer systems to doctors, the current profile of potential clients is important, but if few new practices are being opened, future prospects for new sales are limited.

Entrepreneurs often find they cannot objectively identify markets because the business has never before been attempted. **Apple** Computers were introduced in a market void—microcomputers had never been successfully marketed. **Ultimation** introduced industrial robots, people were actually hostile to them.

an industrial climate in which work was generally accomplished on assembly lines by large numbers of employees. Although Ultimation's robots worked, there were no trained robotic operators or procedures for using robotics. Manufacturers had huge investments in mechanical technology, and employees were suspicious of robots because they could replace large numbers of workers; neither managers nor union leaders were ready to accept this technology. Consequently, Ultimation had difficulty explaining why anyone should buy robots, but when competition between U.S. and Japanese automakers stiffened during the 1970s, it became apparent that the United States would have to retool using advanced technology. A window opened for robotics, and markets could be accurately determined.²⁵

Competitors. It is essential to identify *competitors* and to analyze how competition is likely to change when the new venture becomes established. Too often, entrepreneurs skim over these issues and find themselves outgunned in the market. The minimum requirement is to identify existing competitors and to explain their strengths and weaknesses. If a new product is to be introduced in a highly competitive market, just describing competitors may be an overwhelming task. For example, a new software word-processing program not only will have to compete against major products such as Word Perfect, Multimate, and WordStar, but will also compete against more than 200 firms that have specialized market niches in office software systems. The value of marketing research to uncover competitors and to provide an overall assessment of the venture cannot be overstated.²⁶

For a new business without known competitors, the challenge is to evaluate the potential for competitors to emerge. In other words, what is the "threat of entry" by other firms. There is also the threat of customers "making" rather than "buying" an entrepreneur's product, and foreign competition is always a threat if the new business proves to be profitable. Successful entrepreneurs know their competition and can demonstrate in their plans how they will compete.

Assumptions about the New Venture. A formal *marketing plan* comprises the next major section of the feasibility plan, yet it is important to describe in the marketing research section assumptions that support market projections for the new venture. Specifically, entrepreneurs must identify the market niche, price system, promotional effort, and distribution method to justify a basis for market research contentions.

Market Niche. A market niche is a carefully defined segment of a broader market. It defines the *positioning* of a product or service to create a distinct marketing focus. A brief statement in the plan should explain this focus. Doctors segment their markets by the types of specialized services they offer. Realtors segment services according to commercial, residential, resort, or development properties. Computer retailers may target corporate customers, small business offices, home enthusiasts, or schools. Segments also result from business locations, such as opening a Kwik Kopy franchise near a university; clientele will most likely be faculty members and students.

Pricing Systems. Market research is predicated on a price system that helps describe the venture's market. Describing the price system is essential for developing a customer profile. Luxury prices for name-brand products sold through specialty stores will send a clear signal to customers that quality merchandise and individualized service are offered. Low prices with frequent sales and discounts suggest the opposite. Prices will also be defined by credit policies, location, methods of distribution, and market strategies devised by the founders. These do not have to be elaborate statements, but they must be included.

Methods of Distribution. A method of distribution is the manner in which products or services are brought to market. Office supplies, for example, usually are sold through retail stationery stores, but they also can be sold by discount outlets, distributed through catalogs, or sold through direct mail promotions. The choice of a distribution system often defines the market niche, influences prices, and delineates promotional activities. For most businesses, one type of distribution system will be customary, but often a creative method of distribution gives a business its distinct competency.

The Sales Forecast. Ultimately, marketing research must conclude with solid data on projected sales. A sales forecast is the culmination of research to indicate the quantity of sales and expected gross sales revenue during the planning period. The forecast is the singular most important piece of information in the plan. A good plan will describe projected sales in the executive summary, but present well-documented information here on specific market data and how sales are expected to occur during the first three to five years of business.

A sales forecast includes quantity of sales in numerical terms when the products or services can be individually identified. The number of bicycles a shop will sell or the number of vacation plans a travel agency will market can be documented. Merchandisers, on the other hand, have hundreds of products to itemize, and in these instances sales revenues should be summarized.

Most businesses—even retailers—have a few items that constitute a majority of sales. A commercial nursery may receive 60 percent of its revenue from decorative shrubs, and an advertising agency may generate a majority of its revenue from a few corporate clients. For a merchant retailer, one category of products may dominate sales. A bookstore, for example, may earn 70 percent of its revenue from fiction paperbacks. Therefore, the sales forecast should identify the "lead" product or service, describe sales by volume and revenue, and then describe other categories of sales. The point is that success will rest on a pattern of leading sales items that must be accurately identified.

The Market Plan

The market plan describes an entrepreneur's intended strategy. It builds on the research and distinct characteristics of the business to explain how the entrepreneur will succeed. Some issues addressed in the research section may be reserved for the market plan.

