



# entrepreneurship



THE ART, SCIENCE, AND PROCESS FOR SUCCESS

fourth edition

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## ENTREPRENEURSHIP: THE ART, SCIENCE, AND PROCESS FOR SUCCESS, FOURTH EDITION

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# dedication



*To my family, Yvonne, Moretha, Rob, Sean, Jane, Clara, James, Ada, Andrew, Silas, and Isaac with whom I get to enjoy so much in this life. To my great friend and colleague Garry Bruton who has been my writing partner for over 15 years. To the folks at McGraw-Hill, who still understand that it is good content that students and faculty are looking for in a text.*

Charles E. Bamford

*To my parents, John C. and Ruth W. Bruton, who empowered me with their love, encouragement, and support throughout their lives. They always taught me to do what is right more than what is easy or even profitable. To my wife whose support is constant. And finally, to my oldest friend and co-author, Chuck Bamford, always one of the great constants of joy in my life.*

Garry D. Bruton

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Courtesy of Chuck Bamford

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Chuck's research has been published in the *Strategic Management Journal*, *Journal of Business Venturing*, *Entrepreneurship Theory & Practice*, *Journal of Business Research*, *Journal of Business Strategies*, *Journal of Managerial Issues*, *Journal of Technology Transfer*, and *Journal of Small Business Management*, among others.

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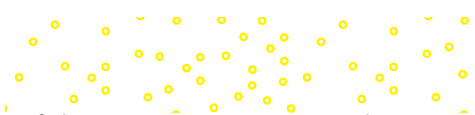
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Courtesy of the Texas Christian University—Neeley School of Business

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# (preface)

We developed the fourth edition of this book with the aim of focusing on three core tenets to starting an entrepreneurial venture:

1. *Science* of practice as the heart of starting and running a successful entrepreneurial venture.
2. *Art* of turning an entrepreneurial venture into a success.
3. *Processes* that tie these two areas together into a coherent and organized business.

The first tenet is that the *science* of practice is central to your success as an entrepreneur. There is an inherent belief by many potential entrepreneurs that they know what needs to be done. However, extensive research suggests that one of the biggest causes of entrepreneurial failure is a lack of knowledge about how to design and build a business. The business that seems so clear to the entrepreneur at founding turns out quite differently. The result is that a lack of knowledge leads to the entrepreneurial venture running out of cash and time.

This book presents a systematic and thorough means for students and potential entrepreneurs to think through their venture and the rich range of concerns around it. Extensive research has been going on in this area for decades, and we know much about what works and what does not work. One of the significant goals of this text is to provide you with information about what really works. Without trying to overwhelm the reader with research citations, we ensure that students have well-researched information, this text is grounded in the academic research with a practitioner view to everything that is done.

The second tenet is that there is a lot of *art* to the concept, design, and implementation effort required to start a new business. To teach the art, we present what other entrepreneurs have done in the past, so students can consider what they would like to have as their own approach. In this text, we provide a great variety of real-world examples.

To fulfill this real worldview of entrepreneurship as an art, each chapter starts with a story about a successful entrepreneur and how he or she grew the business. Additionally, you will find throughout the text two running cases that provide direct, applicable context to the chapter contents. The first running case is John and Bob's Barbershop, which was created by two friends who wanted to practice their craft and be rewarded for their own efforts. The second running case is a business called Hatchboards. This running case follows the development, design, and start-up of a business that combines a virtual selling model with a manufacturing focus. Finally, we have included 14 MiniCases at the end of the book where we personally interviewed entrepreneurs about their story. Each MiniCase finishes with advice from the entrepreneur.

The third tenet of our approach involves the *processes* of conceptualizing, designing, starting, and running a new business. Hundreds of things must be considered, analyzed, and completed to take an idea to a successful business. We firmly believe that these processes are crucial steps along the way and have built this book in a manner that allows the reader to build on each concept by developing a process that results in a fully crafted plan by the time you finish the book. Our belief is that learning these processes by doing will ultimately lay the foundation for students to replicate them to build their own business plan in the future.

The ability to apply the science, art, and process of entrepreneurship developed in this text will lay the foundation for succeeding in entrepreneurship. We say proudly that the overarching desire of this book, *Entrepreneurship: The Art, Science, and Process for Success*, is that students establish highly successful and

very profitable businesses. We believe that following and acting on the issues we lay out here will establish the foundation for that success.

## Entrepreneurship Is Not a Scary Word

If you are taking this course, you have at least some level of desire to be your own boss one day by establishing an entrepreneurial venture. You have a plan to start (and succeed) at your own business venture, and you see this course as groundwork for that plan. Beyond a personal desire to be an entrepreneur, there are real, applicable reasons to take this course. Today, 50 percent of all U.S. employees work for entrepreneurial businesses. Even if you do not ultimately start an entrepreneurial venture, the odds are that at some point in your career, you will work for one. Entrepreneurial businesses are everywhere. They include a wide range of visible firms on the Internet. These firms are the makers and sellers of a myriad of other goods and providers of services that impact our daily lives. Understanding the components of success and failure for your future employer makes you a better employee.

## Book Outline

To develop the understanding necessary to design, start, and manage an entrepreneurial business, we have organized the book into 14 chapters that are, in turn, organized into five major parts. The first part lays the groundwork needed prior to developing a new business idea. Many individuals have considered starting a new business when an opportunity was presented to them or when they were frustrated by their current positions. However, prior to this step, there are several areas that demand examination. Chapter 1 introduces students to the text with a fun and engaging look at the twenty-first-century entrepreneur. Chapter 2 examines the potential entrepreneur's personal propensities or willingness to take on risk, a core aspect of entrepreneurship. Chapter 3 focuses on how to generate ideas and perform an initial evaluation for a new business.

The second part of the text is entitled "Due Diligence on the Business Idea." In the last chapter of Part 1, the potential entrepreneur has generated a business idea. In this part there is due diligence on that idea. Due diligence is a process of examining the environment around the new venture to establish the opportunity for the new business and then using that knowledge to craft the approach. Chapter 4 launches the first step in the due diligence process by developing a set of methods for examining the external environment in which the new business might operate to understand if there is an opportunity for such a business. Chapter 5 develops the crucial steps necessary for the development of a strategy, including the firm's mission.

A key element in the success of the entrepreneurial venture is its financial foundation; no matter how good the idea, without a solid financial foundation, the business will likely fail. Accordingly, Part 3 is titled "Establishing a Financial Foundation." The chapters in this part include Chapter 6, which establishes how to analyze the cash flow of the firm. Chapter 7 discusses methods that the entrepreneur can use to analyze the financial health of the new business.

The fourth part of the text is titled "Building the Business" and focuses on putting the new venture in operation. Chapter 9 discusses marketing the business. Chapter 10 reviews the legal frameworks for a new business, including the many approaches that are available to protect the business. Chapter 11 details human

resource management. Chapter 12 rounds out this important part of the book by discussing the business operations design.

The last part of the book is titled “Important Issues for Entrepreneurs” and examines two other issues critical for an entrepreneur to consider as the entrepreneur starts a business. Chapter 13 examines both exiting the business and the need to turn the firm around if performance is not as great as desired. Chapter 14 examines two means to buy into a business rather than starting it from scratch. They are buying an existing business and franchising.

