



5th Edition

ENTREPRENEURSHIP

Starting and Operating A Small Business



Steve Mariotti

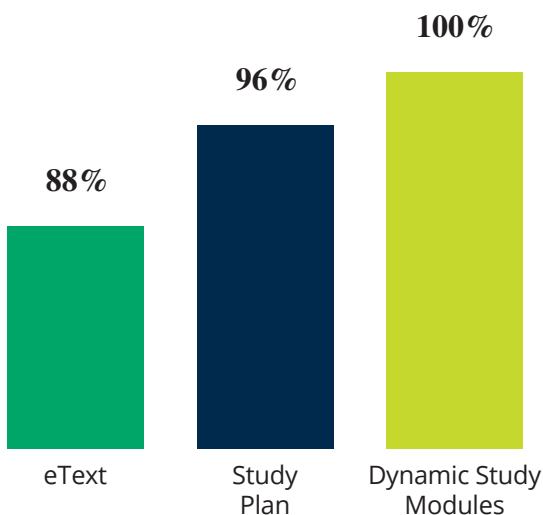
Caroline Glackin

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ENTREPRENEURSHIP: **STARTING & OPERATING** **A SMALL BUSINESS**

Fifth Edition

Steve Mariotti • Caroline Glackin



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Special thanks to Kathryn Davis, Shelby M. C. Davis,
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Also to my mother, Nancy Mason Mariotti,
who taught me that a great teacher can affect eternity.

—*Steve Mariotti*

To my children, Elise and Spencer, whose support and love
are essential parts of this book.
To my parents, Howard and Maria Wiedenman,
who truly understood the importance
of education, my love and gratitude.

—*Caroline Glackin*

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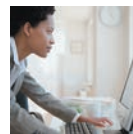
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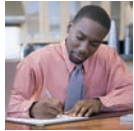
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Preface

New To This Edition

Entrepreneurship: Starting and Operating a Small Business, Fifth Edition, contains substantial new content and changes, including the following:

- Chapter Learning Objectives. The objectives have been revised to conform more fully to the categories of knowledge acquisition, comprehension, application, analysis, synthesis, and evaluation commonly assessed in higher education. Each learning objective is associated with a primary chapter topic.
- Three new short End-of-Chapter Case Studies: Frankie Patterson, MekaMon Robots, eSight Eyewear. Numerous updated cases with the Bakery Companies most revised.
- Four new longer End-of-Chapter Case Studies: Traci Lynn Jewelry, Hammer & Nails, Green and Clean, and Scentsy. Numerous updated cases with Foursquare Swarm the most revised.
- Step into the Shoes, Entrepreneurial Wisdom, BizFacts, and Global Impact Features have been updated and expanded with 10 new featured items, including eight Step into the Shoes, one Global Impact, and one BizFacts.
- Global Impact Features. Among the featured people and organizations are: Pixlee, Lit Motors, Pan Zhang Xin Marita, Gary Vaynerchuk, Burrow, Outcome Health, Chrysler Motors, SafeWander, Tom's, IQVIA, and Doublemint. These features connect chapter content to business facts and examples to reinforce learning.
- Business Model Canvas. The Osterwalder and Pigneur Business Model Canvas is introduced in Chapter 2. Students are encouraged to develop Business Model Canvases and to explore the Lean Start-up process.
- Canvas Connections. This feature has been added to facilitate the use of the customer discovery process and for students to create and evolve their Business Model Canvases as their knowledge and understanding increases.
- BizBuilder Business Plan Questions. These have been modified to clarify the work and connect the content to student work using the business plan templates.

New sections/topics

Each chapter has been substantially revised to include current content and address emerging topics in entrepreneurship and small business management. Some specific changes include:

- Discussion of necessity-based versus opportunity-based entrepreneurship
- Inclusion of an updated Readiness Assessment
- Addition of unicorns and an improved explanation of corporate entrepreneurship

- New section on skills and careers
- New section and illustration for the lean start-up methodology
- Revision of the business plan overview
- Update of the list of business plan competitions with the addition of pitch and business model competitions
- New section on effectual reasoning
- Addition of materials regarding the extended marketing mix and social media marketing with illustrations
- New section on creating a sales force
- Substantial revisions to the accounting and financial chapters for increased clarity and simplicity
- Address Enterprise Resource Planning (ERP)
- Inclusion of direct selling as a go-to-market strategy

Solving Teaching and Learning Challenges

Entrepreneurship: Starting and Operating a Small Business (ESOSB), Fifth Edition is the newest edition in a line of entrepreneurship textbooks written by Steve Mariotti, founder of the Network for Teaching Entrepreneurship (NFTE). Once again, it is written with professor and entrepreneur Caroline Glackin, and it promotes entrepreneurship as a career option for college students.

This textbook is organized to follow the life cycle of an entrepreneurial venture from concept through implementation into harvesting or replication. It is a comprehensive text written in light of the reality that college students often take only one course in entrepreneurship, and the topic is covered in a multitude of ways. For instructors who will teach the course as a “business plan,” *ESOSB 5e* offers step-by-step content to build a plan over a semester or a quarter, as well as cueing questions for students working through the Lean Start-up process.

Business students, as well as those from other disciplines, can benefit from *ESOSB*. For business students, it recasts their prior learning from a typical corporate context and focuses it on small and entrepreneurial enterprises. For students in such fields as hospitality, the arts, engineering, and fashion merchandising, the text introduces key business concepts and provides examples from a broad range of careers. Most importantly, *ESOSB 5e* is a balanced mix of the academic and applied components of entrepreneurship education. Students are introduced to the theories, methods, and knowledge and skills required of entrepreneurs and are immediately given practical examples and discussion opportunities. For those who focus on the management of small and entrepreneurial ventures, there is an abundance of high-quality material on the critical topics of management, human resources, marketing, and operations for such ventures. For those charged with teaching a comprehensive introductory course, all of the components are provided.

To improve student results, we recommend pairing the text content with **MyLab Entrepreneurship**, which is the teaching and learning platform that empowers you to reach every student. By combining trusted author content with digital tools and a flexible platform, MyLab personalizes the learning experience and will help your students learn and retain key course concepts while developing skills that future employers are seeking in their candidates. From **Mini Sims** to **Dynamic Study Modules**, MyLab Entrepreneurship helps you teach your course, your way. Learn more at <http://www.pearson.com/mylab/entrepreneurship>.

The **Study Plan** gives students personalized recommendations, practice opportunities, and learning aids to help them stay on track.

This allows students to focus their study time by pinpointing the precise areas they need to review, and allowing them to use customized practice and learning aids—such as videos, eTexts, tutorials, and more—to help students stay on track.

Study Plan

Recommendations Progress All Chapters

Practice the learning objectives, then take a Quiz Me to prove mastery and earn mastery points (MP).

Recommended learning objectives	
1.1 Summarize what entrepreneurs do.	Practice Quiz Me
1.2 Examine how free-enterprise economies work and how entrepreneurs fit into them.	Practice Quiz Me
1.3 Identify and evaluate opportunities to start your own business.	Practice Quiz Me
1.4 Explain how profit works as a signal to the entrepreneur.	Practice Quiz Me
2.1 Describe a feasibility analysis and choose when to create one.	Practice Quiz Me

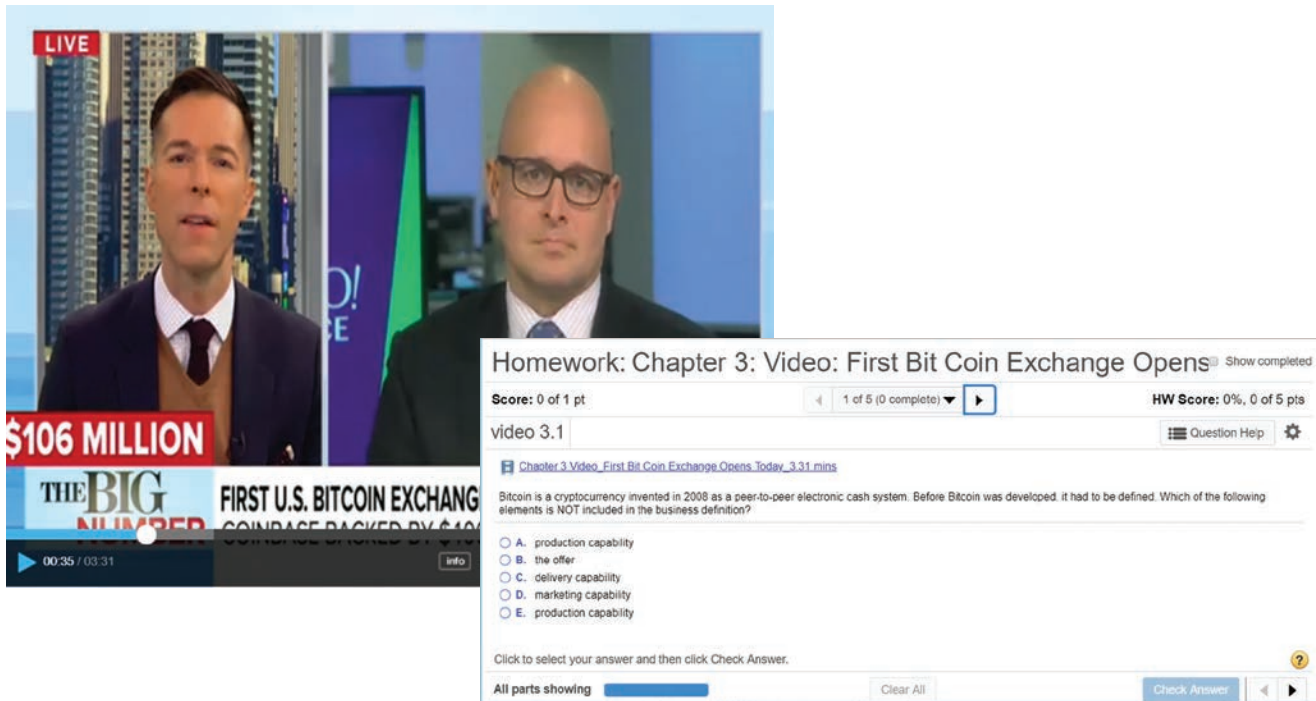
Mini Sims put students in professional roles and give them the opportunity to apply course concepts and develop decision-making skills through real-world business challenges.

The simulations use each student's decisions to create various scenario paths that help them understand the impact their decisions can have on an organization.

The collage displays three screenshots from an Entrepreneurship course interface. The top screenshot, titled "Learning Objectives", shows a progress bar at 0% and a list of three objectives: LO 3.1 (Define your business), LO 3.2 (Articulate your core beliefs, mission, and vision), and LO 3.5 (Calculate the value of a business). The bottom-left screenshot, titled "Decision Point: Starting Your Business", presents a scenario where the user has done research and wants to make a decision. It offers five options: "File articles of incorporation", "Hire employees", "Write the business plan", "Lease the location", and "Obtain business financing". The bottom-right screenshot, titled "Scenario", describes a situation where the user has inherited \$200,000 and decided to start a sandwich shop. It asks the user to meet challenges and make decisions to realize their dream. The progress bar for this scenario is also at 0%.

Dynamic Study Modules use the latest developments in cognitive science and help students study chapter topics by adapting to their performance in real time.

Video Exercises are available for select chapter topics to help engage students and hold them accountable for their learning.