Chapter 4 A Model for New Ventures: Feasibility Planning

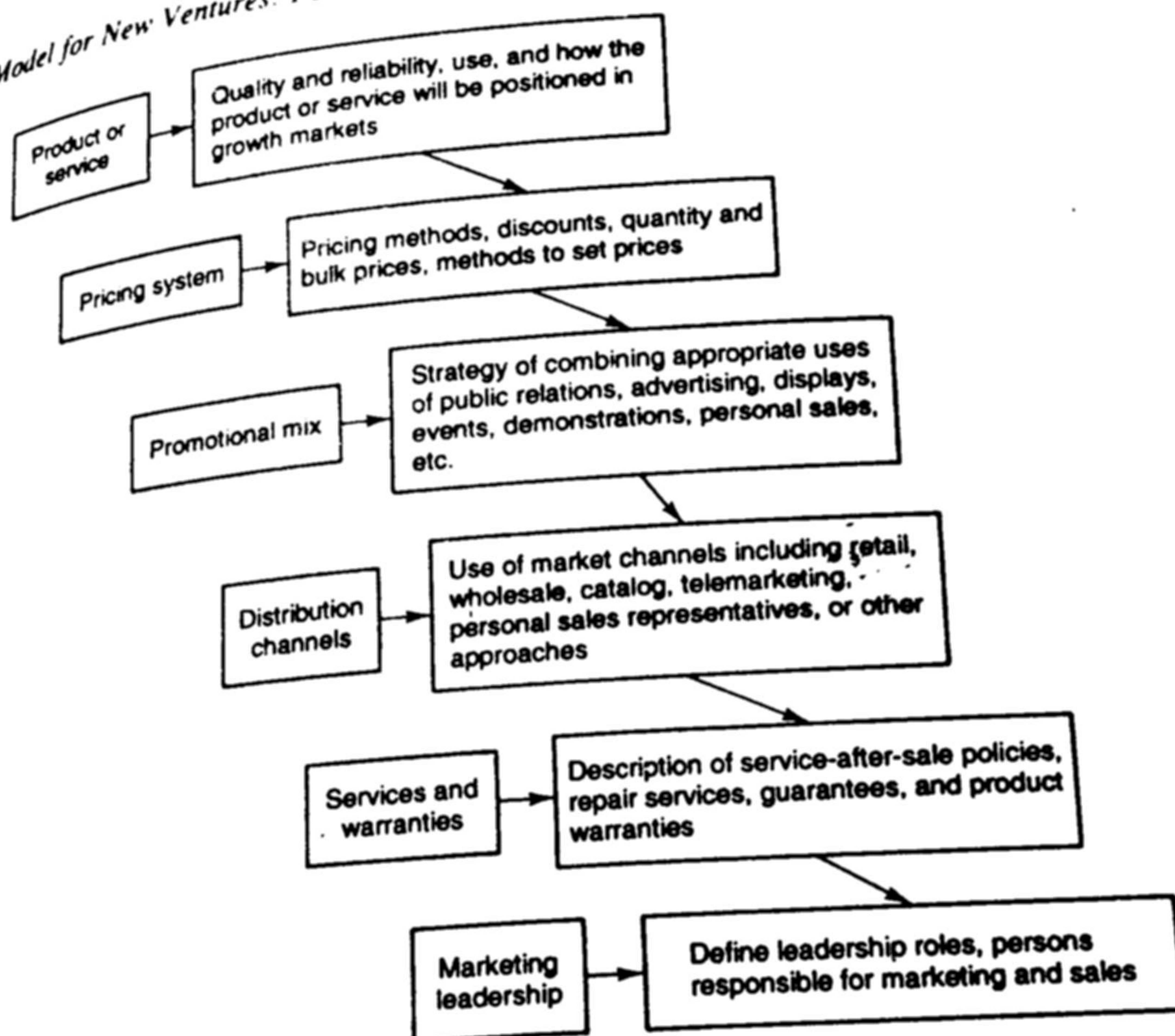


Figure 4-6 Elements of the Marketing Plan

plan, such as describing a market niche. This section usually focuses on specific marketing activities. It describes pricing policies, quality image, warranty policies, promotional programs, distribution channels, and other issues such as service-after-sale and marketing responsibility. These are described in the following paragraphs and outlined in Figure 4-6.

Prices. Well-defined prices are obviously necessary to project sales volume and financial performance. As discussed earlier, prices also indicate quality and product image, and depending on the channels of distribution, prices will reflect the nature of the business. Pricing policies relate to bulk, wholesale, retail, and discount methods used to set prices. Such methods as cost-plus pricing or setting prices to match those of competitors indicate how entrepreneurs will make strategic pricing decisions.

Promotions. Advertising and promotional strategies must be consistent with the product or service image. For example, quality office furniture is not apt to be sold through discount newspaper ads. Choosing proper media for advertising is one

aspect of the plan, but introductory strategies should relate to the start-up stage. For example, a new software program may be introduced at computer trade shows, be demonstrated at seminars offered to select clientele. Software developers may also sponsor business contests, set up displays in bookstores or computer retail outlets, or provide educational versions of programs to universities. The promotional mix is determined by a conscious decision, selecting various promotional tools from advertising, personal selling, public relations, point-of-purchase displays, sampling, and direct-mail solicitation, among others.