## Features New to This Fourth Edition

- The opening vignettes to each chapter have been changed from the prior edition to include cutting-edge entrepreneurial companies including Ancestry, Dannijo, Solidia, Puzzle Break, SparkVision, and Dyson.
- Two new running cases are in each chapter in the revised text. Each chapter follows John and Bob’s Barbershop and Hatchboards as they moved from idea to successful businesses. Each running case is tied to the chapter material.
- In addition to Review Questions in the end-of-chapter material, every chapter also includes a section called Business Plan Development Questions. The goal of these questions is to turn the material in the chapter into actions for the business plans being developed by students. Also, both Individual and Group Exercises have been added to help students develop their entrepreneurial skills individually as well as within a group.
- Fourteen MiniCases are included at the end of the text. Each case is based on interviews by the authors and provides context and entrepreneurial advice simply not available in any other text. These include AddLibra; Aventino’s Restaurant; TechnikOne; Lawn Enforcement, Inc.; Evry Health; and Bark Pet Grooming.
- A Business Plan (The Fraudian Slip) has been carried forward from the previous edition and annotated by the authors as an example of how a business idea is all pulled together by students in a course.

## Additional Changes by Chapter

### Chapter 1 The Twenty-First-Century Entrepreneur

- New Opening Vignette: Ancestry.com.
- Updated to provide a more engaging and fun introduction to the text.
- Every statistic brought forward to 2020.
- Updated examples of entrepreneurs and entrepreneurial firms to some of the newest firms in popular press.

### Chapter 2 Individual Leadership and Entrepreneurial Start-Ups

- New Opening Vignette: Smathers & Branson.
- John and Bob’s Barbershop running case is introduced. This case develops in each chapter through the rest of the text. It follows the design, start-up, and running of a business with friends as business partners.

- Hatchboards running case is introduced. This case develops in each chapter throughout the text. It follows the design, start-up, and running of a business by three friends that combines a virtual selling model and a manufacturing base.
- The two running cases provide contrast for students on a traditional service business start-up and an Internet start-up so that students can see elements of both types of businesses.
- New Ethical Dilemma concerning when people leave their current employer and what they can take with them to their new business.

### Chapter 3 Business Idea Generation and Initial Evaluation

- Updated Vignette: Dannijo (the wildly popular fashion brand).
- Updated and changed the Example of Entrepreneur's Personal Deficit Analysis.

### Chapter 4 External Analysis

- New Opening Vignette: Uncharted Power and how a small idea is changing the world for millions.
- Introduced the concept of applications and its definition and nature in the industry.

### Chapter 5 Business Mission and Strategy

- New Opening Vignette: Solidia (engineered cement that could significantly reduce CO<sub>2</sub> emissions).
- Updated examples in the chapter include Toys R Us, Yahoo! and STEAM as well as updated key terms *strategy* and *sustainable competitive advantage*.

### Chapter 6 Analyzing Cash Flow and Other Financial Information

- New Opening Vignette: EONE (the watch for those with sight impairment).
- Updated financial data in examples.

### Chapter 7 Financing and Accounting

- New Opening Vignette: IDRESE (custom shoes without the custom price or wait).
- Expanded the discussion of bank lending and SBA loans.

### Chapter 8 Business and Financial Analysis

- New Opening Vignette: Halfaker & Associates (veteran-owned business).
- Updated financial data in examples.

## Chapter 9 Legal Issues with a New Business

- New Opening Vignette: Puzzle Break (Escape Room Business).
- Updated to reflect changes in the law.
- Table summarizing the different legal forms and what they do and do not do.

## Chapter 10 Human Resource Management

- New Opening Vignette: Spark Vision (connecting multi-generational organizations).
- Updated based on changes in labor law and health care laws in the United States.

## Chapter 11 Marketing

- New Opening Vignette: Iguana Fix (Argentine business bringing security and stability to home repairs).
- Added new material on social media marketing.

## Chapter 12 Establishing Operations

- New Opening Vignette: Optime (an international marketing consulting firm).

## Chapter 13 Exit/Harvest/Turnaround

- New Opening Vignette: Dyson (inventor who revolutionized the vacuum, fan, and hair dryer industries).
- Updated financial data in examples.

## Chapter 14 Franchising and Purchasing an Existing Business

- New Opening Vignette: JAE Restaurant Group (owner of hundreds of franchises).
- Updated laws concerning franchising in the United States.

## Outcomes

Our ultimate goal is that students will leave this class not only with a much greater appreciation for what it takes to start a business but also with knowledge of the foundations necessary to actually start that business. The entrepreneurial businesses that surround you every day did not come into operation or stay in operation by chance. Instead, it took tremendous effort and work for these businesses to exist and succeed.

We expect that students will be able to take what we present here as a foundation for their own business. Entrepreneurs are the economic backbone of this nation and the central hope for its future.

# acknowledgments

We would like to acknowledge the dedicated instructors who have graciously provided their insights for this fourth edition. Their input has been extremely helpful in pointing out corrections to be made, suggesting areas that needed further development, and topics that needed to be included in the text.

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## End-of-Chapter Material

Each chapter concludes with the following:

- Summary
- Key Terms
- Review Questions
- Business Plan Development Questions
- Individual Exercises
- Group Exercises

## INDIVIDUAL EXERCISES

1. What types of new businesses interest you most and why?
2. What aspects of those businesses are particularly appealing to you?

3. Do you see yourself as an entrepreneur in the next five years?

## GROUP EXERCISES

### Interview an Entrepreneur

Early in this course, every person in the class should interview an entrepreneur. You have wide flexibility as to the types of entrepreneurs you select. However, each entrepreneur must be the original founder of the business or the current owner and should not be your

close relative. Prepare a report on the entrepreneur you interviewed. The report should be no more than three typed, double-spaced pages long, and cover three primary areas. First, discuss the background and characteristics of the entrepreneur, as well as the history and nature of the business. Second, discuss lessons

**THINKING CRITICALLY**

Martin McNeese-TechniOne



Martin McNeese started the opportunity in the Web design industry after graduating with his accounting degree in 1998. He went to work for a major bank as a financial analyst for two years. He then decided to start his own business, TechniOne, a Web design and development company. He was fascinated with Web pages and how they appeared on computer screens. He decided to learn as much as possible about the technology as he could. They not only taught him, but they also gave him the opportunity to work with the technology. He decided to learn as much as possible about the technology as he could. They not only taught him, but they also gave him the opportunity to work with the technology.

**MiniCase 1**

related accounts and then used those to leverage their "word-of-mouth" status with local companies. Clients in the New York City area gave TechniOne their "word-of-mouth" status. The history of TechniOne, from its beginnings in 1998 to its current status as a leading Web design and development company, is a testament to the power of word-of-mouth marketing.

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related accounts and then used those to leverage their "word-of-mouth" status with local companies. Clients in the New York City area gave TechniOne their "word-of-mouth" status. The history of TechniOne, from its beginnings in 1998 to its current status as a leading Web design and development company, is a testament to the power of word-of-mouth marketing.

## MiniCases

MiniCases are now included at the end of the text. These longer cases look at real businesses. They examine a real entrepreneur and how that owner approached the business and the struggles associated with success. These offer practical, real-world examples of core concepts within the entrepreneurial framework discussed in the book.



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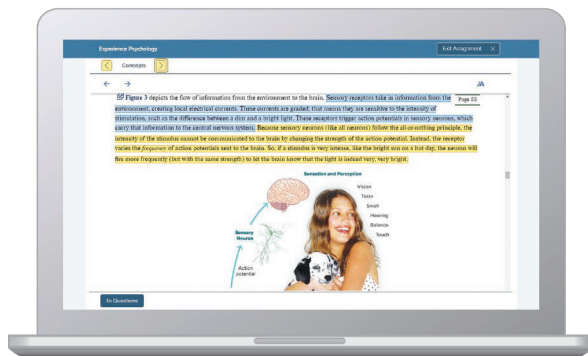
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- Jordan Cunningham,  
Eastern Washington University



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**Instructor's Manual:** The IM outlines course materials, additional in-class activities, and support for classroom use of the text. It has been organized by learning objective to both give instructors a basic outline of the chapter and assist in all facets of instruction. For every question posed in the text, the IM provides a viable answer. Ultimately, this will be to an instructor's greatest advantage in using all materials to reach all learners. There are questions to all minicases in the text to help instructors organize their discussion of the cases with students. Detailed teaching notes for each case have been added for this edition.