The screenshot shows a video player interface. The video content is a news segment with two men on screen. A red banner at the top left says "LIVE". A red banner at the bottom left says "\$106 MILLION". A blue banner at the bottom center says "THE BIG NUMBER". A white banner at the bottom right says "FIRST U.S. BITCOIN EXCHANGE COINBASE BACKED BY \$100 MILLION". The video player has a progress bar at the bottom showing 00:35 / 03:31. Overlaid on the video is a homework interface for "Chapter 3: Video: First Bit Coin Exchange Opens". The interface shows a score of 0 of 1 pt, 1 of 5 questions complete, and a HW Score of 0% of 5 pts. The question asks: "Bitcoin is a cryptocurrency invented in 2008 as a peer-to-peer electronic cash system. Before Bitcoin was developed, it had to be defined. Which of the following elements is NOT included in the business definition?" The options are: A. production capability, B. the offer, C. delivery capability, D. marketing capability, and E. production capability. The interface also includes a "Check Answer" button and a "Clear All" button.

Chapter Learning System

One of the challenges faced by the instructors is to create an authentic experience for the students. This text provides the below tools that help students to learn to think as an entrepreneur.

Honest Tea Business Plan

This is the plan developed by founders Seth Goldman and Barry Nalebuff during Honest Tea's first year of operations. It appears following Chapter 2 and includes a comprehensive market analysis and detailed historical financials. The business raised over \$1 million at a time when sales were less than \$250,000 and the company had operating losses. The Honest Tea plan is an excellent example for students and one that many of them will understand, to some extent, as customers of bottled tea.

The tea is brewed at a brewing and bottling facility located within driving range of the target market. The site was selected based on numerous criteria including capacity, reputation, quality control, production efficiency and willingness to invest in a long-term partnership with Honest Tea. All partners involved in the production process meet United States Department of Agriculture Hazard Analysis Critical Control Plant (HACCP) standards. We are in the process of obtaining Kosher certification from the Orthodox Union ("Circle U").

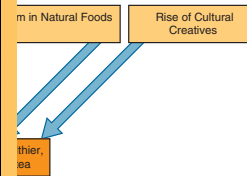
In early 1999 we will be making a change in our manufacturing process that will not affect the quality of the product but will have important ramifications for our profitability. Instead of a two-step packaging process, we will consolidate the brewing and labeling under one roof. This consolidation will save Honest Tea more than two dollars a case.

Our tea leaves are provided by internationally known companies that specialize in tea buying, blending and importation. Our primary source is Hälssen & Lyon of Germany, the largest specialty tea company in the world. Another, Assam Tea Traders, has direct ties to tea estates in the Assam District of Northern India. are in plentiful supply.

Dealing more directly with the tea at we can verify that the labor conditions and International Labor Organization that the tea is grown organically.

Factor for Quality Bottled Tea

...e fueling demand for Honest Tea refreshment beverage market.



(TD) tea and bottled water markets ...minate the beverage market, in the ...tled water have emerged as alterna-



Honest Tea, Inc.

Chapter Openers Set the Stage

Each chapter starts with an inspirational quote, an introduction, and learning objectives that provide a “road map” so readers know where they are headed. Readers connect with a story of a real business in the opening vignette that sets the stage for upcoming material.

“Step into the Shoes” of the Experts

Step into the Shoes features appear in each chapter and offer insight into the business practices of entrepreneurs and an opportunity to discuss the brief example. This feature brings the content to life with real-world application.

Step into the Shoes ...

Matching Employers and Employees—Indeed

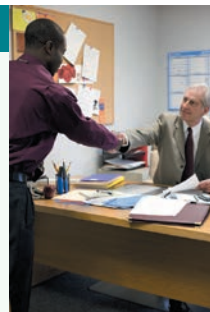
With over 200 million unique visitors per month, Indeed, a subsidiary of Recruit Holdings Co., Ltd., claims the top spot among job sites on the Internet.³ Founded in 2004 by Rony Kahan and Paul Forster, Indeed has offices in six U.S. cities and nine global cities. The service covers some 60 nations and 28 languages.

Indeed is a pay-for-performance recruitment advertising network that provides free access to jobs from company websites and job boards. It consolidates available openings into a single meta-search for job

seekers. Employers pay for the service when job seekers click on job openings.

Prior to founding Indeed, Kahan and Forster were successful cofounders of *jobsinthemoney.com*, a site for financial professionals. They sold it to Financial News in 2003 and founded Indeed a year later.

³Indeed.com, accessed March 30, 2018, <http://www.indeed.com/intl/en/ourcompany.html>.



Creatas/Thinkstock/Getty Images

BizFacts

BizFacts impart useful information regarding entrepreneurship statistics, company practices, or business applications.

BizFacts

Many salespeople work on *commission*, a percentage earned from each sale they make. A salesperson making a 10 percent commission selling cars, for example, would earn \$1,000 after selling a \$10,000 car.

$$0.10 \times \$10,000 = \$1,000$$

Entrepreneurs can use commissions to motivate sales staff. When you are starting out and cannot afford to pay sales representatives full-time salaries, you can offer commissions instead, because they get paid as you get paid and earn more as they sell more.

Entrepreneurial Wisdom

Entrepreneurial Wisdom contains insights or advice that will help students in the preparation of a business plan or management of an enterprise.

Entrepreneurial Wisdom ...

Accounting Differences between Countries

Businesses in different countries prepare and present the income statement differently and even have different names for it. In the United Kingdom, for example, the income statement is called a "group profit and loss account." Topics where global practices can differ widely include inventory measurement methods and ways in which property and equipment are valued. Countries also have varying laws regarding when a sale can be recognized as income and included on an income statement. The predominant standards are the International Financial Reporting Standards.

In the United States, United Kingdom, Denmark, Norway, Belgium, Brazil, and Japan, for instance, income from a long-term contract can only be included on the income statement as each percentage of the contract is completed. If you have done

10 percent of the work, you can show 10 percent of the income on your statement. In Germany, by contrast, you cannot include any of the income on your statement until the contract has been 100 percent completed.



Accounting rules differ among countries.
(Michaela Dusíková/Alamy)

Global Impact

Global Impact, featured in each chapter, provides examples of entrepreneurial ventures around the world or information that can be applied in global trade.

Global Impact ...

College Degrees for the Military

Active-duty members of the U.S. military and their families tend to relocate frequently, often internationally. This job-related relocation makes completing a college degree at a single traditional brick-and-mortar, four-year college difficult at best.

American Military University is a wholly online, private, for-profit, degree-granting program with students across the United States and in more than 100 other countries. Established by a retired Marine Corps officer, James P. Etter, the university has a well-defined target market: military members and their families.

Course delivery, subjects, and content are designed with the military in mind. If they have Internet access, military students can enroll and take courses. Also, military personnel earn education benefits from the government and can use them at American Military University.

American Military University has served its global target market profitably for over 20 years.

Source: American Military University website, accessed February 24, 2018, <http://www.apus.edu>.

End-of-Chapter Learning Portfolio

End-of-chapter materials help students demonstrate a working understanding of key concepts and develop critical-thinking skills.

All chapters include the following:

- **Key Terms** list.
- **Critical Thinking Exercises** that require students to consider important issues and support thoughtful responses.

- **Key Concept Questions** that review core topics.
- **Application Exercises** that give students a structured opportunity to reinforce chapter topics through experience.
- **Exploring Your Community and Exploring Online** assignments that invite students to go into their business communities or search online for information.
- **Canvas Connections**, which provide guidance for students as they evolve their Business Model Canvases during the course of the text.
- **BizBuilder Business Plan Questions**, which guide students through the development of business plan components as they learn new information throughout the book.
- **Cases for Analysis**, including one short case and one longer case with analytical questions. Cases cover a variety of issues and draw on real business scenarios. Examples of businesses that may be familiar to students include Foursquare Swarm, Urban Decay, and Amazon.com. Other organizations that may be less familiar include Happy Belly Curbside Kitchen, Gelato Fiasco, Anago Cleaning Systems, and AYZH. These cases reflect a diverse set of entrepreneurs, industries, and geographic locations.

BizBuilder Business Plan Worksheets and Templates

Students can build their business plans using the BizBuilder worksheets available at www.pearsonhighered.com under Instructor resources.

- **BizBuilder Business Plan Worksheets** provide step-by-step instructions on building a business plan.
- **BizBuilder Business Plan Template** provides a professional-looking format for a business plan that ties in with assignments in the text.
- **BizBuilder Business Plan Presentation Template** guides the student through the process of creating a PowerPoint presentation for a business plan.

The BizBuilder business plan worksheets and templates are accompanied by a **financial worksheet** template to enable students to calculate respective results by plotting relevant data in different worksheets like startup, sales income statement, cash flow, balance sheet, alt. cashflow, and key ratios.

Appendix 2 provides students with instructions on how to use the worksheets that mirror the planning process in the book and contains more questions in some areas than are found in commercially available planning software.

Developing Employability Skills

The purpose behind writing this text was to enable students to take an idea and turn it into an entrepreneurial venture. While working on this their emphasis should be on imagination, design, creation and execution. Creating a business plan requires the student to develop competencies, knowledge, abilities, attitudes, and important skills. The text along with the MyLab helps in developing important skills. In this course, and specifically in this text, students will have the opportunity to develop and practice seven important skills based on various learning features that are summarized in the following table.

Employability Skills Table				
Skills	Sections in the text covering these skills			
Written and oral communication	End-of-chapter questions—critical thinking exercises	Creating and Presenting a business plan—Chapter 2	EOC Writing Assignment—MyLab Entrepreneurship	Writing Assignment—MyLab Entrepreneurship
Critical thinking and problem solving	Critical thinking exercises	Process of developing a business plan—Chapter 2	Video Exercises—MyLab Entrepreneurship	New! Mini Sims—MyLab Entrepreneurship
Teamwork and collaboration	Process of developing a business plan—Chapter 2	Lean start-up process—Chapter 4 and Chapter 7	Chapter 13, “Management, Leadership, and Ethical Practices,” addresses this topic in greater depth.	
Leadership	Chapter 13, “Management, Leadership, and Ethical Practices”			
Creativity	Chapter 1, “Entrepreneurs and Entrepreneurship”	Chapter 2, “Pathways to Success: Processes and Instruments”	Chapter 3, “Creating Business from Opportunity,” introduces creativity and the entrepreneurial mindset.	EOC Writing Assignment—MyLab Entrepreneurship
Ethics	Chapter 13, “Management, Leadership, and Ethical Practices”	End of Chapter—Case Studies		
Information technology skills	End-of-chapter assignments—exploring online			

Instructor Teaching Resources

This program comes with the following teaching resources.

Supplements available to instructors at www.pearsonhighered.com	Features of the Supplement
Instructor's Manual authored by Caroline Glackin	<ul style="list-style-type: none"> • Chapter-by-chapter overview, objectives, and outline • New to the fifth edition • Teaching notes • Lecture enhancers • Key terms • Examples and activities not in the main book • Solutions to all questions and problems in the book

Supplements available to instructors at www.pearsonhighered.com	Features of the Supplement
Test Bank authored by Ramachandran Subramanian	Over 500 multiple-choice, true/false, and short-answer questions with these annotations: <ul style="list-style-type: none"> • Difficulty level (1 for straight recall, 2 for some analysis, 3 for complex analysis) • Type (Multiple-choice, true/false, short-answer, essay) • Learning objective • AACSB learning standard (Written and Oral Communication; Ethical Understanding and Reasoning; Analytical Thinking; Information Technology; Interpersonal Relations and Teamwork; Diverse and Multicultural Work; Reflective Thinking; Application of Knowledge)
Computerized TestGen	TestGen allows instructors to: <ul style="list-style-type: none"> • Customize, save, and generate classroom tests • Edit, add, or delete questions from the test item files • Analyze test results • Organize a database of tests and student results.
PowerPoints authored by Veronica Horton	Slides include all the graphs, tables, and equations in the textbook. PowerPoints meet accessibility standards for students with disabilities. Features include, but not limited to: <ul style="list-style-type: none"> • Keyboard and screen reader access • Alternative text for images • High color contrast between background and foreground colors

Acknowledgments

The guidance and recommendations of the following instructors and consultants helped us revise the content and features of this text. We are grateful for their reviews and truly believe that their feedback was indispensable.