Distribution Channels. If distribution channels have not been identified earlier, they must be described here. For example, unusual gift items ranging from greeting cards to imported beef fillets are sold through catalogs, but Hallmark opened chain stores in shopping malls nationwide to market gifts and greeting cards.²⁷ Liz Claiborne Inc., reached \$3 billion in sales by positioning fashionable women's clothing in department stores through regional distribution centers, but recently the company opened a chain of exclusive stores supplemented with catalog sales.²⁸

Service and Warranty Considerations. Most retail stores offer warranties and service-after-sale guarantees in the event a product requires repair or adjustment. Often the distinguishing characteristic of a car dealership is its service and warranty policies. Appliance dealers may also base their strategies on follow-up services and warranties. Telemarketing companies invariably offer money-back guarantees because customers cannot evaluate products before they buy. On the other hand, there are many cash-and-carry discount outlets that sell "seconds" or flawed merchandise, and customers rarely expect warranty service.

Service companies also compete on warranty and service-after-sale policies. Software firms, for example, typically have "hotlines" for answering customer inquiries. Because software programs are updated with new or enhanced versions, an important question to resolve is whether the entrepreneur will provide free updates, discounts on new versions, or trade-in allowances. In estate planning, a recent new service in which consultants help clients plan their investments, service after sale includes periodic reviews of clients' portfolios, investment newsletters, and special reports on tax laws and legislative activities.²⁹

Marketing Leadership. The market plan should address the way in which organizational members will be involved in the marketing effort. From a strategic perspective, investors want to know who is going to actually take the lead in making customer sales. If the venture requires a sales force, then issues such as sales training, commission structures, recruitment, and sales management become important.
Investors and lenders are accustomed to seeing two general types of poor business proposals that get rejected. First, there are technically competent entrepreneurs who have great ideas but who know very little about marketing. They provide an overkill on product attributes but ignore marketing strategy. Second, there are super salespeople with brilliant ideas who are overenthusiastic.

sales without providing sufficient supporting evidence to convince investors or lenders that they can achieve the results.

A successful combination would be a team with competent technical people, enthusiastic salespeople, and, between them, someone who can manage the "business" of being in business. Although a later section specifically addresses leadership, sales responsibility must be distinguished because market strategies often reflect prerogatives of the person who will pilot this effort.

Manufacturing or Operations Plan

Depending on the nature of the business, a manufacturing or operations plan may not be required. Many small businesses that offer personal services will have little to say about operations and nothing to say about manufacturing. For ventures that manufacture, design, or sell products, as well as for service firms that require capital equipment, this section is important. Figure 4-7 illustrates elements of the manufacturing or operations plan.

Facilities. Nearly every business requires physical facilities. Retailers are usually involved in choosing a location and either securing a lease or purchasing a store. Manufacturers face far more complex issues in leasing or purchasing properties, assuring transportation services, and dealing with legal issues such as EPA requirements and zoning ordinances. Service enterprises will be concerned with having offices easily accessible to clients. Professional businesses require expensive suites in prime locations.

Facilities include fixtures, furniture, equipment, parking space, and renovations necessary to open for business. Simply signing a lease and installing a telephone is rarely sufficient. Equipment lists are usually prepared so that potential investors can evaluate lease-buy decisions and identify collateral. Start-up costs for renovations,