**PowerPoint Slides:** PowerPoint slides include important chapter content and teaching notes tied directly to learning objectives. They are designed to engage students in classroom discussions about the text.

**Videos:** The video collection illustrates various key concepts from the book and explores current trends in business and entrepreneurship.

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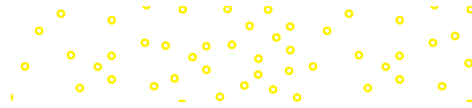
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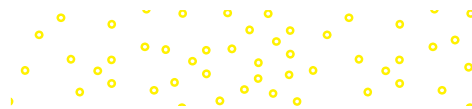
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# entrepreneurship

THE ART, SCIENCE, AND PROCESS FOR SUCCESS

fourth edition





Alija/iStock/Getty Images

## learning objectives

After studying this chapter, you will be able to:

- LO1-1** Explain the rationale behind starting an entrepreneurial business.
- LO1-2** Discuss the history of entrepreneurship in the United States.
- LO1-3** Identify the type of people who are entrepreneurs.
- LO1-4** Describe the impact of entrepreneurial businesses on society.
- LO1-5** Discuss the worldwide impact of entrepreneurial businesses.
- LO1-6** Define an entrepreneurial business.

# The Twenty-First-Century Entrepreneur

## ANCESTRY.COM



Source: Ancestry

DNA testing has rapidly become an accepted and trusted approach for paternity tests, criminal prosecutions (proving both innocence and guilt), and even hunting down criminals from cases decades old (Pillowcase Rapist and The Golden State Killer). This was not always so. Although Charles Darwin proposed the idea of DNA testing, it did not become a reality until 1985.

Today DNA testing boasts an accuracy rating of 99.9999 percent and while the use of it for criminal prosecutions gets a lot of the headlines, the reality is that most of the use is for personal exploration. The largest company in the industry by far is Ancestry.com, boasting more than 15 million completed samples in its database as of May 2019. The company was formed as a combination of two companies—one founded as a genealogy publishing company in 1983 and the other as a floppy-disk family history software company in 1990.

Ancestry.com has bought and sold many operations since its founding as it transformed into the DNA testing/genealogy-tracking company that it is today. Technology that simply did not exist previously has allowed the firm to evolve and change over time. This transformation includes moving into the testing of DNA.

By the early 2000s the company was focused almost solely on allowing people to pay a fee to search for their ancestors on an impressive database of census records. The firm had over 1 billion records digitized by 2001. The DNA testing option began rather meekly in 2002 with a partnership company that processed DNA kits sold by Ancestry. The company realized the potential early on for aligning their searchable database with

DNA mapping. By 2016 the company had expanded its product offering (now on multiple platforms) to over 30 countries.

The focus in the past few years has been on the DNA kit. This kit is sent directly to individuals who generally spit in a tube that is sent to a testing lab. Some 6-8 weeks later a report arrives electronically with various information provided. Leading competitors to Ancestry include 23andMe, CRIgenetics, MyHeritageDNA, LivingDNA, Vitagene, and Helix among many others.

While growth in the industry is expected to slow, the business model that most offer includes a recurring revenue stream that makes the industry quite attractive. Ancestry went public in 2009 and then was bought out by a private equity firm and went private again in 2012.

### Questions

1. What are some of the technological changes that have allowed firms like Ancestry.com to grow?
2. Do you see opportunities in an industry right now that have similarly been triggered by changes in technology?
3. What dangers do you see in widespread use of DNA testing?

Sources: D. Ovalle and C. Rabin, "DNA Hit That Led Cops to Suspected Pillowcase Rapist Came from Another Arrest. Of His Son," *The Miami Herald*, January 21, 2020. [www.miamiherald.com/news/local/crime/article239481848.html](http://www.miamiherald.com/news/local/crime/article239481848.html); "A History of DNA Testing: An Interesting Timeline," June 21, 2018. [www.pocketnewsalert.com/2018/06/a-history-of-dna-testing-an-interesting-timeline.html](http://www.pocketnewsalert.com/2018/06/a-history-of-dna-testing-an-interesting-timeline.html); "Ancestry Continues to Lead the Industry with World's Largest DNA Network." [www.ancestry.com/corporate/newsroom/press-releases](http://www.ancestry.com/corporate/newsroom/press-releases); [www.ancestry.com/corporate/about-ancestry/our-story](http://www.ancestry.com/corporate/about-ancestry/our-story); "How Do Ancestry DNA Kits Work? Trace Your Irish Heritage," February 14, 2018. [www.irisharoundtheworld.com/ancestry-dna-kits](http://www.irisharoundtheworld.com/ancestry-dna-kits); [www.dnaweekly.com](http://www.dnaweekly.com); S. O'Brien, "Ancestry CEO Steps Down, Delays IPO," CNN Business, September 12, 2017. [www.money.cnn.com/2017/09/12/technology/business/ancestry-ceo-resigns/index.html](http://www.money.cnn.com/2017/09/12/technology/business/ancestry-ceo-resigns/index.html).

## LO1-1

Explain the rationale behind starting an entrepreneurial business.

### United States Small Business Administration (SBA)

The SBA is the agency officially organized in 1953 as a part of the Small Business Act of July 30, 1953, to “aid, counsel, assist and protect, insofar as is possible, the interests of small business concerns.” The agency provides a wealth of information and assistance at all levels of organizational development and management for new entrepreneurial businesses. See [www.sba.gov](http://www.sba.gov).

### Fortune 500

The Fortune 500 is published annually by *Fortune* magazine and documents the 500 largest corporations (by sales) in the United States.

## Why Start a Business?

There are many reasons that individuals decide to start a new business. A lifelong dream, a desire to make a difference in the lives of other people, a realization that you can solve a nagging problem for yourself and others, your sudden unemployment, a desire to be your own boss, a response to an opportunity brought to you, and many more. These reasons have been shared with us by individuals who are part of the tremendous pent-up desire by many people to be an entrepreneur. Although people are regularly bombarded with stories about the new businesses that exploded into massive companies (Amazon, Facebook, Grubhub, Etsy, iRobot, etc.), most new companies stay well under the press radar. Yet many of the firms you never hear of are very successful and are an essential element in any economy.

The evidence of entrepreneurial businesses’ importance to the economy can be seen in the following 2019 statistics from the **United States Small Business Administration (SBA)**<sup>1</sup>:

- 99.9 percent of all businesses in the United States are small.
- 48 percent of private sector employees are in small businesses (60 million out of 126.8 million employees in the United States).
- 33.3 percent of known export value are from small businesses (\$29 billion out of \$1.3 trillion).

Furthermore, these entrepreneurial businesses are growing rapidly. Small businesses created 9.6 million net new jobs from 2000 to 2018, or just under 65 percent of net new job creation in the United States. Large businesses were responsible for just 5.2 million.

Beyond the statistics, there are also countless stories of successful entrepreneurial new ventures in every community around the world. One needs to remember that every business in the **Fortune 500** started out as a new venture. Each one was the brainchild of a single individual or a small group of people. Recall from history that entrepreneurs such as Henry Ford (Ford Motor Company), Ron Brilland and Pat Farrah (Home Depot), Thomas Edison and Charles Coffin (General Electric), Barney Kroger (Kroger), Ralph Lauren (fashion), Sam Walton (Walmart), Estee Lauder (cosmetics), Oprah Winfrey (media), and Richard Branson (Virgin) all started out as small-business owners.