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love and guidance. Thanks are due to all the other teachers, students, experts, and friends who were kind enough to look over my work and help me improve it. Finally, I want to thank my mother, Nancy, a wonderful special education instructor who showed me that one great teacher can affect eternity.

Steve Mariotti

To my coauthor Steve Mariotti, who brought hope, opportunity, and change out of adversity to create the Network for Teaching Entrepreneurship and started this journey—many thanks. As Steve noted, the team at Pearson has been wonderful to work with again. Faculty reviewers and faculty members who have contacted me directly regarding earlier materials are always a valued source of insights.

Most importantly, I appreciate the terrific entrepreneurs who shared their stories with me, including the good, the bad, and the downright ugly! Their interest in sharing their experiences with students and willingness to carve out time to tell their tales demonstrates the kind of energy and enthusiasm we associate with successful entrepreneurs. They have made this endeavor interesting and engaging.

On a more personal note, I would like to thank my “family” at the University of North Carolina System’s Fayetteville State University for their support and encouragement as I worked on *Entrepreneurship: Starting and Managing a Small Business, 5e*. Special thanks to Jay Azriel, Lynn Bible, Terri Hasson, Burcu Adivar, Connie Lightner, and Pam Jackson. Finally, to Elise and Spencer Glackin for being the best cheering section a mother could ever have—thanks and love to you both.

Caroline Glackin

About the Authors



STEVE MARIOTTI, founder of the Network for Teaching Entrepreneurship (NFTE), is considered one of today's leading experts in education for at-risk youth. In 1982, he changed career paths when he decided to leave the corporate sector and become a special education teacher in the New York City public school system.

Mariotti's first assignment was in the East New York section of Brooklyn, and his last was in the Fort Apache section of the South Bronx. During his six and a half years of teaching, Mariotti discovered he could successfully motivate even his most challenging students by teaching them how to run a business. This experience inspired him to create a new kind of program—the first to bring entrepreneurial education to low-income youth.

In 1987, Mariotti founded the NFTE. Today, NFTE's mission is to provide entrepreneurship education programs to young people from low-income communities around the world. NFTE's programs have a proven track record of success, and the network is widely viewed as the thought leader in the field. NFTE is an active member of the Council on Foreign Relations. In 2013, Mariotti traveled to Southeast Asia as a guest of the U.S. State Department on a mission to spread entrepreneurial education to youth from emerging economies in the region.

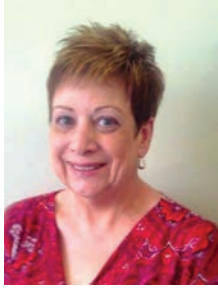
Mariotti was recently nominated for a Pulitzer Prize for his work chronicling the lives of entrepreneurs worldwide for *The Huffington Post* and for a Nobel Peace Prize for his pioneering work in entrepreneurial education. A life-long advocate for low-income students, Mariotti is the recipient of numerous awards, including:

- Ernst & Young Entrepreneur of the Year Award
- Bernard A. Goldhirsh Social Entrepreneur of the Year Award
- National Director's Entrepreneurship Award from the Minority Business Development Agency of the U.S. Department of Commerce
- Association of Education Publishers' Golden Lamp Award
- ACE/Currie Foundation Humanitarian—Venture Award
- America's Top High School Business Teacher

In addition, Mariotti has been the subject of many national media profiles on such programs as *ABC Evening News* and *20/20*.

He has authored and coauthored 34 books and workbooks on entrepreneurship, selling over 10 million copies worldwide and distributing many more for free to at-risk communities, including prisons. His popular book *The Young Entrepreneur's Guide to Starting and Running a Small Business* has recently been published in a new edition by Random House and is used to teach entrepreneurship from the United States to China, India, and the Middle East. Mariotti is a regular attendee and speaker at the World Economic Forum.

Raised in Flint, Michigan, Mariotti received his B.B.A. in business economics and his M.B.A. from the University of Michigan, Ann Arbor. He has also studied at Harvard University, Stanford University, Brooklyn College, and Princeton University. He started his professional career as a treasury analyst for Ford Motor Company before founding his own company, Mason Import/Export Services.



CAROLINE GLACKIN, PH.D., is a “pracademic” who has successfully worked as a microenterprise and small business owner and manager, as an executive director of a community development financial institution, and as an academic in areas of community development finance, entrepreneurship, and management. She is entrepreneurship faculty at Fayetteville State University (University of North Carolina constituent institution). She has been assisting entrepreneurs in achieving their dreams for over 30 years.

Dr. Glackin earned a doctorate from the University of Delaware, where her research emphasis was on access to capital and microfinance. She received an M.B.A. from the Wharton School at the University of Pennsylvania and an A.B. from Bryn Mawr College. Her professional career began with the DuPont Company, American Bell, Bell Atlantic, and American Management Systems. She has consulted for businesses and not-for-profit agencies in turnaround and high-growth situations. After exiting a family business, she became the executive director of a community development financial institution serving businesses and not-for-profits.

Dr. Glackin has succeeded in leading change in the practical fields of her research and has received numerous honors and awards. These include the first Gloeckner Business Plan Award at the Wharton School, the Minority Business Advocate of the Year for Delaware from the U.S. Small Business Administration, and the She Knows Where She’s Going Award from Girls Inc. Dr. Glackin cochaired the Delaware Governor’s Task Force for Financial Independence. She has participated in the Cornell University Emerging Markets Think Tank Series and has presented her research and pedagogy at numerous professional conferences.

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Entrepreneurs and Entrepreneurship

Learning Objectives

- 1.1** Summarize what entrepreneurship is and what entrepreneurs do.
- 1.2** Examine how free-enterprise economies work and how entrepreneurs fit into them.
- 1.3** Describe small business.
- 1.4** Understand the costs and benefits of entrepreneurship.
- 1.5** Recognize the various entrepreneurial options.
- 1.6** Identify and evaluate opportunities to start your own business.
- 1.7** Distinguish between ideas and opportunities.
- 1.8** Explore the multiple paths to entrepreneurship.
- 1.9** Explain success signals for entrepreneurs.
- 1.10** Develop skills for a future career—employment or entrepreneurship.

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Tom Szaky, TerraCycle.
(Paul Zimmerman/
WireImage/Getty
Images)



“Everyone lives by selling something.”

—Robert Louis Stevenson, Scottish author

Tom Szaky was a 20-year-old college student in need of inspiration for a business plan competition when he happened to visit friends who were using red worms to compost waste that they then used as plant fertilizer. The idea captured his imagination, and he created a business plan for an environmentally friendly company that would convert trash into fertilizer. Although he finished in fifth place in the competition, Szaky moved ahead to make the company a viable venture.¹

TerraCycle Inc. expanded its product lines to encompass a wide range of recycling and upcycling products, including branded products for Target and Kraft Foods. The company was the producer of the world’s first product made from and packed in recycled waste: fertilizer generated from waste. Szaky sold to some of the world’s largest retailers, including Walmart, Target, and Home Depot. From there he led the evolution of the company to involving entire communities in recycling projects, and the company has collected literally billions of discarded items. Its Drink Pouch Brigade (which started with Honest Tea), Bottle Brigade, Yogurt Cup Brigade (Stonyfield Farms), and Energy Bar Brigade (CLIF Bar) collected and repurposed products. TerraCycle plant food was twice named the eco-friendliest product in Home Depot. The company now has international offices, Szaky has authored three books, and more major corporations are partners. Tom Szaky and TerraCycle have turned waste into treasure.

Understanding Entrepreneurs and Entrepreneurship

Learning Objective 1.1

Summarize what entrepreneurship is and what entrepreneurs do.

➤ Have you ever eaten a Subway sandwich? Used an Apple device? Listened to music with Skullcandy headphones? The entrepreneurs who founded these companies brought these products into your world. Entrepreneurship is all around us.

What Is an Entrepreneur?

Most Americans earn money by working in *business*. They are somehow engaged in the buying and selling of products or services to earn money.

product something tangible that exists in nature or is made by people.

service intangible work that provides time, skills, or expertise in exchange for money.

- A **product** is something that exists in nature or is made by human beings. It is *tangible*, meaning that it can be physically touched.
- A **service** is labor or expertise exchanged for money. It is *intangible*. It cannot be physically touched.

Someone who earns a living by working directly for someone else’s business is an *employee* of that business. There are many roles for employees. At Ford Motor Company, for instance, some employees build the cars, some sell the cars, and some manage the company. But most employees have one thing in common—they do not *own* the business; they work for others who do. They know how much money they can earn, and that amount is limited to salary or wages, plus any bonuses and stock options they may receive.

¹ TerraCycle Inc., accessed February 4, 2018, <http://www.terracycle.com>.

entrepreneur a person who recognizes an opportunity and organizes and manages a business, assuming the risk for the sake of potential return.

People who have their own businesses work for themselves and are called *business owners* or **entrepreneurs**. Entrepreneurs are often both owners and employees. For an entrepreneur who is driven and has the right product-market fit, the sky is the limit as far as earnings are concerned. Unlike an employee, an entrepreneur owns profits that his or her business earns and may choose to reinvest profit in the business or take it as payment.

An entrepreneur is someone who recognizes an opportunity to start a business that other people may not have noticed and acts on it. As economist Jeffry A. Timmons wrote in the preface of *New Venture Creation: Entrepreneurship for the 21st Century*, “A skillful entrepreneur can shape and create an opportunity where others see little or nothing—or see it too early or too late.”²

The French word *entrepreneur* began to take on its present-day meaning in the seventeenth century. It was used to describe someone who undertook any project that entailed risk—military, legal, or political, as well as economic. Eventually, it came to mean someone who started a new business venture—often of a new kind or a new (or improved) way of doing business. French economist Jean-Baptiste Say wrote at the turn of the nineteenth century:

An entrepreneur is an economic agent who unites all means of production—the land of one, the labor of another and the capital of yet another, and thus produces a product. By selling the product in the market he pays rent on land, wages to labor, interest on capital and what remains is his profit. He shifts economic resources out of an area of lower and into an area of higher productivity and greater yield.³

Say argued that entrepreneurs “added value to scarce resources.” Coal is a resource because it is used as fuel. Wood is a resource because it can be used to build a house or a table, to make paper, or to burn as fuel. Economists consider *scarce* all resources that are worth money, regardless of their relative availability.

Debbi Fields, founder of Mrs. Fields Cookies, took resources—eggs, butter, flour, sugar, chocolate chips—and turned them into cookies. People liked what she did with those resources so much that they were willing to pay her more for the cookies than it cost her to buy the resources to make them. She *added value* to the resources she purchased by what she did with them and created a multimillion-dollar business in the process.

Entrepreneurs have differing motivations for starting ventures. There are two main categories to differentiate between them according to motivation. **Necessity-based entrepreneurs** enter entrepreneurship because circumstances make self-employment their best available option for income replacement. For example, they may become unemployed and be unable to find suitable work or their family may have health issues which preclude regular employment. **Opportunity-based entrepreneurs** start businesses to exploit a perceived opportunity or to pursue one that they created. Their motivation is not income replacement, but rather one of an envisioned future.