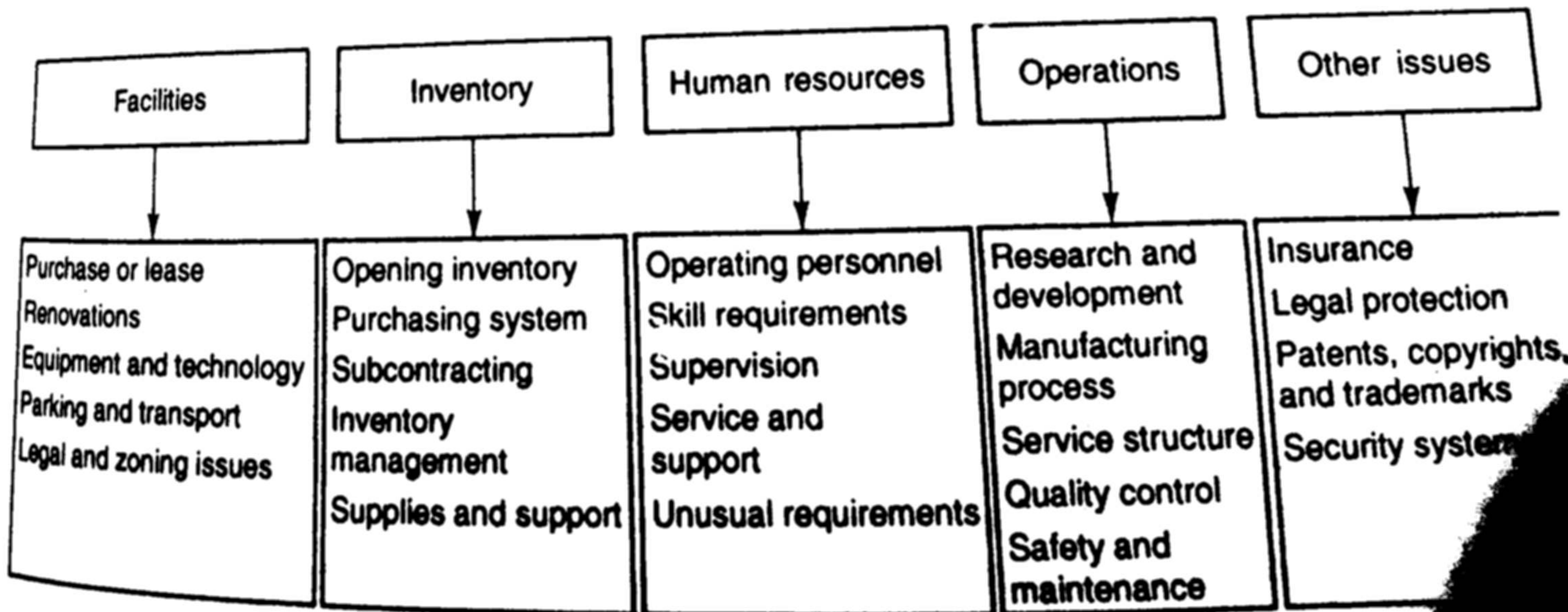


Figure 4-7 Manufacturing and Operating Elements

fixtures, and equipment installation should also be itemized because they represent "sunk costs"—costs that are essential and unrecoverable if the venture fails to open for business.

Inventory Management. Retailers will describe beginning inventory required to open for business and explain how merchandise will be replenished. Manufacturers will describe raw materials and supplies needed in inventory prior to production, and they will also describe projected finished-goods inventory at opening. Many ventures subcontract production; consequently, this section may be simplified to include cost estimates from subcontractors and operational plans for filling inventory. Service-based enterprises may have no inventory to address.

With the exception of personal service firms, entrepreneurs will have to explain their *inventory control* systems, keeping in mind that they are writing a feasibility plan, not a production manual. That is, entrepreneurs should be able to describe briefly how inventory is purchased (or made) and explain the logic behind forecasts for inventory requirements. A sales forecast developed in the marketing research section will anchor inventory requirements, but because inventory must be purchased well in advance of sales, inventory expenses will almost always precede sales revenue. This situation is further complicated by *seasonality*, in which businesses experience peak sales periods and virtual droughts. Poor inventory and purchasing controls can result in "stockouts" during peak periods and excessive inventory stockpiled during sales droughts. Because poor inventory management is one major reason for business failure, investors and lenders are on guard to watch for carefully planned inventory systems.

Human Resource Requirements. From a manufacturing viewpoint, human resource requirements should be summarized with information on the number of personnel and type of skills needed. If the business depends on unusually talented personnel, such as research scientists, then they should be identified. In most instances, specific personnel details can be omitted, but an adequate description is required for management and technical staff.

Similar summaries are required for retail businesses, but services often rely on a few individuals with special qualifications; therefore, human resource requirements may become quite detailed in the plan. An export agent with markets in Japan, for example, may require someone adept at dealing with Japanese business executives (perhaps a Japanese partner).

Operational Rationale. If the firm will engage in R&D, the plan should spell out the extent of this effort. If operations include manufacturing, the plan should describe vendor relations, supply requirements, maintenance expectations, and transport requirements. Manufacturers also will be expected to describe their quality control policies, safety requirements, and other specific operations related to the enterprise. For example, a biotech company producing new enzymes must show how its hazardous waste is disposed of, and a food-processing company must describe how it meets health and safety standards.

If the company is primarily concerned with marketing, then the market planning section described earlier should be sufficient without further elaboration. However, if success depends on unusual operational procedures (such as product installation and training), then these should be explained.

Legal and Insurance Issues. Most businesses must consider insurance and legal protection to avoid disasters. Specifically, entrepreneurs will need business liability insurance, and when the business relies on a few talented people, the founders may want to purchase personal life and disability insurance on key people. Restaurants will carry substantial fire insurance, and retailers will insure their inventory. Protection through contractual arrangements for markets, supplies, product licensing, and franchise rights may also be essential.

Leadership—The Entrepreneurial Team

Recall an earlier comment that investors put greater emphasis on the entrepreneurial team than on the business concept. This has become an axiom common among venture capitalists who will buy into an "A team with a B product" faster than they will buy into a "B team with an A product." Consequently, entrepreneurs must take care to profile the entrepreneurial team honestly but effectively. They should emphasize team members' strengths, past successes, and positive characteristics, and they should include brief résumés of the principals. Each person's role in the new venture should be described briefly, including board members or investors who may not be involved directly in operations yet be able to influence decisions.

Major Events, Risks, and Progressive Checkpoints

Major events, critical risk factors, and activities that constitute progressive checkpoints are important to delineate in the plan. They provide the entrepreneur with a set of controls for monitoring the new venture. Major events might include a schedule for lining up facilities, testing prototypes, hiring personnel, acquiring inventory, and staging a grand opening. Figure 4-8 shows how a desk-top publishing firm scheduled its start-up events.