To illustrate how entrepreneurial businesses can grow to be on the Fortune 500 list, consider how in 1976, Steve Jobs worked with Steve Wozniak to design and sell the first Apple personal computer from Jobs’ parents’ garage. To raise the approximately \$1,600 in capital to start the business, Jobs sold his microbus and Wozniak sold his calculator. By 1979 Apple had earned over \$200 million. In 1985 Jobs was pushed out of the company. He went on to found another computer firm NeXT and funded the spinout of the computer graphics division of Lucasfilm, which he renamed Pixar. In 1997 as Apple floundered, Apple bought NeXT and brought Jobs back to Apple to lead the turnaround at the firm. Jobs would go on to usher in an entire category of products that individuals did not even know they needed, including the iPad, iPhone, and iTunes.<sup>2</sup>

We do not mean to suggest that every new venture will ultimately grow to dominate some aspect of world business. What it does mean is that new ventures are the foundation for all businesses. Some grow large; some do not. Regardless, they all initially go through a process much like the one you will study in this book, and that process of business development from scratch is quite different from the processes followed by established businesses. The process of developing, initiating, and running a new business is so unique that it has developed into one of the most sought-out areas of study at colleges and universities around the globe.

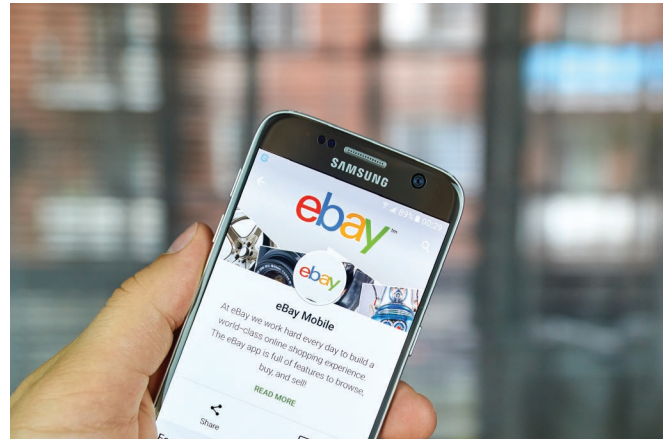
The success of entrepreneurial businesses occurs partially because they are simply more focused than their large corporate counterparts. Entrepreneurial businesses are not burdened with having to create and manage policies, procedures, corporate

layers of management, and public stockholders, so new businesses are free to put all their energy into satisfying the needs of their customers. A customer calling on a big jewelry chain to get a battery changed in his or her watch will find that the chain either does not perform those services or treats the effort to change the battery as a burden. The same customer calling on a locally owned jewelry store, however, will most likely get immediate assistance and gratitude for the business. The local business has the advantage of an owner whose fortunes are directly tied to the success of the firm. The average manager of a large firm, although interested in the success of the company, does not have any personal capital at risk. If the firm does not do well, the manager moves to another firm, whereas an owner may lose his or her savings.

Large firms can obtain **economies of scale** in some industries. In other words, large firms can sometimes do things more efficiently because of their ability to operate on a larger scale than a small firm.<sup>3</sup> For example, advertising is typically much cheaper per unit if purchased in large volume. Thus, a large firm such as Walmart can buy its advertising much more cheaply on a per-unit basis than can a small retailer. Similarly, in manufacturing it is often much cheaper on a per-unit basis to produce large volumes of a product than to produce small volumes. This is the reason that small car manufacturers must charge an extraordinarily high price to cover their costs. Tesla Motors, which produces an all-electric suite of vehicles, has taken the battery vehicle concept and crafted it into a set of high-performance cars. By 2019 the firm was selling over 350,000 vehicles. Today most major cities in the world have a Tesla storefront. An individual can charge his or her car at home or at one of the approximately 14,500 Superchargers located in 1,636 Supercharger stations around the world.<sup>4</sup> While it still takes considerably longer time than filling with gas, the effort to grow charging stations will at some point allow an individual to charge his or her car essentially in the same manner (albeit not with the same speed) that a person fills up with gas in a combustion engine. Many cities provide prime parking for such charging stations as the cities seek to limit pollution and encourage more electric cars. The infrastructure may allow a critical mass of charging options at some point. The expectation is that the sales of electric cars will expand even faster and the economies of scale may allow Tesla and the many new electric vehicle (EV) automobile makers to lower the cost for their vehicles.

Many years ago the apparent efficiencies of very large businesses led some economists to predict that small entrepreneurial businesses would be largely replaced by a much smaller number of large businesses. The exact opposite actually happened. The ability of entrepreneurs to respond more quickly and to operate more effectively (more focused on the specific needs of customers) led to a growth in the raw number of entrepreneurial businesses rather than a decline.

This text develops the methods, applications, and processes that lead to the idea generation, investigation, start-up, and successful management of a new entrepreneurial business. How you grow your new business is a function of how you start your business. We firmly believe that the development and implementation of a new business is part art and part science. This field has been studied for a long time and there is a well-developed body of knowledge that should be the foundation of all your efforts. This text lays out a process for the “science” of forming and managing a new entrepreneurial business in a clear, sequential manner that is rich in its practical application as well as well grounded in research. The “art” is a matter of practice, example, and the skill of the founder or founders of the new business. The text encourages you as you go through the process of developing your ideas and work to develop your own personalized business plan. Although we will not be



*Pierre Omidyar of eBay is an excellent example of a small-business owner with a vision that exceeded expectations. He took his personal website which he used to auction off items he found and created a phenomenon.*

dennizn/Shutterstock

### economies of scale

A condition that allows the long-run average cost to continue downward as production increases. It leads (in its most extreme case) to a condition where a single firm making 100 percent of the product is the most efficient. In reality, this condition is moderated by the ability of management to adjust the size.

with you as you actually found your business, the goal of this text is to provide you with the fundamentals of starting the business and help you to develop your business into a functioning entity. Beyond all the statistics about how many new businesses fail (and many of them do fail), research (including our own studies) has found that there are three critical elements that an entrepreneur must solve for success:

1. An effective sales generation model. You are only as good as your pipeline. You must develop the ability to generate consistent and growing sales.
2. Sustainable operating profit margins. Profit margins are key to successful businesses.
3. Being properly financed. It is crucial that you have sufficient resources (either yourself or by raising funds) to get the business to the point where it is self-funding.<sup>5</sup>

We believe that the principal way to be a part of the group that survives and thrives is to thoroughly plan and lay a solid basis for the business.

## LO1-2

Discuss the history of entrepreneurship in the United States.

## A Brief History of Entrepreneurial Businesses in the United States

Before we start looking at entrepreneurial businesses today, it is important to note that entrepreneurs have always been a critical part of the country's success. Alexis de Tocqueville was a Frenchman who toured the United States in the early 1830s and wrote a famous analysis of the country. One of his observations was that the United States was not so much a nation with ventures that were marvelous in their grandeur, but instead a nation of innumerable small ventures. The history of the United States has always been intimately tied to entrepreneurial businesses. In fact, until the mid-1880s, almost all U.S. businesses were still relatively small.

The 1880s saw the initial development of the nation's large industrial base. It was from these beginnings that the robber barons developed. We associate their names today not only with great success but also with great abuses in business. They took advantage of the economies of scale that were suddenly possible with the industrial age and quickly came to dominate new sectors of the economy (e.g., Andrew Carnegie's domination of the steel industry). However, the robber barons were coming to dominate industrial sectors that had not existed historically, so they generally did not put smaller operations out of business. In fact, smaller entrepreneurial businesses continued to thrive during these times as new businesses grew up to serve the needs of these new industrial sectors.<sup>6</sup>

The Great Depression of the 1930s was harder on entrepreneurial businesses than on larger more mature businesses, and as a result it encouraged industrial concentration. The outcome was that following World War II, entrepreneurial business as a percentage of the U.S. economic output began to decline. It was during this time that Charles Wilson, secretary of defense for President Eisenhower, made the famous statement that "what is good for General Motors is good for the nation." The implication was that what was good for big business would be good for all of the people in the country.