Regardless of the reasons to start and continue their businesses, entrepreneurs share the common focus of creating and capturing sustained value for their customers and themselves. Entrepreneurs seek

necessity-based entrepreneurs enter entrepreneurship because circumstances make self-employment their best available option for income replacement.

opportunity-based entrepreneurs start businesses to exploit a perceived opportunity or to pursue one that they created.

² Jeffry A. Timmons & Stephen Spinelli, *New Venture Creation: Entrepreneurship for the 21st Century*, 8th ed. (New York: Irwin/McGraw-Hill, 2008).

³ Jean-Baptiste Say, *A Treatise on Political Economy; Or the Production Distribution and Consumption of Wealth (Traité D'économie Politique ou Simple Exposition de la Manière Dont se Forment, se Distribuent et se Composent les Richesse)*, ed. Clement C. Biddle, trans. C. R. [slightly modified] (Philadelphia: Lippincott, Grambo & Co., 1855). Library of Economics and Liberty, accessed June 26, 2013, <http://www.econlib.org/library/Say/sayT.html>.

opportunities that they envision as generators of incremental income, or *wealth*. Whether the business is intended to meet short-term household cash needs, to be passed down through multiple generations, or to grow into a publicly traded company, viability is critical. Each activity of the firm should be driven by this need.

The Free-Enterprise System

An economy is the wealth and resources of a country or region, including its financial structure. The economy of the United States is a **free-enterprise system** because it is characterized by private (rather than governmental) ownership of capital assets and goods, and prices are determined by markets; anyone is free to start a business. Americans do not have to get permission from the government to go into business, although they are expected to obey laws and regulations and report their earnings.

The free-market system, which is also called **capitalism**, typifies the following attributes:

- Individuals and companies may compete for their own economic gains.
- Private wealth and property ownership are permissible.
- Free-market forces primarily determine prices.

Cash or goods invested to generate income and wealth is called **capital**; in a free-enterprise system, anyone who possesses or can raise the necessary capital may start a business.

Voluntary Exchange

The free-enterprise system is also sometimes referred to as a *private enterprise free-trade system* because it is based on **voluntary exchange**. Voluntary exchange occurs when buyers and sellers willingly engage in a market transaction that benefits each party. Each wishes to take advantage of what the trade offers. The parties agree to the exchange because each will benefit.

For example, José has a construction business, and his neighbors hire him to renovate their kitchen. He wants to earn money and is willing to use his skills and time to do so. The neighbors are willing to give him money to get the renovation done. They each have something the other wants, so they are willing to trade. A satisfactory exchange only takes place when both parties believe they will benefit.

Benefits and Challenges of Free Enterprise

The public benefits from living in a free-enterprise system because it discourages entrepreneurs who waste resources by driving them out of business. It encourages entrepreneurs to use resources to satisfy consumer needs efficiently by rewarding them with profit and wealth.

Where entrepreneurs are free to trade voluntarily to as large a market as possible, their ability to find customers to buy their goods or services increases, as well as their overall ability to meet customer needs. Meanwhile, the Internet has made it much easier for businesses to sell to clients all over the world. Shipping, too, has become much faster and less expensive.

Society in general benefits because free enterprise encourages competition between entrepreneurs. Someone who can make cookies that taste as good as Mrs. Fields Original Cookies and sell them at a lower price would eventually attract the company's customers. This would force Mrs. Fields



Learning Objective 1.2

Examine how free-enterprise economies work and how entrepreneurs fit into them.

free-enterprise system

economic system in which the market determines the products, services sold, and prices charged, and where businesses operate relatively free of government interference.

capitalism the free-market system, characterized by individuals and private companies, as opposed to governments, competing for economic gains, ownership of private property and wealth, and price determination through free-market forces.

capital money or property owned or used in business.

voluntary exchange a market transaction between buyers and sellers who willingly agree to the trade.

Global Impact . . .

Free Trade

For much of recorded history, international trade was difficult and hazardous. To sell products in another country often required long and dangerous journeys overland or by ship. Many countries were closed to outside trade. Governments also used their power to give their own businesspeople competitive advantages over those from other countries by establishing trade barriers, such as imposing taxes (tariffs) on foreign goods that made them very expensive. Governments could also enforce restrictions on how many imports or exports could cross their borders.

Today, trade barriers have fallen in many parts of the world. The North American Free Trade Agreement (NAFTA)

of 1994 eliminated trade barriers between the United States, Mexico, and Canada. This turned the entire continent into a free-trade zone. The General Agreement on Tariffs and Trade (GATT) cut or eliminated tariffs between 117 countries. This evolved into the World Trade Organization, which has 164 members.

On the flip side, free enterprise has some disadvantages. If a company fails, its employees are out of work. Owners who have invested their financial resources in the business lose money. Other companies or individuals that depended on the products and services of the failed business themselves lose customers or suppliers.

to lower prices to stay competitive, or the company would go out of business. Consumers would benefit because they would get to buy the same-quality cookie at a lower price.

What Is a Small Business?

Learning Objective 1.3

Describe small business.



Many people think of business only in terms of “big” businesses—companies such as Apple, Walmart, Microsoft, General Motors, and Berkshire Hathaway. However, the clear majority of businesses are small businesses. A small business is generally defined by the U.S. Small Business Administration’s Office of Advocacy as having fewer than 500 employees and selling less than \$5 million worth of products or services annually. A neighborhood restaurant, a mattress manufacturer, a technology research company, and a clothing boutique can all be examples of a small business; even a leading local employer may be classified as “small” under this definition.

The core principles involved in running a large company—like Microsoft—and a corner deli are the same. However, the operations of a small business are not the same as those of a large one. Most multi-million-dollar businesses started out as small, entrepreneurial ventures. Therefore, entrepreneurship is often called the engine of an economy. It drives economic creativity, giving rise to wealth and jobs and improving the standard of living.

Definitions of Success—Monetary and Other

The millennial generation (born between 1977 and 1995) and Generation Z (born after millennials through the mid-2000s) have redefined success. For them, success is more individualized than the traditional concept and is based on factors beyond those of income and wealth. Business owners may start an enterprise to create a more environmentally friendly approach to a product or process, to provide jobs for a disadvantaged population, or to improve the mental or physical health of themselves or others. For these entrepreneurs, success might be measured by the ability to have an impact on the population they serve. Or success may mean working to provide a lifestyle that permits a shortened work week

BizFacts

- There are 29.6 million small businesses in the United States; this means that 99.9 percent of all companies have fewer than 500 employees.
- Small businesses in America employed 48 percent of the country's private (nongovernment) workforce, hired 43 percent of high-tech workers, and created 67 percent of net new jobs annually from 2007 to 2016.
- Home-based businesses make up 52 percent and franchises 2 percent of all small firms.
- Small firms constituted 97.7 percent of all identified exporters and produced 33.6 percent of the country's known export value in fiscal year 2013.

Source: U.S. Small Business Administration, accessed February 4, 2018, <http://www.sba.gov>.

or telecommuting. Recognition from peers and others could also be a goal. Financial success may be just one of many measures of achievement for an entrepreneur.

Starting a business is an opportunity, and like any opportunity, it should be evaluated by taking a careful look at all aspects of it. One thing is certain, though: *The desire to make money, alone, is not a good enough reason to start one's own business.*

The financial rewards of owning your own business may not occur until you have put in years of hard work. The desire to make money may not be enough to keep you going through the difficult early period. Most successful companies have been founded by an entrepreneur with a powerful and motivating vision and passion, balanced by a strong work ethic and dedication.

Entrepreneurs have declared that they are “not in business for the money” so often that it has become a cliché, but like most clichés, it is based on a degree of truth.

Taking the Long View

Successful entrepreneurs know it is important to begin with the end in mind, so that they can have an idea of where they want the organization to be at their personal exit point, even before they make the first sale. Because the daily tactical decisions they make will be affected by what they hope to create in the short *and* long term, a clear vision is vital. However, they also recognize the flexibility and resilience needed to succeed, because their assumptions about the business may not play out, and they must pivot to succeed. As you consider an entrepreneurial path, consider these questions:

- Are you planning to be active in the business until retirement? At what age will you retire? Who will take over then? A family member? A new owner?
- Do you plan to grow the business to a certain size or level of maturity and then sell it? If so, what is the target level? Are you looking at an initial public offering or a small private sale? Would you stay with the business after it was sold?
- Would you want to stay active for a given number of years? Then what would you do?

Taking the long view also means considering your personal satisfaction and priorities, including conformance with individual values and ethics. Entrepreneurs make hundreds of choices and decisions every day.

These decisions may conform to their values and ethics or violate them to meet a customer need, provide an expedient or cost-effective solution to an immediate problem, or the like. If you find yourself facing such a decision, for your long-term wellness and the benefit of those around you, it will be critical to keep your core values in the forefront. Consider the legacy you want to leave behind.

Benefits and Costs of Becoming an Entrepreneur

Learning Objective 1.4

Understand the costs and benefits of entrepreneurship.



Entrepreneurs put a great deal of time and effort into launching their own businesses. While establishing a business, an entrepreneur may also pour all of his or her money into it, along with some from friends and family. An entrepreneur may not be able to buy new clothes or a fancy car, go on vacation, or spend much time with family—at least until the business becomes profitable and starts generating cash.

If so much work and sacrifice are involved, why become an entrepreneur? Even if you have a clear vision that you believe will motivate you through the ups and downs of running a business, look closely at the costs and benefits of being an entrepreneur before you decide whether this is the life for you. This examination is fundamental in the decision to become an entrepreneur.

Potential Benefits of Entrepreneurship

The entrepreneur is working for the following potential rewards:

1. **Control over time.** Do you work better at midnight than at 8 A.M.? Are you the kind of person who would rather work really hard for two weeks, nonstop, and then take a break? If you start your own business, you will have control over how you spend your time based on the type of business it is. You can structure your schedule to make this possible. You can also choose to hire others to perform tasks you do not like to do or are not good at, so you can stay focused on what you do best. Bill Gates liked to spend his time designing software. He hired people to manage Microsoft's operations and to market and sell its products. Many eBay entrepreneurs have carved out flexible schedules for responding to orders, packaging, and shipping. Brick-and-mortar retail stores, by contrast, do not often afford such flexibility.
2. **Fulfillment.** Successful entrepreneurs are passionate about their businesses. They are excited and fulfilled by their work. Entrepreneurs who are working to reach their full potential are rarely bored, because there is always plenty to do. If one facet of running the business is uninteresting, and they have the income to support it, they can hire someone else for that task.

Social entrepreneurs who want to contribute to societal improvement find ways to do this while also earning profits. Founders of not-for-profit organizations create enterprises to address public issues that are personally important. Other entrepreneurs start lifestyle businesses that allow them to earn money while following a passion. For example, avid pilots may operate aviation-oriented businesses in which they can fly often, such as specialty delivery companies or flight instruction schools. Art lovers may open galleries, create art rental firms, or operate art tours.

3. **Independence/autonomy.** Because they are not reporting to managers or supervisors, business owners do not have to follow orders or observe working hours set by someone else. They have control over their decisions.
4. **Creation/ownership.** Entrepreneurship is a creative endeavor. Doing what they love to do or turning a skill, hobby, or other interest into a business can be highly satisfying. The words of Confucius, “Choose a job that you love, and you will never have to work a day in your life,” are often cited with respect to entrepreneurship.