After the business is started, a schedule of important events might include periodic performance reviews, meetings with stockholders, and special promotions designed to position the business in new markets. An enterprise may have to leap hurdles during each stage, such as obtaining FDA approval on a new medical instrument or obtaining a patent for a new product.

Critical risk factors should be identified to help prevent unforeseen disasters. For example, if success depends on holding product costs below a certain point, and those costs escalate, then the business may fail. If success depends on entering markets without competition, and competitors appear, the venture is threatened. If an entrepreneur has assumed that certain economic conditions will prevail (such as stable interest rates), and these things change, the business may be at risk. Every business

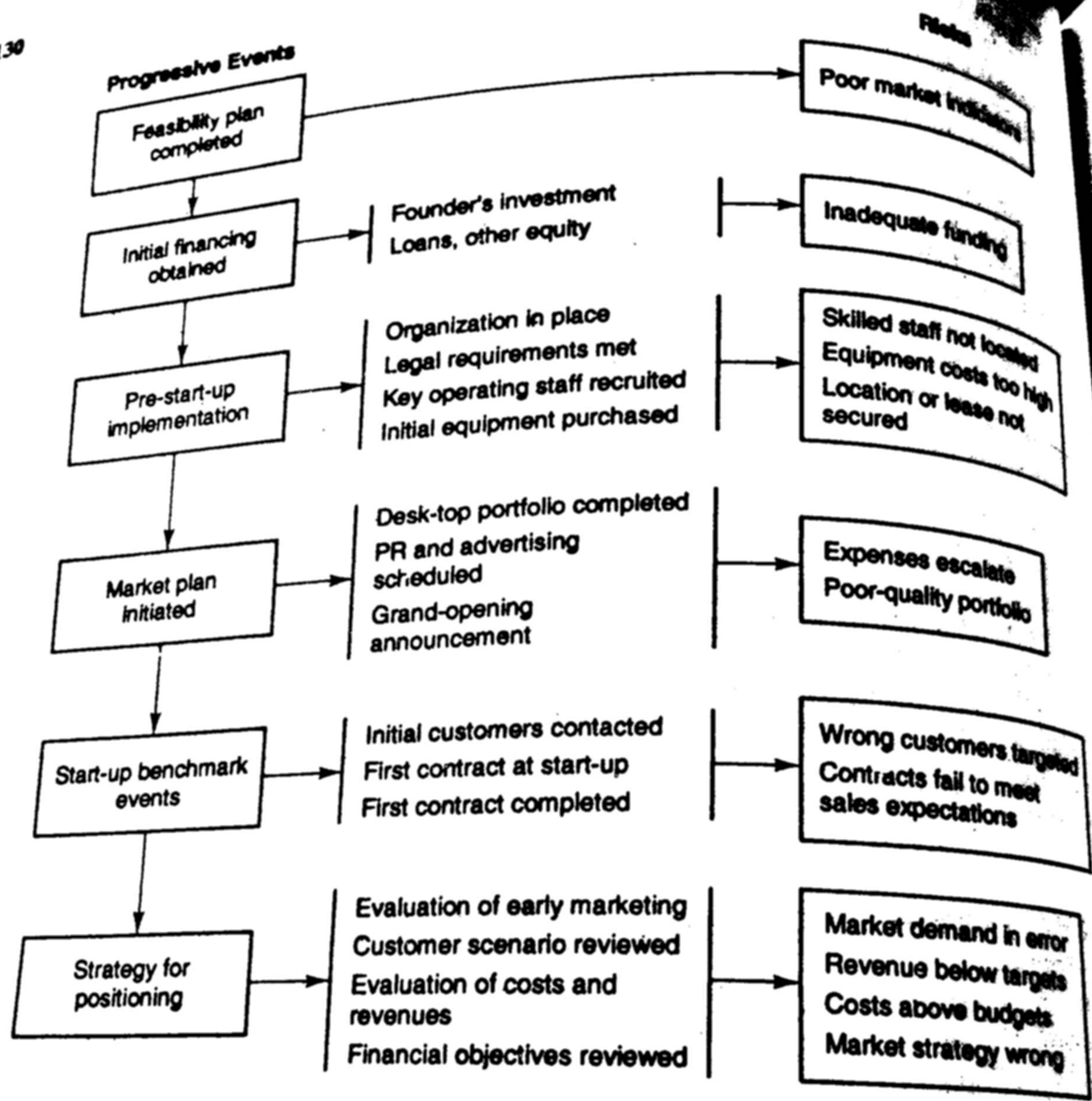


Figure 4-8 Schedule of Major Events for a Desk-top Publisher

is predicated on certain assumptions, and when these assumptions are faulty the business is affected.

Financial Documentation

Since money is the objective measure used to gauge a firm's progress, it follows that financial statements come under close scrutiny. Financial statements for a new venture, called pro formas, are projections based on previously defined operating and marketing assumptions. If earlier parts of the plan are accurate, the financial pro formas are completed with little difficulty. However, if marketing research or cost data are faulty, these efforts can be painful.