In the late 1970s and early 1980s, the nation was in economic turmoil as many of the large firms that had grown to dominate the U.S. economy were having difficulty, owing to global competition. Entire industries, such as steel and automobile manufacturing, were in decline. It was during this time that President Jimmy Carter described the country as in a "malaise." The Japanese were in the dominant economic position in the world, and the widely discussed fear was that the United States was in decline much as Britain had been 100 years earlier. However, the decline of the large multinational firms in the United States opened new opportunities that entrepreneurial businesses rose to fill. The economic growth and success that the nation experiences today is due primarily to the entrepreneurial firms that found an economic footing and grew very rapidly. Today many of the multinational

firms in the United States are technology firms that began in the late 1970s and early 1980s. The vast number of businesses that start up each year are responsible for much of the innovation that pushes established companies to new levels.

Therefore, as you begin your study of entrepreneurial businesses, you should recognize that you are examining a domain that has historically been the backbone of the economic success of the nation. Entrepreneurial businesses today continue to play a dominant role in the ability of the nation to adapt quickly and to make economic progress. The time line of business in the United States (Figure 1.1) highlights the central role of new business development.

## Who Are Entrepreneurial Business Owners Today?

One of the huge advantages of starting one's own business is that it provides the setting where the business owner can be the boss. As we will discuss in Chapter 2, the owners of a new business are the most important single factor in the business's success. The new business owners have both the opportunity and the responsibility to lead. However, although many new business owners want this independence, they also need to recognize they are not alone in the business; there are other important **stakeholders** of their entrepreneurial business. These are individuals or other organizations that may impact the success of the business and depend on the success of the business for their own livelihood. Stakeholders include key suppliers, customers, and employees—all of whom are critical to the success of the new business.

It is true that the rewards of owning a business extend far beyond the financial. That said, the financial rewards to entrepreneurs can be stunning. In their book entitled *The Millionaire Next Door*, Thomas Stanley and William Danko highlight statistics that demonstrate the potential for financial rewards from starting a business.<sup>7</sup> For example, they point out that almost two-thirds of U.S. millionaires are self-employed, despite the fact that self-employed people make up fewer than 20 percent of the workers in America. They go on to state that 75 percent of these self-employed millionaires are entrepreneurs; the other 25 percent are self-employed professionals, such as doctors and accountants. So, close to 50 percent of the millionaires in this country are entrepreneurs. These are the individuals who start a business, run it well, and over time build their financial success. Most millionaires are individuals you know in your community. These individuals achieved their success by taking the bold step to actually start and run a business. This is the same step you can take at any time. We hope that by following the processes outlined in this book, you will be more confident and better prepared to succeed.

The financial rewards can be overwhelming for successful entrepreneurs who often start with little or no thought of where the company could grow or what it might be. Elon Musk has a pattern of entrepreneurial success. He first created the online city guide Zip2, which was purchased by Compaq in 1999 for \$307 million. He then created X.com, an online payments site that became PayPal, which was acquired by eBay for \$1.5 billion. Musk used those proceeds to found private rocket company SpaceX in 2002 and electric car company Tesla Motors in 2003. Not all entrepreneurs are immediately successful. Travis Kalanick dropped out of UCLA in 1998 to work on a Napster-like file-sharing company, Scour, which was sued for a quarter of a trillion dollars in 2000 before closing. His next company, Red Swoosh, another file-sharing firm, sold for \$19 million in 2007. His next company was Uber, which he founded in 2009. Mark Zuckerberg and his roommates started Facebook as a way to connect with other students at Harvard (its first incarnation was a site designed to compare two people at the same time and decide which one was “hotter”).

### LO1-3

Identify the type of people who are entrepreneurs.

#### stakeholders

Individuals or other organizations that impact the success of a business.

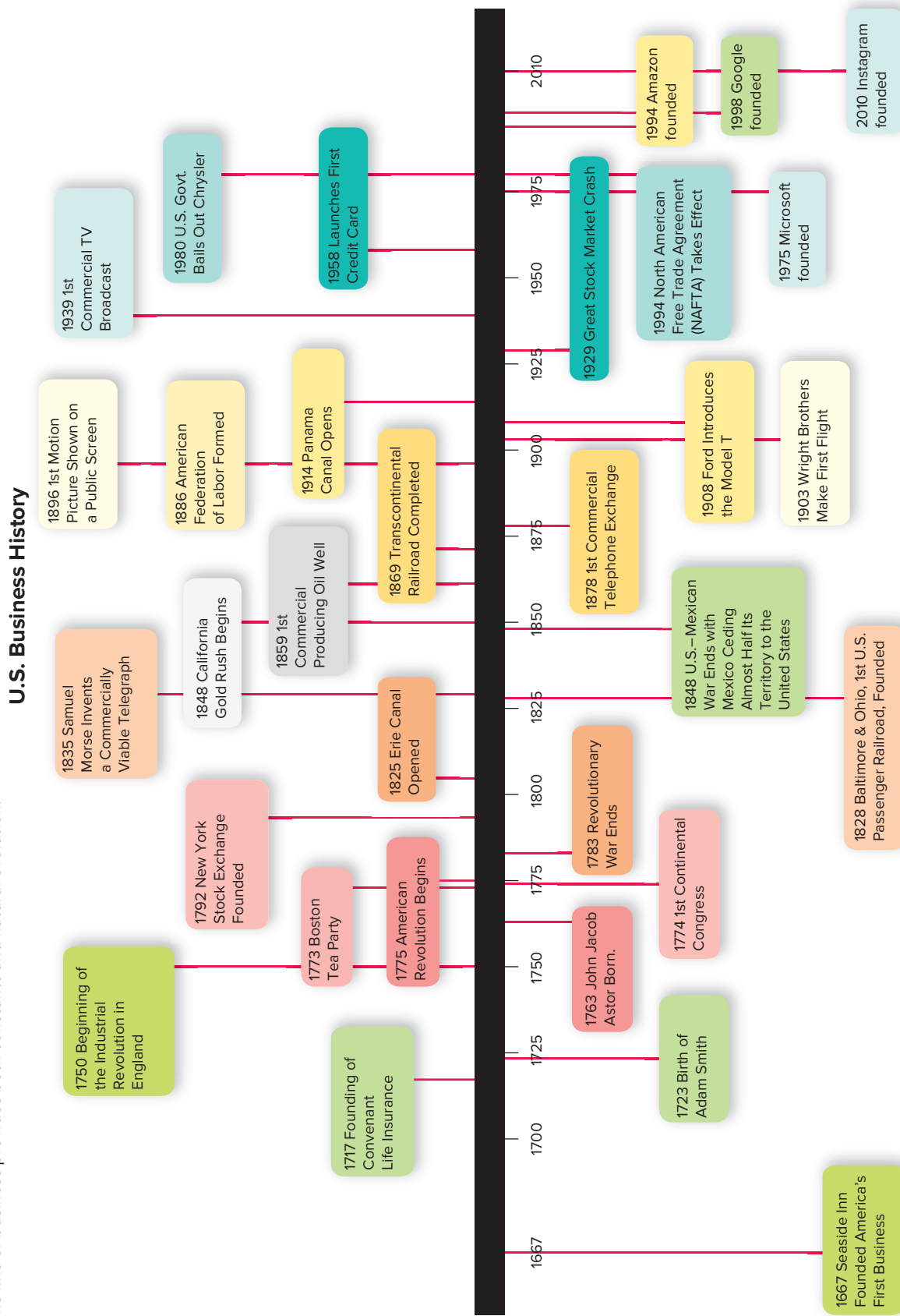
### EXERCISE 1

1. Name some successful entrepreneurs you personally know.
2. What types of businesses do they run?
3. Why do you think they are successful?
4. How would they define success?
5. How did these individuals start their business?