Entrepreneurs put time and effort into creating a venture they expect will survive and become profitable. Entrepreneurs own the businesses they create and the profits those businesses earn. *Ownership* is the key to wealth. One goal is to build a business that creates a sustained stream of earnings. Eventually, you may be able to sell that company for a multiple of those earnings. That is how entrepreneurs create wealth. Many entrepreneurs, such as Bill Gore, the inventor of GORE-TEX fabric, start their own business after becoming frustrated or disillusioned in other roles or having ideas rejected by an employer, and leverage the opportunity into personal satisfaction and wealth.

5. **Financial reward/control over compensation.** Entrepreneurs can build income and wealth through their endeavors. Although income potential is generally capped for employees, entrepreneurs are limited only by their own imagination and tenacity. Entrepreneurs built most of our country's great fortunes. At the same time, many part-time, seasonal, and lifestyle entrepreneurs find ways to fund gaps in household income, pay for college, or support extraordinary expenses through their business endeavors.

Entrepreneurs choose how and when they are paid. As owner of your company, when funds permit, you can decide to:

- Pay yourself a **salary**, a fixed payment made at regular intervals, such as every week or every month. Salaries are not applicable to sole proprietorships, where owners may take a “draw” on revenues, or partnerships, where they may “draw down” profits.
 - Pay yourself a **wage**, a fixed rate per hour. This is not a common choice, but it is available.
 - Take a share of the company's profit. As the owner, you can pay yourself a portion of the business's profits. In a corporation, this kind of payment is called a **dividend** and must be paid to all shareholders.
 - Take a **commission** on every sale you make. A commission is a percentage of the value of a sale. If you decide to pay yourself a 10 percent commission, and sell an item for \$120, your commission on the sale would be \$12.
6. **Control over working conditions.** As an entrepreneur, you can create a work environment that reflects your values. If you support recycling, you can make sure your company recycles and encourage recycling, much as TerraCycle has. Depending upon the business, you may bring your dog with you or you may dress informally. You will also evaluate your own performance. If you have control of the company, no one else has the power to fire you. If equality is essential, you may have an office with equal working spaces, no special privileges for managers, and few management layers.

salary fixed amount of money paid to an employee at regular intervals.

wage fixed payment per hour for work performed.

dividend each stockholder's portion of the profit-per-share paid out by a corporation.

commission a percentage of a sale paid to a salesperson.

7. **Self-esteem.** Knowing that they created something valuable can give business owners a strong sense of accomplishment. It can help them feel good about themselves and increase their self-confidence.
8. **Contribution to society.** Business owners decide how they can add value to their communities and the wider world. The issues they care about can be “designed in” when they form their companies and supported throughout the organization.

Some of the greatest entrepreneurs in the world dealt with problems such as extreme poverty, abuse, or learning disabilities. Sir Richard Branson, for example, had such severe dyslexia that he dropped out of high school. He became a successful entrepreneur, however, creating more than 200 companies—including Virgin Airlines, Virgin Galactic, and Virgin Records. The Virgin Group employs about 69,000 people in 35 countries and has revenues of approximately £16.6 billion.⁴ Branson has a personal net worth of about \$5.3 billion, making him number 324 on the Forbes list of billionaires.⁵ As an entrepreneur, he was able to create an environment in which he could succeed.

Potential Costs of Entrepreneurship

While there are many potential benefits of entrepreneurship, entrepreneurs also face numerous possible costs.

1. **Business failure.** About one in five new businesses fails in the first eight years. Another one-third of new businesses close because the entrepreneurs become discouraged and give up. Entrepreneurs risk losing not only their own money but also the financial investments of others.
2. **Obstacles.** Entrepreneurs run into problems that they will have to solve, primarily by themselves. In addition, their families and friends may not support their vision and may actively discourage them.
3. **Loneliness/isolation.** It can be lonely and even a little frightening to be completely responsible for the success or failure of a business. While owners have control, they also have responsibility and cannot defer to someone else for decisions.

Step into the Shoes . . .

Solving a Problem and Founding a Company

When Jennifer (Jenn) Hyman recognized a problem that her sister encountered, she developed the idea into an opportunity with her Harvard Business School section mate, Jennifer (Jenny) Fleiss. Jenn’s sister, Becky, wanted a fashionable outfit to wear to a wedding, but such an outfit was beyond the budget for her salary. What if, Jenn thought, the Beckys of this world could have

access to their dream closet—a new dress for every occasion? And what if designers were able to get their pieces into the hands of young, fashionable women and build an addiction for designer fashion?⁶ Jenn and Jenny tested the concept and created Rent the Runway, a platform through which users rent designer clothing for special events.

⁴ Virgin Group, accessed February 4, 2018, <http://www.virgin.com>.

⁵ K. A. Dolan, “Forbes 2017 Billionaires: Meet the Richest People on the Planet,” *Forbes*, March 20, 2017, accessed February 4, 2018, <http://www.forbes.com>.

⁶ Rent the Runway, accessed February 4, 2018, <http://www.renttherunway.com>.

4. **Financial insecurity.** Owners are not guaranteed a salary or benefits, or even income at all. They may not always have enough money to pay themselves, particularly in the first 18 months or so of a new enterprise. They also must set up and fund their own retirement and insurance plans.
5. **Long hours/hard work.** Entrepreneurs must work long hours to get their businesses off the ground. Many entrepreneurs work six or even seven days a week, often for 12 hours or more per day. While they decide when to work, they often end up working or thinking about their businesses many more hours as entrepreneurs than they would as employees.
6. **Strain on personal relationships.** Even with the strong support of family and friends, the inherent challenges of a small business can strain relationships to the breaking point.

Not everyone is cut out to be an entrepreneur. Entrepreneurs must be able to tolerate more risk and uncertainty than is typical for people who work steady jobs at established employers. With higher risk, however, comes the potential for higher rewards.

Cost/Benefit Analysis

Using a comparison of benefits and costs to make a decision is called a **cost/benefit analysis**. It is a helpful tool because people often evaluate pros and cons based on emotions, not intellect. Strong emotions may take over to the point where they see only the benefits and not the costs of an action (or vice versa).

For example, Xavier plans to buy a car. He might be overwhelmed by the idea of making such a large purchase, even if the benefits are greater than the costs. In contrast, he might decide to buy a car at a cost that outweighs the benefits it will bring, simply because he is temporarily blinded by a desire to own an impressive vehicle. Making a list that includes the dollars and cents of the costs and benefits of a purchase is a concrete way to take emotion out of the decision, while also considering nonfinancial factors.

To turn an opportunity into a business, entrepreneurs invest both time and money. Before making this kind of investment, think carefully about:

Costs. The money, energy, and time you will have to invest, as well as the opportunities you will be giving up, to operate the business.

Benefits. The wealth you will accrue and the knowledge, skills, self-esteem, and experience you will gain.

cost/benefit analysis a decision-making process in which the costs of taking an action are compared to the benefits.

Opportunity Cost

Cost/benefit analysis is incomplete without considering **opportunity cost**. This is the cost of your “next-best investment.” Perhaps your goal is to become a composer who writes scores for movies. You get a full-time job at a local music store for \$400 a week to support yourself, so you can write and record music in the evenings that you hope to sell to producers, agents, or film companies.

You find, however, that whenever a producer or agent wants to meet with you, you cannot get out of work to go. You realize that, even though you are making \$400 a week, you are missing some important opportunities. Perhaps it would be smarter to take a part-time job for \$300 a week that would leave your mornings free for meetings. The opportunity

opportunity cost the value of what must be given up to obtain something else.

cost of the \$100 a week you will lose is offset by the potential income from film-scoring jobs you are missing by not being free to see people in the business. If your first film-scoring job pays \$5,000, for example, you would have made the right decision to earn \$100 a week less for a few months.

People often make decisions without considering the opportunity cost and then wonder why they are not happy with the outcome. Each time you make a decision about what to do with your time, energy, or money, think about the cost of the opportunities you are giving up. **Exhibit 1-1** presents a simple quiz that can help you decide whether you have what it takes to be an entrepreneur.

Seeking Advice and Information to Succeed

While experience is an excellent teacher, using knowledge, skills, and abilities to avoid errors, problems, and delays is much healthier. A savvy entrepreneur learns from the mistakes of others and appreciates the wisdom and experience of trusted advisors and mentors.

Preparation and planning are keys to avoid making many types of mistakes. Thoughtful consideration of the entrepreneurship option is an excellent starting point. Thorough research and taking advantage of training and/or one-on-one consulting to bridge gaps in your preparation can make a world of difference. You will never be perfectly prepared for entrepreneurship, but you can build competencies, knowledge, and attitudes that will support your entrepreneurial path.

Two of the best resources for getting and staying on track are mentors and business advisors. A **mentor** is a trusted advisor with whom a person forms a developmental partnership through which information, insight, skills, and knowledge are shared to promote personal and/or professional growth. Finding a committed business mentor with industry-specific knowledge and experience, broad general business experience, or both, is often difficult, but can be a worthwhile endeavor. A successful entrepreneur in your field, perhaps outside of your geographic area, may prove invaluable if he or she will mentor you. Many successful entrepreneurs will carve out time for promising newcomers. Unfortunately, becoming a mentor may be more of a commitment than your identified entrepreneur is willing or able to make. Perhaps he or she will become an informal advisor instead.

In addition to your paid professional advisors, such as attorneys and accountants, individual advisors or an advisory board may mean the difference between success and failure. Even if you are forming a venture with a full slate of experienced technical and managerial professionals, the guidance of a carefully composed advisory board can provide valuable counsel and connections. Such a board might meet only once or twice during a year to listen to your problems, share experiences, and help you advance. During the times between meetings, advisors may also be able to offer substantial assistance.

Of course, taking advantage of available courses in entrepreneurship, whether brief workshops, individual college courses, an entrepreneurial certificate program, or a degree program, can offer considerable benefits. The opportunity to learn from the experiences of others and to systematically explore entrepreneurial options and build skills can be important. There are numerous Internet resources for nascent entrepreneurs, too.

A well-prepared entrepreneur is more likely to get and stay on the path to success.

mentor a trusted advisor with whom a person forms a developmental partnership through which information, insight, skills, and knowledge are shared to promote personal and/or professional growth.

Exhibit 1-1 *U.S. Small Business Administration—Small Business Readiness Assessment*

Becoming an entrepreneur is not for everyone. In business, there are no guarantees. There is simply no way to eliminate all the risks. It takes a special person with a strong commitment and specific skills to be successful as an entrepreneur.

Are you ready to start your own business? Use the Readiness Assessment Guide to better understand how prepared you are. This can be found on the SBA site at <http://www.sba.gov> where your score can be calculated.

Readiness Assessment Guide

This guide is designed to help you better understand your readiness for starting a small business. It is not a scientific assessment tool. Rather, it is a tool that will prompt you with questions and assist you in evaluating your skills, characteristics, and experience—as they relate to your readiness for starting a business.

Readiness Questions**General**

1. Do you think you are ready to start a business?
2. Do you have support for your business from family and friends?
3. Have you ever worked in a business like what you are starting?
4. Would people who know you say you are entrepreneurial?
5. Have you ever taken a small business course or seminar?

Personal Characteristics

6. Are you a leader?
7. Do you like to make your own decisions?
8. Do others turn to you for help in making decisions?
9. Do you enjoy competition?
10. Do you have willpower and self-discipline?
11. Do you plan?
12. Do you like people?
13. Do you get along with others?
14. Would people who know you say you are outgoing?

Personal Conditions

15. Are you aware that running your own business may require working more than 12 hours a day, six days a week and maybe Sundays and holidays?
16. Do you have the physical stamina to handle a “self-employed” workload and schedule?
17. Do you have the emotional strength to deal effectively with pressure?
18. Are you prepared, if needed, to temporarily lower your standard of living until your business is firmly established?
19. Are you prepared to lose a portion of your savings?