An income statement, or profit and loss statement, is required to show revenue, cost of goods sold, operating expenses, and net income. Cash-flow budgets reflect information from the profit and loss statement adjusted properly for credit sales (actual cash flow indicated rather than accrual income), non-cash expenses (depreciation), and cash obtained and used outside of operational income (infusions of capital from investors and cash payments on loan principle). A projected balance sheet will summarize assets and liabilities, and a break-even analysis will reveal when the enterprise begins to turn a profit.

The income and cash-flow statements are typically developed for monthly information during the first year of operations, then quarterly for at least two successive years. Many investors prefer to see five-year plans with footnotes to the statements indicating assumptions about growth or changes in performance. A balance sheet is usually prepared in a "comparative form" with the firm's position at start-up and at year-end for up to five years.

In addition to these documents, a venture in the development stage without income will provide a development budget outlining expenses and overhead. For example, the commercial development of videocassette recorders (VCRs) began in 1965 through research by several small U.S. and Japanese companies. By 1971 these pioneering firms had given up because of a lack of funding, and research migrated to university centers. Funding was still insufficient, and research evolved toward industrial backers. Three Japanese firms—Matsushita, JVC, and Sony—took the lead, and in 1974, after a decade of research by a dozen different organizations, Sony introduced the first commercial VCR. Observers who studied failures found that researchers had inadequate development budgets, thus opening opportunities for others to put resources behind successful VCR projects.³⁰

During a development period, people must be paid, research supported, facilities and materials underwritten, and start-up costs funded. Although most small businesses have a brief pre-start-up development period measuring in weeks or months, they require expenditures that must be covered. The plan should spell these out clearly so that proper allowances are made for financial underwriting.

► CHECKPOINT

Identify each major section of the feasibility plan and describe one key activity in each that an entrepreneur should address.

Explain how a sales forecast influences marketing and financial plans.

RESPONSIBILITY FOR BUSINESS PLANNING

The entrepreneur is the most knowledgeable person about the proposed business, and although there are many ways to get help, the entrepreneur is ultimately responsible for planning. No outsider will have the same vision or motivation, and vision and

motivation are prominent features that emerge from between the lines. Unfortunately, many entrepreneurs do not know how to write a plan, and many others avoid it.

One solution to this problem is to work with a consulting organization that has an established track record in new venture planning. Ernst & Young, Deloitte & Touche; Peat, Marwick, Mitchell & Company; and Price Waterhouse are a few companies with services for new venture planning.³¹ A second option is to seek assistance through universities with entrepreneurship centers. A third option is to seek state agencies established to encourage venture development, or one of many federal

With all the help available, it is curious that so few entrepreneurs want to create a plan. It is the most compelling way to attract investors and to convince lenders of a venture's worth, but it is also a prodigious marketing tool, the entrepreneur's pronouncement to the world that a new and exciting venture is about to be born. Perhaps most important, the plan is an asset to the entrepreneur as his or her personal set of guidelines for creating a successful venture. It is a toolbox of decision-making criteria and a synopsis of expectations, objectives, and essential activities.

Writing the plan can be an extraordinary task, but the entrepreneur is the only person who can articulate the necessary information effectively. However, the plan should not be written in isolation. To the contrary, the more help an entrepreneur can garner the better the final plan will be, but its composition rests squarely with the entrepreneur. As a closing note, we must repeat that a feasibility plan is not carved in granite. It is flexible and should be a pragmatic effort to present an entrepreneur's proposed enterprise logically and succinctly.

► CHECKPOINT

Explain why planning benefits an entrepreneur and why the planning process can, by itself, be helpful to an entrepreneur.

Consider how you might realign a plan to fit a hypothetical business.

▲ ▲ SYNOPSIS FOR LEARNING

1. Discuss the concept of a planning paradigm for new ventures.

A planning paradigm is a model for new ventures, and although there are several models to choose from, there is no fixed set of guidelines or one ideal model. Planning should be pragmatic—a feasibility study that gives information needed to investors and bankers for their decisions but does not entangle the entrepreneur in busyness. A feasibility plan is more important to entrepreneurs to establish decision-making criteria concerning products or services, markets, and finances. A planning paradigm is also important to help entrepreneurs envision the future of a business, focusing narrowly on the present.

Chapter 4 A Model for New Ventures: Feasibility Planning

2. Describe the four-stage growth model of entrepreneurship.

The four-stage growth model identifies *pre-start-up*, *start-up*, *early growth*, and *later growth* stages. The *pre-start-up* stage is concerned with planning the venture and preparing to open the business. During this first stage, the business concept, products and services, customer scenario, markets, operating procedures, and projected financial resources are researched and described. In addition, the entrepreneur must assemble resources and organize the venture for opening. The *start-up* stage is concerned with initial business operations. This is the critical period of intense development when a venture is given the acid test of operations. It is a stage in which "reality shock" sets in as an entrepreneur positions the business to compete in the real world. The *early growth* stage assumes the venture has been initially successful and is growing at a healthy rate. It is a stage that requires careful coordination of resources so that an entrepreneur does not outrace his or her ability to underwrite growth, nor grow too slowly to be profitable. The fourth stage represents an evolution into an established enterprise when the venture must be professionally managed.