**Figure 1.1**

**Business Time Line**

The time line of business provides both constants and natural evolution.



## How Does Society Benefit?

### LO1-4

Describe the impact of entrepreneurial businesses on society.

New business development is an important driver of the economic success of a community, a region, and a state. As a result, civic leaders increasingly look up to entrepreneurs as a means to promote economic strength. There are some well-known areas where such efforts have been widely publicized, such as North Carolina's research triangle; Austin, Texas; the Denver-Fort Collins Innovation Corridor; Silicon Valley; and Boston's 128 corridor. These areas are well known for generating new employment with entrepreneurial ventures, providing a growing tax revenue base, and providing a basis for significant improvements to the area's economic vitality.<sup>8</sup> The success of these areas has encouraged others to seek to promote entrepreneurship to a much greater degree. A program called Economic Gardening is growing across the United States to help start new entrepreneurial businesses in an area. Littleton, Colorado, has used the program to add 15,000 jobs to the regional economy.<sup>9</sup>

Entrepreneurial businesses act as a catalyst for societal change in other ways as well. They have the ability to garner profits in markets that have been ignored by large corporations. Large organizations will regularly ignore business opportunities if they do not believe the results will generate high profits, whereas entrepreneurial businesses are more flexible and willing to pursue a wider range of opportunities. The owners and employees of the entrepreneurial businesses have an understanding of the local community not easily obtained by a large conglomerate. For example, after a large military base or factory closes, there is obvious economic damage to that region, as the businesses that catered to the base or factory must either reset their target market or close their doors. Examinations of these areas suggest that a crisis such as a military base closing can lead to the formation of a much higher level of new business formations. Those individuals who have lost their jobs generally do not wish to leave the area (or cannot afford to leave the area). These individuals may have been satisfied with their location, and while they dreamed of starting a business, it was only when faced with the challenge of unemployment that they took the risk to start their dream. Studies have found that people facing a crisis from closure of an existing business often form new businesses, which, in many cases, can turn the economic fortunes of the area around.

The federal General Accounting Office (GAO) did an analysis of the impact of the closure of military bases. It found that in cities with base closings including Salt Lake City, Kansas City, and San Jose, the areas around the bases had unemployment rates lower than the national average and income growth higher than the national average. There had been large initial job losses in these communities; however, the state and community leaders had responded to the closing of the bases with tax breaks and programs to support the development of new businesses. The result was that numerous new businesses rose up to fill the economic gap that had resulted from the closing of the bases.<sup>10</sup>

In Aurora, Colorado, the Fitzsimons Life Science District was developed on the site of the former Fitzsimons Army Medical Center. Within two years of its opening, the area had 17 start-up or early-stage bioscience businesses housed there.<sup>11</sup> Today it is a thriving center of research, employment, and new business growth. Pittsburgh, Pennsylvania, was once severely depressed economically as the U.S. steel industry faltered. However, by 2016 the downtown area was a center



A view of downtown Pittsburgh Pennsylvania's skyline showing the Duquesne Incline.

Sean Pavone/123RF

## ETHICAL CHALLENGE

What motivates you to start a business? As we will discuss in Chapter 2, there can be multiple motivations. Finance is clearly a strong motivation. Individuals desire money, and clearly the rewards for entrepreneurship can be substantial. A key motivation can also be other things such as control over your life and doing those things you enjoy. It is simply not true that success in an entrepreneurial business can be achieved only with brutally hard and long hours. Many entrepreneurs make a very good living working limited numbers of hours each week. These entrepreneurs could clearly make more money in their life, but they structure their business as a means to live rather than why they live.

Every entrepreneur must think through what his or her motivations are for the business and structure the

business accordingly. Entrepreneurs must be honest with themselves and their potential partners and investors. We place this consideration here in an ethics box to start because we think the absence of honesty about entrepreneurs' motivations with themselves and others is a critical ethical decision that should be made at the very formulation of the firm.

### QUESTIONS

1. What do you see as your key motivations for starting a business?
2. If you had to allocate percentages to lifestyle, money, freedom, and family for motivators, what would they be?

of renaissance as technology companies like Google, Facebook, and Uber established offices in the area to tap local talent from the University of Pittsburgh and Carnegie Mellon University.<sup>12</sup>

Entrepreneurial businesses provide more than just jobs; they also provide a means to meet the varied demands that individuals face in a society. Individuals can become frustrated with large corporations over the lack of promotion opportunities or the inflexibility of the corporations in dealing with the needs of family and children. Starting a new business may allow individuals to meet these demands in their lives in a way that large corporations are simply unwilling to do.

The number of women starting new businesses has increased to the point where they are now the largest single group of new business founders. In part, this growth has come from the fact that women are often frustrated by what is referred to as the "glass ceiling." This refers to the fact that women, like minorities, may be hired by large firms but experience limits placed on their advancement. As a result, these women leave the large firms and start their own businesses. Women entrepreneurs also start businesses to allow them to have greater control over their lives, so they can better balance their family's and children's needs. A new business provides a valuable safety valve so that the citizens of a society can address the demands and needs in their lives.

Heather Schuck (left) worked in investments and then in a psychiatric treatment home before her frustration with work-life balance helped push her to start her own business, Glamajama, which makes trendy baby clothes. Founded in 2003, the firm's products today can be found at national retailers such as Bed Bath & Beyond, Nordstrom, Target, and J.C. Penney. Using her experience, Schuck wanted to encourage women to achieve business success while also being allowed to stay focused on family, so she later started the very popular GlamaLIFE.com online community, which connects women interested in business. This



Courtesy of Heather Schuck

community is built around the ideas in Schuck's 2013 book entitled *The Working Mom Manifesto: How to Stop Hoping for Happiness and Start Creating It*. The central argument is that women can create successful businesses around family rather than forcing the family to be centered around the business. Schuck has appeared on every significant talk show and is a classic example of how one can achieve in many facets of life.<sup>13</sup>

## Entrepreneurship Around the World

New and growing businesses are critically important around the world. The World Bank estimates that one of the strongest factors in the growth in any nation's Gross National Product (GNP) is the presence of entrepreneurial small- and medium-sized enterprises (SMEs). Today there are widespread efforts in almost all nations to encourage the development of small and medium enterprises. These governmental efforts range from tiny contributions of capital or time to large, multidimensional programs that cross the boundaries of multiple nations.

Some of the efforts to encourage SMEs around the world are quite small, but still have a big impact. For example, microloan programs have been in existence for years to encourage self-development. These loans are often for only a few dollars each and are made directly to entrepreneurs, often women. The businesses founded through such loans can be as simple as delivering lunches, weaving baskets, or washing clothes. However, the success of such loans has been substantial, with great strides being made in many desperately poor nations. It is interesting that the repayment rate on such loans is typically 99 to 100 percent, a much higher repayment rate than on most types of loans. The success of these loans has resulted in an increasing dedication of the U.S. aid budget to microloans for developing nations.<sup>14</sup>

At the other extreme are nations that have prepared a full range of programs to encourage new venture start-ups. A program in Singapore is aimed at encouraging high-technology ventures among highly educated individuals. The government is providing a range of services and facilities to assist in the development of these ventures and encourage the founding of firms that might result. Although these two examples are at different extremes, they both demonstrate a high level of interest and investment by governments in small-business initiation. The result of these efforts is that the pace of small-business start-ups is increasing around the world.

### EXERCISE 2

1. What motivates your interest in entrepreneurship?
2. What opportunities do you see in your community?
3. Have these opportunities attracted other businesses, large or small? Why or why not?

### LO1-5

Discuss the worldwide impact of entrepreneurial businesses.