Skills and Experience

20. Do you know what basic skills you will need to have a successful business?
21. Do you possess those skills?
22. Do you feel comfortable using a computer?
23. Have you ever worked in a managerial or supervisory capacity?
24. Do you think you can be comfortable hiring, disciplining, and delegating tasks to employees?
25. If you discover you do not have the basic skills needed for your business, will you be willing to delay your plans until you have acquired the necessary skills?

Entrepreneurial Options

Learning Objective 1.5

Recognize the various entrepreneurial options.

social entrepreneurship

a for-profit enterprise with the dual goals of achieving profitability and attaining social returns.

Entrepreneurship extends beyond the fast-growing technology enterprises that are most commonly associated with it. There are many variations on entrepreneurship, and the opportunities are innumerable. For example, entrepreneurship may include for-profit enterprises that support the missions of not-for-profit organizations, businesses designed for social impact, and ventures that are environmentally oriented.

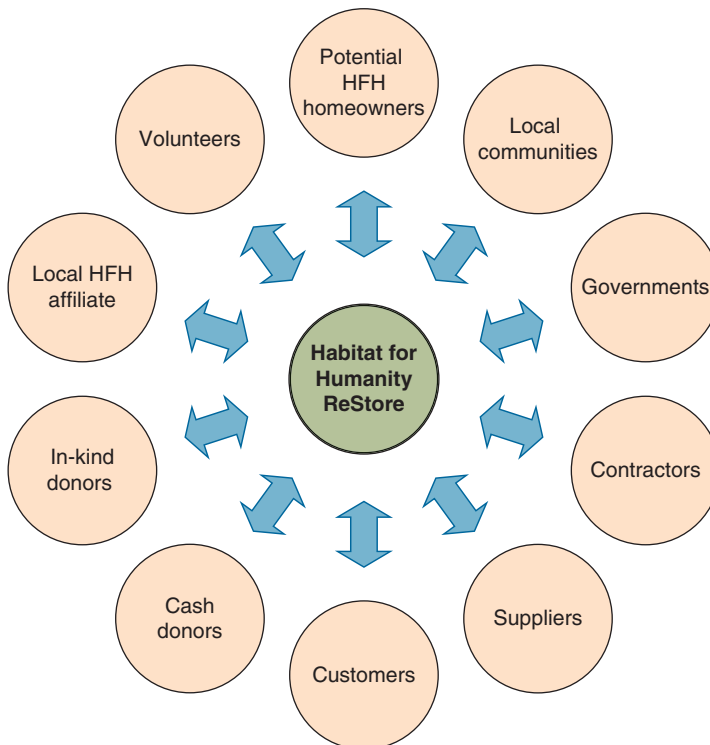
Social entrepreneurship has multiple definitions and forms, but it is commonly thought of as a for-profit enterprise with the dual goals of achieving profitability and attaining beneficial returns for society. Another view is that of taking an entrepreneurial perspective toward social problems. Gregory Dees has created the following definition:⁷

Social entrepreneurs play the role of change agents in the social sector by:

- adopting a mission to create and sustain social value (not just private value);
- recognizing and relentlessly pursuing new opportunities to serve that mission;
- engaging in a process of continuous innovation, adaptation, and learning;
- acting boldly without being limited by resources currently in hand; and
- exhibiting heightened accountability to the constituencies served and for the outcomes created.

In this view, social entrepreneurship is less about profit than it is about social impact. **Figure 1-1** provides a visual representation of the many

Figure 1-1 Habitat for Humanity ReStore® Stakeholders



⁷ Gregory Dees, "The Meaning of 'Social Entrepreneurship,'" May 30, 2001, accessed July 9, 2013, <https://entrepreneurship.duke.edu/news-item/the-meaning-of-social-entrepreneurship/>.

stakeholders of a social enterprise, a Habitat for Humanity ReStore. Such retail outlets rely on donations of inventory from individual community members, businesses, and other mission-driven organizations.

In addition to “social entrepreneurship,” there is the more recent concept of the **social business**, “a non-loss, non-dividend company designed to address a social objective within the highly regulated marketplace of today. It is distinct from a non-profit because the business should seek to generate a modest profit, but this will be used to expand the company’s reach, improve the product or service, or in other ways to subsidize the social mission.”⁸ In his book *Creating a World without Poverty—Social Business and the Future of Capitalism*, Mohammad Yunus defines two kinds of social business:

- Type I provides a product and/or service with a particular environmental, social, or ethical purpose. Grameen Danone does this by providing food for the poor in Bangladesh.
- Type II is profit-oriented business with ownership consisting of underprivileged people who can benefit directly or indirectly.

In addition, **venture philanthropy** is a subset or segment of social entrepreneurship. Financial and human capital is invested in not-for-profits by individuals and for-profit enterprises with the intention of generating social rather than financial returns. In some cases, venture philanthropy may involve the investment of capital in the for-profit, commercial part of a not-for-profit. In others, it may mean investing in not-for-profits directly, to encourage entrepreneurial approaches to achieve social impact.

Green entrepreneurship is another form of social entrepreneurship and can be defined as: “Enterprise activities that avoid harm to the environment or help to protect the environment in some way.”⁹ TerraCycle is an excellent example of green entrepreneurship. According to the Corporation for Enterprise Development (CFED), green entrepreneurship can:

- create jobs and offer entrepreneurship opportunities;
- increase energy efficiency, thus conserving natural resources and saving money;
- decrease harm to workers’ health;
- enable businesses to tap into new sources of local, state, and federal funding;
- take advantage of consumer preference for environmentally friendly goods; and
- preserve limited natural assets on which businesses and communities depend for business and quality of life.

Each of these alternative approaches offers opportunities for innovation and growth for the right entrepreneur.



Oleksandr Boiko/123RF

social business a company created to achieve a social objective while generating a modest profit to expand its reach, improve the product or service, and subsidize the social mission.

venture philanthropy a subset or segment of social entrepreneurship wherein financial and human capital is invested in not-for-profits by individuals and for-profit enterprises, with the intention of generating social rather than financial returns on their investments.

green entrepreneurship business activities that avoid harm to the environment or help to protect it in some way.

⁸ Muhammad Yunus, *Creating a World without Poverty: Social Business and the Future of Capitalism* (New York: PublicAffairs, 2009) 320.

⁹ “Green Entrepreneurship,” *Corporation for Enterprise Development: Effective State Policy and Practice*, 5, no. 2, April 2004, <http://www.cfed.org>.

The Many Faces of Entrepreneurship

Entrepreneurs are as diverse as the composition of the economy. They are of all ethnicities, races, and religions, and they come from every socioeconomic status. They enter self-employment for a wide range of reasons and choose to continue as entrepreneurs or return to outside employment for just as many. There are women and minority entrepreneurs and young entrepreneurs in record numbers. There are also refugee and immigrant entrepreneurs.

This diverse pool of entrepreneurs does not produce a single path to entrepreneurial success. Rather, the types of businesses formed reflect the diversity of their founders. In addition to full-time ventures founded to maximize growth and wealth, some are started as part-time businesses and microenterprises, artisanal and opportunistic businesses, direct selling distributors, and others.

Microenterprises

microenterprise a firm with five or fewer employees, initial capitalization requirements of under \$50,000, and the regular operational involvement of the owner.

Most businesses are founded as **microenterprises**, which are defined as businesses with five or fewer employees, initial capitalization requirements of less than \$50,000, and the habitual operational involvement of the owner. In fact, more than 60 percent of all U.S. firms have four or fewer employees, according to the U.S. Small Business Administration.¹⁰ The Association for Enterprise Opportunity (AEO) estimates that the more than 25.5 million microenterprises in the United States account for 91 percent of all businesses and 31 percent of all private employment.¹¹

Microenterprises are founded for a variety of reasons and are often more fluid than other types of businesses. These firms may be founded to provide only part-time employment for their owners. They may not be intended as long-term enterprises and may not have the goal of growing larger. They may be planned as only temporary ventures to provide income during periods of unemployment or to supplement household finances for a purpose. **Lifestyle businesses** are microenterprises that permit their owners to follow a desired pattern of living, such as supporting college costs or taking vacations. However, a microenterprise could make the difference between a family living in poverty and achieving economic stability.

lifestyle business

a microenterprise that permits its owners to follow a desired pattern of living, such as supporting college costs or taking vacations.

Other microentrepreneurs get their start as distributors for direct selling companies. Rather than create the product or service model from scratch, these microentrepreneurs join a network of distributors to build businesses by marketing products from direct selling firms such as Amway, Mary Kay, Scentsy, and Princess House. They are independent representatives but are supplied with training, education, marketing materials, and other support to build their own networks and profits. The usual startup cost is approximately \$100, and direct selling organizations that are members of the Direct Selling Association are guided by a code of ethics that protects the distributors.

Mainstream Small Firms

These constitute the bulk of the small businesses in public perception, in the press, and in community visibility. They provide, or have the potential to provide, substantial profits to their owners. Mainstream small firms can be operated by founder-entrepreneurs, subsequent generations of family members, successor owners, or franchisees. They create many of the jobs included in statistics from the U.S. Small Business Administration and employ most American workers. Unlike many microenterprises, they are

¹⁰ U.S. Small Business Administration, Office of Advocacy, 2013.

¹¹ Association for Enterprise Opportunity, accessed February 4, 2018, <http://www.microenterpriseworks.org>.

established with continuity and permanent wealth building in mind and are more often registered with local, state, and federal agencies. Among these mainstream firms are many **family enterprises**, which are companies owned and operated primarily by related family members. They may span multiple generations and have been passed down from one generation to the next, or they may include siblings in a new venture. The dynamics and issues of family enterprises are interesting and robust. You will have the opportunity to read about many of them in this text and may interact with them as you engage in your community.

family enterprise a company owned and operated primarily by related family members.

Unicorns

Some firms are high growth and highly uncommon. These are often labeled as **unicorns**. In the investment community, startup companies that are valued privately or publicly at over \$1 billion are called unicorns, not because they do not exist, but because they are rare and valuable. The term was coined in 2013 by Aileen Lee, founder of Cowboy VC.¹² According to Lee, approximately four unicorns are born per year.

unicorns startup companies valued at over \$1 billion.

Corporate Entrepreneurship

Entrepreneurship is not limited to new and small ventures. **Corporate entrepreneurship** or intrapreneurship occurs when an individual or team within an existing corporation creates or identifies new opportunities for increased profits and/or improved competitive position, secures the necessary resources, and creates value through a new organization or innovation within the firm. Intrapreneurs can be found within large organizations globally and are most successful when the organization supports their efforts and rewards entrepreneurial creativity and accepts failure as part of the process.

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How Do Entrepreneurs Find Opportunities to Start New Businesses?

In the twentieth century, Joseph Schumpeter expanded on Say's definition of entrepreneurship by adding that entrepreneurs create value "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, by reorganizing an industry and so on."¹³ This view emphasizes innovation as the key to entrepreneurship. Management expert Peter Drucker simplified this view to its essential core of creating a new business, taking on risk, and persevering in light of uncertainty.¹⁴

Schumpeter's definition describes five basic ways that entrepreneurs find opportunities to create new businesses:

1. Using a new technology to produce a new product
2. Using an existing technology to produce a new product
3. Using an existing technology to produce an old product in a new way
4. Finding a new supply of resources (that might enable the entrepreneur to produce a product more economically)
5. Developing a new market for an existing product

Learning Objective 1.6

Identify and evaluate opportunities to start your own business.