3. Discuss the fundamentals of a good feasibility plan.

A good feasibility plan will identify the essential information needed by investors and bankers to make decisions about equity financing or loans. It will be succinct, yet thorough. It will be clearly written and include essential details with supporting documentation without the tedious attention to detailed research that might characterize a fully developed business plan in a major company. The feasibility plan is meant to be an *initial* effort to show that a business idea can be realized and to give reasons why it will succeed. The plan will describe the entrepreneurial team and the crucial assumptions underpinning projections for success.

4. Explain the major components in a feasibility plan.

The first component is the *executive summary*, which is a synopsis of the enterprise. The second is the *business concept*, in which the product or service is described, the entrepreneur's purpose and major objectives are identified, and the concept of how business will be conducted is defined. The third section is usually the *marketing* section, presented here in two parts: *marketing research and analysis* and the *marketing plan*. Marketing research identifies the customer, market niche, and assumptions of price, promotion, and distribution. It is critical here to culminate in a *sales forecast* that clearly establishes the volume and revenue expected from business operations. The marketing plan focuses on strategies employed to make the business succeed, and it defines the pricing, promotional mix, distribution system, and responsibility for marketing. The next component is the *manufacturing and operations* section, which describes how business is conducted. A manufacturer will describe facilities, technology, materials, processes, human resource requirements, and administrative systems. A service firm will identify most of the same elements but will emphasize human resource requirements and skills. An important component is devoted to the *entrepreneurial team*. In this section, principal people are identified and their responsibilities delineated. Finally, a *financial* section will provide financial statements that include at least profit-and-loss, cash-flow, and projected balance sheet summaries

for a minimum of three years. In addition, a break-even analysis and a development plan will be presented.

5. Explore planning responsibilities and ways in which entrepreneurs can get assistance.

The entrepreneur is ultimately responsible for the feasibility plan, but there are ways to find help. The Small Business Administration has specific programs for new ventures. Major consulting firms also have small business divisions. State local agencies provide assistance, and Chambers of Commerce can direct entrepreneurs toward help. In addition, a number of universities have centers for entrepreneurs specifically developed to help new ventures.

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“I Can’t Believe It’s Yogurt!”

“I can’t believe it’s yogurt,” an outburst by an obscure customer, became the founding name of one of the nation’s most successful new ventures. The company—the I Can’t Believe It’s Yogurt!—is the result of hard work and solid planning by founders Julie and Bill Brice. In 1979, Julie and Bill were students in Dallas, Texas. Julie had only recently completed her introductory courses in business at Southern Methodist University, and the brother-and-sister team were busy working at a local ice cream shop to help pay college costs. Before the year ended, they had purchased the shop and converted from ice cream to yogurt. The idea came to them as their friends and students became preoccupied with low-calorie foods and health-conscious diets. Yogurt fit the bill.

Julie and Bill worked 70 to 80 hours a week in their store, expanded to a second store, and managed to carry a full load of courses at SMU. Both graduated with honors and soon set about creating Brice Foods, Inc., the parent firm of their current system of franchise operations. During those early years, however, the Brices behaved more as students running a pair of small businesses than entrepreneurs trying to create an integrated company. They admit that they did little planning beyond ways to make ends meet. The venture was little more than a classroom exercise in entrepreneurship, and the Brices only had \$10,000 tied up in equipment when they started. The weekly income from sales returned that investment quickly.

After they graduated and began thinking about their careers, the notion of Brice Foods as an expanding franchise business pushed them into systematic planning. For both, planning was the most difficult part of business, and it

consumes much of their time today. In any case, less, planning has paid off.

The first stage of planning was creating a small chain of a dozen stores. Franchising was not yet a consideration. The cost of buying yogurt was too high to provide good profit margins, and through careful cost analysis, the Brices decided to build their own factory to produce the mix. Within a year after accomplishing this feat, they found themselves trying to manage too many locations and decided to franchise in a corporate format. By 1985 they had expanded to nearly 20 states. This expansion also created a distribution problem, so further changes resulted in plans for a fully integrated company.

Today, Brice Foods, Inc., includes a European purchasing network for yogurt ingredients, a large dairy that provides millions of gallons of milk needed for ICBIY stores, yogurt production facilities, and two distribution systems. One is directed at franchisees and the other supplies a wholesale market for the ICBIY products to major grocery chains such as Safeway, Krogers, and Skaggs.

Julie and Bill Brice are innovators who have expanded into cookies and other confections to complement yogurt. They have a network of nearly 200 stores and expect to increase in size during the 1990s. Ranked in the top ten “under-30 entrepreneurs” in the United States, the Brices point to an extraordinary record of having no franchise failures. They conclude, is due largely to their emphasis on business planning and training franchisees.