## What Is an Entrepreneurial Business?

It is clear from the previous discussion that new businesses have benefits for individuals and society within the United States and around the world. Individuals typically associate small and entrepreneurial businesses together. For classification purposes, the U.S. government considers any business with fewer than 500 employees to be a small business while the European Union caps that number at 50. We would suggest that a business with almost 500 employees is actually a large firm requiring formal personnel policies, specialized services, and an administrative structure that is in no way close to the reality of most small businesses. For the vast majority of people, the businesses formed will have far fewer than 500 employees.

We suggest that there is a further level of definition that is needed for clarity. Multiple terms can be used to refer to the same types of businesses including *entrepreneurial businesses*, *small businesses*, sometimes as *small-to-medium-sized businesses or enterprises* (SMBs or SMEs), and *family businesses*. These terms are roughly equivalent and do not specify the differences between the two main types of new business. We see two main categories of start-up businesses.

### LO1-6

Define an entrepreneurial business.

The first category of start-up businesses includes those formed as high-growth, often high-tech, ventures that have several unique characteristics and are generally venture capital-backed firms. Venture capital start-ups can be characterized by the following descriptions:

### harvest plan

A plan to exit a business. Typically, the owners have the intention to sell the business to another firm or take it to an IPO.

1. The businesses are well-funded by venture capital or angel investment. In fact, without such capital it is virtually impossible to begin this particular type of venture.\* Venture capitalists are a specialized type of investor; they typically do not invest less than \$2 million and in return they expect extraordinary returns.
2. These businesses are formed with a **harvest plan** in place; this is a plan to exit the business that allows the investors to take advantage of growth. A harvest plan may include selling the business to another firm, selling it to a group of investors, or even participating in an IPO (an initial public offering of stock). Size is the deciding metric in a potential public offering or sale to a larger organization.
3. As a result of the harvest plan, these firms are organized to grow as quickly as possible and are generally heavily laden with debt. Many are harvested before they can achieve positive net cash flow.
4. They have a developed organizational structure.
5. They often hire an experienced president to grow the company.
6. They tend to develop operations in multiple locations very shortly after the initial investment.
7. They are inherently risky operations whose growth is dependent on the exploitation of unknowns in the market (a new invention, unique patents, etc.).
8. These businesses either start or grow quickly to employ a relatively large number of employees.

The second category of business is a more common type of business and is the focus of this book. These firms are most often referred to as *entrepreneurial firms* and are defined by these characteristics:

1. The start-up is self-funded or funded by those close to them.
2. The development plan is oriented around positive cash flow.
3. The management structure is designed to take advantage of the skills of the founder or founders.
4. The operation is designed in the image of the founder(s).
5. The business is oriented toward the personal goals of the founder(s).
6. The number of employees may be zero or as few as one and typically would not be expected to grow to more than 50 to 100.

When we discuss *entrepreneurial businesses* throughout this text, it is this second category of firms to which we refer. Such entrepreneurial businesses are the type you are much more likely to found than are venture capital-backed firms. This is not to suggest that a business founded as an entrepreneurial business does not sometimes become a capital-backed business. Although Facebook or even LinkedIn was founded as an entrepreneurial business, we would more accurately describe either of them as a venture capital-backed business, since both quickly required millions of dollars of investment from venture capitalists to grow. In contrast, the businesses of the majority of millionaires discussed in the book *The Millionaire Next Door* almost always started as entrepreneurial businesses. These individuals made their fortunes in areas such as lawn care, plumbing, and elec-

\*The concepts of venture capital and angel investors will be dealt with in greater detail in later chapters. For reference here, both are investors who provide capital to the start-up firm in exchange for ownership in the new firm. This ownership level can be and often is over 50 percent of the firm.

trical work, and their businesses were almost all founded in a manner consistent with the second category of business. This second category of business is also what typically will be found outside of the United States. The presence of venture capital for start-ups is limited outside of the United States. Often even funds that say they are venture capitalists are in fact only providing funding for mezzanine or mature, existing firms that are looking to expand. In the text we will discuss some of the differences that can be expected outside of the United States, but we argue that most of what we present here is relevant outside for firms starting up in a wide variety of markets.

Although some of the concepts discussed in this text are applicable to venture capital-backed firms, the focus in this text is on the systematic designing of a successful entrepreneurial business start-up. The U.S. Census tracks employment by number of employees (among many other statistics) and the latest census reports indicate that firms with fewer than 99 employees represent 76 percent of all firms in the United States, and also represent approximately 33 percent of all full-time employees in the United States.<sup>15</sup>



*Mark Zuckerberg is a great example of massive entrepreneurial business success. His story is more the exception than the rule. What lessons can we learn from Zuckerberg's success that might apply to businesses on a smaller scale?*

Erin Lubin/Bloomberg/Getty Images

## Business Plans—Another Difference in Types of Firms

Another critical difference between an entrepreneurial business and a venture capital-backed firm is in the size and detail required in their initial business plans. An entrepreneurial business's resources are significantly more constrained than those of a venture capital-backed business. Whereas the venture capital-backed firm generally develops a business plan as a promotional tool to be sent to potential investors, the entrepreneurial business develops a business plan as a guide for the running of the business. Many ventures seeking capital hire professional consultants to assist them in the development of their business plans; in contrast, we strongly advise all entrepreneurial business owners to develop their own plans as a part of their process.

A venture capital-backed business plan runs from 25 to 45 pages long, though we have seen many that are more than 100 pages (ugh). The business plan for a small business should be relatively short (15 to 25 pages) and should be developed in a manner that helps the small-business person understand the industry, the firm that he or she wishes to develop, and what will be needed to create success in that business. Thus, the business plan for a new entrepreneurial business is developed with three goals in mind:

1. To be a guide to managing the business in its early development.
2. To provide a self-evaluation: Putting the information down in writing allows for evaluation and honest analysis.
3. To provide potential closely held investors with the critical information necessary to evaluate the key criteria of the business: its cash flow, management team, and competitive advantage.

The business planning process that we develop in this text is a very practical and logical guide for the establishment and initial management of a new business. We do not discuss the long, intricate business plans that are sometimes written

### EXERCISE 3

1. Do you have any initial ideas for a new business? Write these ideas down. As we go through the course, you will be asked to evaluate your business idea in light of the concepts presented in that chapter. Most ideas will undergo significant evolution as you begin to study the topic more.
2. How many employees would your initial business require? Why?

to attract venture capital. Instead, you will develop a working document that is grounded in the needs of the new entrepreneurial business. A well-thought-out business plan has heightened importance for the new business as a tool for you to think through a wide range of issues, as most new businesses will not actually obtain financing from big-money investors. This type of business will either be self-funded or obtain financing from friends and family. These types of investors are not looking for a slick five-year formal plan; instead, they are looking for a document that explains the value of the business and how it will succeed.