¹² Aileen Lee, "Welcome to the Unicorn Club: Learning from Billion-Dollar Startups," *TechCrunch*, November 2, 2013. Accessed February 4, 2018, <https://techcrunch.com/2013/11/02/welcome-to-the-unicorn-club/>.

¹³ Joseph A. Schumpeter, *Capitalism, Socialism and Democracy* (New York: Harper & Row, 1942).

¹⁴ Peter Drucker, *Innovation and Entrepreneurship: Practice and Principles* (New York: Harper Collins, 1985).

Entrepreneurs Creatively Exploit Changes in Our World

Contemporary economists and business experts have defined entrepreneurship even more specifically. Drucker pointed out that, for a business to be considered entrepreneurial, it should exploit changes in the world. This is in alignment with Schumpeter's definition of entrepreneurship but explicitly takes it a step further—to take advantage of circumstances. These changes can be technological, like the explosion in computer technology that led Bill Gates and Paul Allen to start Microsoft, or cultural, like the collapse of communism, which led to a great many new business opportunities in Eastern Europe. Babson professor Daniel Isenberg narrows the definition of entrepreneurship to “the contrarian creation and capture of extraordinary value.”¹⁵

Nothing changes faster than technology. Not so many years ago, there were no bar codes and no electronic scanners, hardly anyone used email, and smartphones didn't exist. Today, even the smallest of organizations must use current technologies to be competitive. Sharp entrepreneurs increase their efficiency by taking advantage of the latest breakthroughs. To learn about what's new in technology, read current business and trade magazines and visit such websites as:

- TechCrunch, <http://www.TechCrunch.com>
- The Next Web, <http://www.TheNextWeb.com>
- Mashable, <http://www.Mashable.com>
- The Verge, <http://www.TheVerge.com>

Peter Drucker defined an entrepreneur as someone who “always searches for change, responds to it, and exploits it as an opportunity.” Entrepreneurs are always on the lookout for ways to create businesses from the opportunity of change.

Where Others See Problems, Entrepreneurs Recognize Opportunities

Here is a simple description of an entrepreneur that captures the essentials: *An entrepreneur recognizes opportunities where other people see only problems or the status quo.*

Many famous companies were started because an entrepreneur turned a problem into a successful business. An entrepreneur recognized that the problem was an opportunity. Where there are dissatisfied consumers, there are likely opportunities for entrepreneurs.

Anita Roddick was an excellent example of an entrepreneur who started as a dissatisfied consumer. She started The Body Shop International because

BizFacts

Entrepreneurship has proven to be an effective way for minorities and women to enter the business world.

- Approximately 9 million businesses were minority-owned in 2012, and they generated \$1.4 billion in revenues.
- In 2012, there were more than 12.4 million non-farm businesses owned by women (or co-owned equally with men), accounting for 36 percent of all U.S. companies.

Source: U.S. Small Business Administration, accessed February 4, 2018, <http://www.sba.gov>.

¹⁵ Daniel Isenberg, *Worthless, Impossible and Stupid: How Contrarian Entrepreneurs Create and Capture Extraordinary Value* (Cambridge, MA: Harvard Business Press, 2013).

How Do Entrepreneurs Create Business Ideas?

1. **Listen.** By listening to others, entrepreneurs get ideas about improving a business or creating a new one. Create one business idea by listening. Describe how you got the idea.
2. **Observe.** By constantly keeping their eyes and ears open, entrepreneurs get ideas about how to help society, about what kind of businesses they could start, and about what consumers need. Create a business idea by observing. Describe how you got the idea.
3. **Analyze.** When entrepreneurs analyze a problem, they think about what product or service could solve it. Create a business idea by thinking up a solution to a problem. Describe how you arrived at the idea.

she was tired of paying for unnecessary perfume and fancy packaging when she bought makeup, and she thought other women might feel the same way.

Train Your Mind to Recognize Business Opportunities

An important step in becoming an entrepreneur is to train your mind to recognize business opportunities. A further step is to let your creativity fly. List your interests, passions, hobbies, and challenges. Put them together in new and interesting ways. What business ideas emerge? Consider developing your entrepreneurial instincts by asking yourself:

- What frustrates me the most when I try to buy something? What do I observe frustrating others?
- What product or service would really make my life better? What could improve the lives of my community members?
- What makes me annoyed or angry? What annoys my friends and family?
- What product or service would take away the aggravation?

Entrepreneurs Use Their Imaginations


Businesses are also formed when entrepreneurs not only fume about products or services that annoy them, but fantasize about products or services they would like to have in their lives or for others. Jump-start your imagination by asking yourself such questions as:

- What is the one thing I would like to have more than anything else?
- What would it look like? What would its other attributes be like?
- What would it do?
- What innovative product or service idea have I been mulling over in my mind?
- What problem have I encountered in everyday life and thought: “There has to be a better way to do this”?

Consider posing these questions to friends and family members as well. You might hear about an opportunity you had not yet recognized.

An Idea Is Not Necessarily an Opportunity

Not every business idea you have or invention you explore is an opportunity. In fact, most ideas are not viable business possibilities. An *opportunity* has a unique characteristic that distinguishes it from an ordinary idea. An opportunity is *an idea that is based on what customers need or want and are willing to buy sufficiently often at a high enough price to sustain a business.*

 **Learning Objective 1.7**
Distinguish between ideas and opportunities.



Larry Lilac/Alamy Stock Photo

A successful business sells what customers need at prices they are willing to pay. Many small businesses fail because entrepreneurs do not understand this or forget how vital it is.

In addition, according to the late Jeffry Timmons, “An opportunity has the qualities of being attractive, durable, and timely and is anchored in a product or service which creates or adds value for its buyer or end user.”¹⁶

Timmons’s definition of a business opportunity includes these four characteristics:

1. It is attractive to customers because it creates or adds value for its customers.
2. It will work in the business environment.
3. It can be executed in a defined window of opportunity.
4. It can be implemented with the right team to make it durable.

The window of opportunity is the length of time available to get the business idea to market before the market either diminishes due to lessening demand or is dominated by a competitor. You might have a great idea, but if other entrepreneurs have it too, and have already brought it to the marketplace, that window of opportunity is potentially closed or closing.

Remember, *not every idea is an opportunity*. For an idea to be a genuine opportunity, it must lead to the development of a product or service that is of value to the customer and is profitable for the business.

Opportunity Is Situational

Opportunity is *situational*, meaning it is dependent on variable circumstances. There are no rules about when or where an opportunity might present itself. A problem is one example of an opportunity that entrepreneurs need to be able to recognize. A changing situation or a trend is another.

Consider recent changes in computer technology. In the early 1990s, the conventional wisdom was that only the biggest telecommunications companies were able to exploit the Internet and all the opportunities it had to offer. How could entrepreneurs compete with established, resource-laden companies? The opposite has been true. Entrepreneurs penetrated

Entrepreneurial Wisdom . . .

A useful way to evaluate a business idea is to look at its strengths, weaknesses, opportunities, and threats (SWOT). This is called a *SWOT analysis*.

- **Strengths.** All the capabilities and positive points the company has, from experience to contacts. These are internal to the organization.
- **Weaknesses.** All the negatives the company faces, such as lack of capital or training, or failure to set up a

workable accounting system. These are internal to the organization.

- **Opportunities.** Any positive external events or circumstances that can help the entrepreneur get ahead of the competition.
- **Threats.** Any external factors, events, or circumstances that can harm the business, such as competitors, legal issues, or declining economies.

¹⁶ Jeffry Timmons and Stephen Spinelli, *New Venture Creation: Entrepreneurship for the 21st Century*, 8th ed. (New York: Irwin/McGraw-Hill, 2008) 7.

and have dominated the market for Internet-based services. Think of Facebook, Google, and Snapchat. Each was an entrepreneurial venture that left industry giants scrambling to catch up.

It can take a huge corporation multiple years to develop and implement a new business strategy, while entrepreneurs can be nimble and enter and exit the market like roadrunners. Successful entrepreneurs can “turn on a dime rather than a dollar bill.”

The Five Roots of Opportunity in the Marketplace

Entrepreneurs can exploit “five roots of opportunity.”¹⁷ Notice how similar these are to Schumpeter’s definition of entrepreneurship.

1. **Problems** your business can solve
2. **Changes** in laws, situations, or trends
3. **Inventions** of new products or services
4. **Competitive advantages** in price, location, quality, reputation, reliability, speed, or other attributes of importance to customers
5. **Technological advances** that entrepreneurs take from the laboratory to the marketplace

Step into the Shoes . . .

Finding Multiple Opportunities at a Young Age

Kyle Wong started his entrepreneurial journey well before most of his peers. He is a graduate of the Network for Teaching Entrepreneurship (NFTE) program and was part of the founding of a few companies at the time. He also was the first member of his immediate family to attend college, enrolling at Stanford University.

At Stanford, Wong was accepted into the university’s prestigious accelerator program, which encourages participants to build from an idea to an opportunity to a functioning company. While part of the accelerator, he co-founded Pixlee, a platform for social media marketing campaigns, with Awad Sayeed in 2012.

Describing Pixlee on his LinkedIn profile, Wong writes, “Powered by the belief that customer stories are the most powerful way to articulate the value of a product or service, Pixlee helps brands market and sell with real customer photos and videos.”¹⁸ Customer-generated content is curated in real time. Pixlee counts Kenneth Cole, Levi Strauss, 1-800-Flowers, numerous professional sports teams, and The North Face among its approximately 150 clients.

Wong identified an opportunity, exploited it, and secured strong funders, including Andreessen Horowitz, Rothenberg Ventures, XSeed Capital, GS Shop, David Jones (You and Mr. Jones), and Bryan Weiner (360i). In addition, he was a contributor for *Fortune* and *Forbes* magazines and was named to the 2014 *Forbes* “30 Under 30” List.



Courtesy of Kyle Wong

¹⁷ Adapted from John Clow, ed., *Master Curriculum Guide: Economics and Entrepreneurship* (New York: Joint Council on Economic Education, 1991).

¹⁸ Kyle Wong LinkedIn profile, accessed May 20, 2018, <https://www.linkedin.com/in/kylewong/>.

Learning Objective 1.8

Explore the multiple paths to entrepreneurship.



Paths to Enterprise Ownership

Not all business owners start their ventures from the ground up. Although the emphasis of this book is on starting and growing your own enterprise, the paths to business ownership are varied. You could buy an existing company, secure franchise rights, license or purchase critical technology or methods, inherit a company, or be hired as a manager.¹⁹ There are pros and cons to each approach, and it is worthwhile to give thought to each option. Note the possibilities in **Exhibit 1-2**.

Secure Franchise Rights

franchise a business that markets a product or service developed by a franchisor, typically in the manner specified by that franchisor.

“A **franchise** is a legal and commercial relationship between the owner of a trademark, service mark, trade name, or advertising symbol and an individual or group seeking to use that identification in a business.”²⁰ The two primary forms of franchising are product/trade name franchising and business format franchising. Franchisors can aid in marketing, site selection, securing financing, training, product supply, and business systems. McDonald’s is an example of a business format franchise. Each company’s franchise agreement is different, and while franchises fail less often than fully independent businesses, they are not guaranteed to succeed.

For many people who want to own and operate a business, it is worthwhile to consider franchising as a path to business ownership. Some factors to consider before selecting this option are shown in Exhibit 1-2.

Buy an Existing Business

acquisition a business purchase.

due diligence the exercise of reasonable care in the evaluation of a business opportunity.

The purchase of a business, or **acquisition**, can be a good way to jump-start entry into small business ownership. If you are purchasing a company, you should perform **due diligence**, which is the process used to learn about its true financial condition (the current owners may have incentives to provide incomplete, misleading, or inaccurate information), its reputation, and its continuing viability. There is both an art and a science to buying an existing business.