The Brices have a vision of the future, and they are determined to be the

They want every 100 percent philosophy in the in community scholarship through the preneurs. The excellent business did not place paramount their first

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They want every customer in every store to be 100 percent satisfied, and they instill this philosophy in their franchisers. Both are also active in community affairs and sponsor a nationwide scholarship contest for "new business plans" through the Association of Collegiate Entrepreneurs. They attribute their success partly to excellent business planning, and although they did not plan their initial venture, planning was paramount to building the company beyond their first two shops near SMU.

CASE QUESTIONS

1. Identify the four stages of growth and how they might be described for ICBIY.

2. What planning challenges faced the Brices during the start-up stage when they defined the business as more than two local shops selling yogurt?
3. A central planning issue is the "business concept." Describe the business concept for ICBIY, and tell how that concept seemed to change over time.
4. Discuss what you feel to be the key success factors for Brice Foods. Why did the first stores succeed, and what assures success today?

Sources: Roger Thompson, "Business Plans: Myths and Reality," *Nation's Business*, August 1988, pp. 16, 20. Also Julie Brice, "Focus on Youth," keynote address at the Association of Collegiate Entrepreneurs convention, Washington, DC, March 12, 1988.

CASE 4-2

The Company as an Environmental Tool

Patagonia Inc., was the brainchild of Yvon Chouinard, a middle-aged sportsman and weekend rock climber who turned his interests in outdoor sports into a multimillion-dollar enterprise. Patagonia has been one of the premiere distributors of outdoor clothing and unusual sporting accessories for nearly a decade. Specializing in products such as Alpine climbing attire and tropical beach attire for Jet Skis, the company uses mail-order techniques to market to a small segment of the population able to afford extravagant prices for the highest-quality product line of its kind.

Chouinard, however, does not describe himself as an avid businessperson or an astute planner. He explains success as having defined a clear market niche, estimated what people wanted and could afford, then satisfied their interests through exquisite catalogs, advertise-

ments, and public relations. Having accomplished his objectives of serving this market, he was ready to get out of business several years ago. "I didn't need the power of having a bigger business. I had no more reason to stay," he explained. "I'd made a successful company. I'd accomplished what I set out to do."

Chouinard had always been concerned about the environment, and he was on the verge of selling his company in order to pursue his personal interests in environmental protection. "What turned me around was the discovery that I could use the company as a tool," he said. "I'd never equated business with doing anything good. . . . I'd always thought that if you're going to do something good, you do it personally."

Today, Chouinard directs the company's profits entirely to environmental causes, but it

is more than giving away money. The company recycles all its paper and more than 70 percent of its waste. It even has a system for recycled waste from employees' homes, and through community programs, Patagonia sponsors environmental speakers and encourages its executives to pursue clean-up efforts. This transformation in purpose has had an interesting effect on the company. Managers and employees not in tune with Chouinard's philosophy have left, but in their place have come more dedicated people and many high-powered executives who are there to pursue the environmental purpose of being in business. Profits have increased beyond expectations because earning more profits provides the financial strength to fund more projects. As the company has grown, its prominence has given management the added strength of political leverage.

In communities in several states where Patagonia has operating facilities, managers and employees can demand environmental action. For example, when Chouinard was contemplating locating facilities in Bozeman, Montana, he lashed out at city officials, literally blackmailing them into environmental action. "I happened to tell them they had an ugly town," he explained. When they asked him about moving there, Chouinard replied, "Well, not until you guys get some controls over your future. I'm leaving California because we trashed the quality of life out there. I don't want to come up there and do the same goddamn thing."

Bozeman put in place campaigns to clean out strip malls, tear down billboards, and waste recycling, and set up long-term plans for environmental protection. Chouinard repeated this scenario several times, and the leverage of his company has paid off. His company still sells clothes and sporting accessories and it has global markets now in two categories: those who want his extravagant products, and those who feel good about doing business with a company that is doing something positive about the environment.

CASE QUESTIONS

1. Describe company mission and objectives for Patagonia during its early and recent endeavors. In your opinion, do these conflict, or are they compatible with one another?
2. A critical part of good business planning is knowing why a company is in business and how it will serve its customers. Explain these issues with respect to Chouinard as an entrepreneur and with respect to his company.
3. What would you envision as requirements for Patagonia's market research activities? Financial planning activities?

Sources: Yvon Chouinard, "Coming of Age," *Entrepreneur*, April 1989, p. 54. Also "Patagonia's Commitment," *Entrepreneur Institute Insights*, Spring 1990, p. 1.

PART TWO

▲▲ Product and Service ▲▲ Concepts for New Ventures ▲▲

Part Two is concerned with developing products, obtaining legal protection for them, and creating new service businesses. The presentation begins with Chapter 5, which discusses product and service concepts. Topics include inventions, technology, new processes, and a model of product innovation. Chapter 6 addresses patent, copyright, and trademark protection. It also describes the problems facing entrepreneurs in protecting their ideas, with suggestions on how to resolve those problems. Chapter 7 focuses on service-related business ventures and the challenging opportunities that exist today for developing new services in an information age.