Exhibit 1-2 Selected Business Entry Options

Business Aspects	Start a Business	Buy a Business	Secure a Franchise or License	License Technology
Customers	None	Established	None—but may have name recognition	None
Location	Needed	In place	Assistance possible	Needed
Management Control	Owner	Owner	Owner within terms of license	Owner within terms of license
Operational Control	Owner	Owner	Owner within terms of license	Owner
Marketing	Needed	In place (+/–)	Assistance possible; rules absolutely	Needed
Reputation	None	In place (+/–)	Should exist; if not, why license?	Possible
Royalties/Fees	Not usual	Maybe	Ongoing	Likely
Financing	Needed	Prior owner may provide	Assistance possible	Needed
Disclosures	None	Buyer beware	Franchise Disclosure Document and contracts	Agreement

¹⁹ Jerome A. Katz and Richard P. Green, *Entrepreneurial Small Business* (New York: McGraw-Hill/Irwin, 2008).

²⁰ U.S. Small Business Administration Workshop, “Is Franchising for Me?” accessed December 2007, http://www.sba.gov/idc/groups/public/documents/sba_homepage/serv_sbp_isfforme.pdf.

The challenge is to do a complete, in-depth analysis of the opportunity, just as you would for a start-up, with the added dimension of considering an existing history, whether for better or worse. Be wary of owners whose businesses seem to be too good to be true or who are overly eager to sell. Be thorough, whether you are buying an entire firm, a customer list, or some or all assets—and especially if you are taking on some or all debt. Done well, buying a business can be the starting point for success. Done poorly, buying a business can be more challenging and problematic than starting a new venture.

License Technology

One way to potentially shorten the product-development cycle and to access innovative technology is to identify and *license* that technology—that is, to enter into a contract to use it without purchasing the rights to own it. Whether you acquire such rights through a university, economic development office, federal agency such as NASA, or an individual scientist/inventor, you can create a business based on technology transfer. Or you may find that it makes more sense to purchase the rights outright or over time.

The MBA team of Bruce Black and Matt Ferris, from the University of Georgia, developed a business plan that garnered numerous competitive awards for the KidSmart Vocal Smoke Detector, someone else's invention that they legitimately brought to market. The product is now available in major retail stores and on the Internet as the Signal One Vocal Smoke Alarm.

Before securing franchise rights, purchasing a business, or licensing technology, be certain to do your research thoroughly to understand what you are and are not buying, and what your ongoing obligations—financial, operational, legal, and reporting—will be. Because these transactions are complex and can have significant financial and personal implications, it is important to invest in qualified legal and financial counsel before signing any agreements of this kind.

Making the Business Work Personally and Professionally

What makes a business work is not simply profitability and cash flow. Each entrepreneur has his or her own goals and objectives for the organization. As an entrepreneur, it will be up to you to determine how you want your business to be and to make it happen.

A Business Must Make a Profit to Stay in Business

No matter how big or small, a business must ultimately make a **profit**—that is, show a positive gain from operations after all expenses are subtracted. Most businesses lose money initially because entrepreneurs must spend money to set up operations and advertise to attract customers. If the business cannot make a profit and generate cash, eventually the entrepreneur will be unable to pay bills and will have to close.

Closing a business is nothing to be ashamed of, if you operate ethically and learn from the experience. In fact, many successful entrepreneurs open and close more than one business during their lives. If your venture is not making a profit after you have gotten it up and running, that is a signal you may be in the wrong business for you. Closing it may be the best decision.

An entrepreneur may change businesses many times over a lifetime in response to changing interests, competition, and consumer needs. Some entrepreneurs enjoy the start-up and early stages and prefer not to remain

Learning Objective 1.9

Explain success signals for entrepreneurs.

profit amount of earnings remaining after all costs are deducted from the income of a business.

past that time. Others recognize the need for managers with other skills and step aside. Still others have the desire and skills to remain with their organizations for the long haul.

Profit Is the Sign That the Entrepreneur Is Adding Value

Profit is the sign that an entrepreneur has added value to the resources he or she is using. Debbi Fields added value to scarce resources by creating something that people were willing to buy for a price that gave her a profit. In contrast, not making a profit is a sign that the entrepreneur is not using resources well and is not adding value to them.

Profit Results from the Entrepreneur's Choices

An entrepreneur's choices directly affect how much profit the business makes. For example, suppose, like Debbi Fields, you have a business selling homemade cookies. You might decide one week to buy margarine instead of butter because it is cheaper, and you haven't promised real butter in your advertising, even though the cookies may not taste as good made with margarine. This type of choice is called a **trade-off**. You are giving up one thing (taste) for another (money).

trade-off the act of giving up one thing for another.

If your customers do not notice the change and continue to buy your cookies, you have made a good choice. You have conserved a resource (money) and increased your profit by lowering your costs. The increase in profit confirms that you have made the right choice.

If your customers notice the change and stop buying your cookies, your profit will decrease. The decrease in profit signals that you have made a bad choice. Next week you should probably go back to butter and hope that you can regain the lost customers. The profit signal taught you that your customers were dissatisfied, and the trade-off was not worth it. Every choice an entrepreneur makes is a trade-off.

The Team Approach

While most businesses do not hire employees, successful entrepreneurial ventures grow well beyond their initial founder. Some have multiple co-founders while others grow their teams along with their businesses. The

Entrepreneurial Wisdom . . .

Build Your Brain

Becoming a successful entrepreneur is all about making connections, those "Aha!" moments when you realize what your business opportunity is or when you figure out how to do something better than the competition. Research indicates that mental exercise helps the brain become better at making such connections. Even the most erudite scientists recognize the value of activities that encourage brain cells to make new connections. Robotics engineer Hugo de Garis, who has worked on such projects as building an artificial brain for an artificial cat, plays classical piano every day before he sits down at the computer. "This helps to build my own brain," he told *The New York Times*.²¹ Arnold Scheibel, head of the University of

California–Los Angeles Brain Research Institute, suggests the following brain-builders:

- Solving puzzles
- Playing a musical instrument
- Fixing something, such as learning to repair cars or electrical equipment
- Creating art, writing poetry, painting, or sculpting
- Dancing
- Making friends with people who like to have interesting conversations

²¹ Nicholas D. Kristof, "Robokitty," *The New York Times*, August 1, 1999.

team approach can make or break a business. For example, alone, neither Russell Simmons nor Rick Rubin had enough skills or money to launch a record label, but together they were able to do it. Def Jam was also aided by the fact that each knew different artists and had different contacts in the recording industry.

Potential team members are all around you. Some people in your immediate circles of friends and family members might have skills, financial resources, equipment, or contacts that would make them valuable business partners. At the same time, you may reach across the globe to find team members. Perhaps you very much want to start a website design business, because you know of companies in your community that want to put up websites. You are a graphic artist, but you do not know how to use website development programs. If you have a friend who has that knowledge, you might start a business together. Or maybe you would like to start a DJ venture, but you only have some of the necessary equipment. If you form the business with a friend, you can pool equipment. (When forming a business team, organize the enterprise so that everyone involved shares in the ownership and profits. People work better when they are working for themselves.) Just be careful of jumping into business relationships with undue haste.

Now carry this idea a step further. Everyone you meet is a potential contact for your business, just as you may be a valuable contact for theirs. Thinking this way will encourage you to *network* or exchange valuable information and contacts with other businesspeople. Keep your business cards with you always and truly view every individual you encounter as an opportunity for your business. Remember, though, that networking is a two-way street. See how you can help those that you meet first rather than always focusing on how they can help you. The results can be nothing short of amazing.

Developing Skills for Your Career— Entrepreneurship or Employment

Whether you intend to become an entrepreneur, already are one, or never expect to become one, the competencies, knowledge, skills, abilities, and attitudes you can experience and develop through using of this book and taking this course can serve you well. The principles of entrepreneurship apply to all aspects of life, not only to business, and can assist you in being a more valuable and valued member of your team and community. Large and small companies, new and established ones, for-profit and not-for-profit organizations—all need skilled people to sustain them. Almost without variation, employers and entrepreneurs value skills and competencies such as written and oral communications, critical thinking and problem solving, teamwork and collaboration, creativity, leadership, ethical behavior, and information technology. By being an engaged learner, you will develop and hone your skills in those critical areas:

- **Written and oral communication.** Successful business leaders communicate well in writing and orally. Routine written correspondence and verbal interactions should be clear, concise, and correct. As entrepreneurs search for partners and capital, they must articulate the value they are creating and the assistance they require. For example, business plans, financing proposals, and pitches must be excellent. This text provides an outline and set of guide questions throughout, and these items can serve as writing prompts for you. The skills you develop while answering end-of-chapter questions will assist you in your chosen career.

◀ Learning Objective 1.10

Develop skills for a future career—employment or entrepreneurship.

- **Critical thinking and problem solving.** Successful entrepreneurs have solid critical thinking and problem-solving skills, as do successful business leaders. In fact, the most successful businesses solve urgent and valued problems for customers. Entrepreneurs constantly practice these skills. Each chapter has a set of “Critical Thinking” exercises and a variety of opportunities to develop and grow these skills. The process of developing a business plan requires these skills, too.
- **Teamwork and collaboration.** There is power in numbers, and the success rate of businesses with multiple founders is greater than that of businesses with solo founders. Regardless of the number of founders, it takes many stakeholders for business success. Key to this is working in teams in a collegial and constructive manner. Collaboration with internal and external people matters. Whether you are an entrepreneur or an employee, these skills are valuable and valued. You may work with a team through the Lean Start Up process or while developing a business plan during this course. You will read numerous cases about businesses and the teams that created and grew them. Chapter 13, “Management, Leadership, and Ethical Practices,” addresses this topic in greater depth.
- **Leadership.** A key entrepreneurial competency is conveying a clear, compelling vision for the organization, so that others want to commit to it and perpetuate it. This skill is built from the onset when developing opportunities through exit and harvesting. Chapter 13, “Management, Leadership, and Ethical Practices,” focuses on leadership qualities and skills. While you may lead a company later in life, the skills are important in any employment role.
- **Creativity.** While many people do not see themselves as creative, creativity comes in many forms. Employers want creative talent, and entrepreneurs must be creative to identify and assess opportunities where others only see problems. Chapter 1, “Entrepreneurs and Entrepreneurship,” Chapter 2, “Pathways to Success: Processes and Instruments,” and Chapter 3, “Creating Business from Opportunity,” introduce creativity and the entrepreneurial mindset.
- **Ethics.** Employees with the skills to act ethically according to common sense and codes of ethics are highly valued. Ethical dilemmas arise in many seemingly straightforward daily decisions, and deciding among options is often difficult. Organizations, whether entrepreneurial ventures or large corporations, rise and fall on their ethical decisions, so these skills are essential. Chapter 13, “Management, Leadership, and Ethical Practices,” addresses this topic in greater depth, and cases throughout the text discuss founder and management decisions.
- **Information technology skills.** Employers expect employees to be up to date in the use of business information technology. These skills also serve entrepreneurs well. You can use projects and activities throughout the semester, as well as end-of-chapter assignments, particularly Exploring Online, to build your technology skills. If you create a business plan, you will use multiple skills that are important regardless of the life path you choose.

All these skills are life skills for entrepreneurs and employees alike. Each of them in isolation is valuable. The combination of all is potent. Being competent in all the above skills and others you may develop will serve you well in your career. This book, used as a resource in your course, will provide much of the information, practice, and knowledge you need to develop, enhance, and hone your skills.