Therefore, you should note the following:

1. *No cookie-cutter business plan programs.* We will not use any of the cookie-cutter business plan programs that are available. If you google the term *business plan*, you will find any number of programs on the Internet that encourage you to plug in information and allow the program to “generate” a plan. We believe such programs really inhibit the process of designing a business. Each business plan, much like each business, should have its own voice, feel, and presentation. We suggest to you that a good business plan is best developed by the individual(s) contemplating the business, not by paid consultants who will have none of the enthusiasm of the founder(s). The fact that potential investors to an entrepreneurial business will be those closest to the founder makes it critical that the entrepreneur(s) seek to ensure the chances of success by doing thorough planning and thinking. It is one thing to lose money and close a business if the investment comes from investors you know casually. However, if the investors are your parents, in-laws, grandparents, or siblings and the business closes, it can be truly painful and may, in fact, cause ruptures in the relationships you hold most dear. A well-designed business plan has already helped the founder(s) consider every aspect of the new business and allows everyone else involved to have a true “feel” for where this opportunity is heading.
2. *You should plan to develop the elements of your plan as you finish each chapter.* This text is designed for you to have a full business plan crafted by the time you reach the end of the book. Crafting that section of your plan along the lines developed in the chapter leads to a more comprehensive and well-designed plan that is fresh in your mind as you write. The final section of the book has a fully developed entrepreneurial business plan and a full discussion about each section of that plan. The plan in the appendix is one developed by students as a class project. Our hope is that you will be able to produce an equally detailed plan in this class. The business plan you produce should ultimately be a good solid start on a plan you could use to begin your own business. You will want to refine the plan more after you leave the class, but the class will provide you with the tools to begin the process of forming your own business.
3. *Do not be intimidated by the effort needed to bring forth a business.* It is a daunting task to think about all the aspects of crafting a new business. It should be done in pieces with each piece fitting into a whole picture. At the end of every chapter, you should ask yourself whether the business you are designing still makes sense. There is as much value in deciding not to pursue a particular business idea as there is in actually starting a business. It is a process; take it step-by-step.
4. *Craft a one-page pitch for your business.* We will discuss this several times in this text, but it is crucial that you develop an attractive, one-page pitch about your business as you go through the process of developing your business plan. It clearly lays out the crucial information about the new business idea and provides an effective starting point for every potential supplier, employee, or investor. Although each one will be somewhat unique, a one-page pitch generally should cover the information as the one in Figure 1.2.

## The ToolGym

**The ToolGym:** A gym-like facility and atmosphere provides access to the tools and expertise necessary to allow users to pursue their interest in woodworking.

We solve the problem of niche woodworking tool availability and variety and eliminate the common barriers to entry in pursuit of these interests such as personal time, space, and money.

**Business Summary:** Operating under a similar guise as a gym membership or cloud computing model, the user wants access to assets without acquiring, setting up, and maintaining the equipment.

**Initial Product Offering:** We will provide all access to the tools, workspace, storage, and expertise for woodworking hobbyists and professionals under one roof. Our pilot will consist of one location, strategically positioned, whose benefits offer high density of target demographic as well as ease of materials access.

**Customer Problem/Target Market:** The ToolGym solves the problem that exists with any expensive hobby: The resource utilization typically does not commiserate with cost. Much like SaaS models in technology, ToolGym solves this issue with a consumption-based model that commoditizes time, money, and accessibility for the woodworking hobbyist.

Our target market is the trade craftsman and fine woodworking segments where the cost-to-utilization ratio unbalance exists.

**Management Team:** Our executive team has an extensive experience in developing companies from incubation to exit or sale with a deep domain knowledge of the trade craftsman and woodworking industries.

Our finance expertise is based on years of financial strategy consulting deeply rooted in emerging markets and hypergrowth opportunities.

Our sales and marketing team is highly skilled in direct and indirect (channel) sales strategies and leverages a wealth of market analytics expertise to execute market entry and sales growth initiatives.

### Our Customers:

- The woodworking hobbyist who is constrained by the time, space, and money required to own and maintain a workspace to tackle significant woodworking projects.
- The woodworking beginners—those with entry-level skills but the desire and resources to pursue.
- The trade unions in need of a training facility or apprentice program as well as schools that have dropped shop classes but have an interested audience of students.

**Sales Strategy:** Full immersion into the woodworking hobbyist culture using positioning (location) and partnerships (with fine/rare woods and finishes suppliers) that will add instant credibility to the services resources we deliver.

### Marketing Strategy:

- Classes for beginners.
- Partnerships with suppliers, storage facilities, and industry trade shows.
- Storage for projects in progress.

**Figure 1.2**

### One-Page Pitch Sheet

An example one-page pitch sheet provides a snapshot of the business at a point in time.

(continued)

**Figure 1.2**  
(continued)

#### **Competitors:**

- Every hobbyist garage and/or home woodworking space within our target demographic.

#### **Competitive Advantages:**

- **Exclusivity:**
  - The ToolGym will offer a line of unique tools and tool accessories.
  - Partnerships with fine woods stores, given their limited supply, adds immediate credibility and exaggerates the importance of being first to market.

#### **Risks:**

- Inability to grow membership.
- Liability; insurance requirements necessary.
- Highly skilled labor.
- Target audience messaging.
- Space and tool use optimization.

#### **What we need:**

- **Phase 1:** \$225,000 for 20 percent equity in the ToolGym
  - Equals 12 months of operating expenses.
  - Cash flow positive at 13 months.

## Lean Start-Up

The approach we have in this text is consistent with a concept you may hear often—lean start-up. The term *lean start-up* indicates that a start-up business will need to rapidly change. Rather than pursuing a fixed business idea, you should visualize the start-up as an experiment. The focus is on building a business that generates something the customer that is an early adopter actually desires. The lean approach means seeking a model that is scalable—or able to build into something bigger. The approach we have detailed here fits with this approach. The lean start-up seeks to shorten the product/service cycles by quickly testing and experimentation of a product. The goal of this book and of the lean approach to business start-up seeks to iteratively build products or services with a particular focus on early customers. This process requires constantly testing the business's products/services with real customers and incorporating their feedback into the entrepreneurial effort. The result is that your ultimate business may look very different than what you initially start. One key to this model that we stress later in the text is measuring your outcomes. Your measures of success—financial and otherwise—must be exacting as you build a quick understanding of your actions and their outcomes. One key to the lean entrepreneurial process and where the term originates is the start-up must be lean. To make changes, an entrepreneur must be flexible. If you have invested heavily in a piece of equipment, for example, you may be unwilling to abandon it when it is clear that this is not what the business needs. Thus, the entrepreneur must recognize that change will be the nature of the business, and so whether such an investment is helpful or confining must be evaluated by the entrepreneur. The key for the entrepreneur is the adaptation. Keeping any production or action simple can quickly be eliminated if it does not generate the

success the entrepreneurial team is seeking. We stress throughout the book that a plan is useful as a discipline to think through concepts and ideas. However, the goal is not to generate a long, involved document that does not change. From day one, the entrepreneurial team must be flexible.

## SUMMARY

This chapter began by discussing the impact that new businesses have on the economy. A brief history of new ventures was discussed, with the observation that every business you can think of, regardless of size, was started by one person or a small group of people. Given that, there are still two very distinct types of businesses: (1) those that are funded by large amounts of outside venture capital with the intent of growing them as fast as possible and (2) those that are primarily in business for

the benefit of the founders and their families. The second group is far more prevalent around the globe and is the focus of this text. The remainder of the chapter set up three main principles we want you to remember: (1) No cookie-cutter business plan programs should be used, (2) build your own business plan along with the chapters in this book, and (3) this is a process, so take it in bite-sized pieces. The concepts of a lean start-up were discussed and will be incorporated throughout the book.

## KEY TERMS

economies of scale 5  
Fortune 500 4

harvest plan 12  
stakeholders 7

United States Small Business  
Administration (SBA) 4

## REVIEW QUESTIONS

1. How do entrepreneurial businesses impact the economy?
2. Beyond some classic examples (Steve Jobs, Elon Musk, Michael Dell, Larry Page, and Sergey Brin), name several entrepreneurs who have grown their businesses into major organizations.
3. Explain what is meant by the science and the art of starting and managing a business.
4. How have entrepreneurial businesses impacted the growth of the United States?
5. Why does “profit as a goal” present an ethical challenge to new business owners?
6. What differentiates an entrepreneurial business from one that is a venture capital-backed business?

## INDIVIDUAL EXERCISES

1. What types of new businesses interest you most and why?
2. What aspects of those businesses are particularly appealing to you?
3. Do you see yourself as an entrepreneur in the next five years?

## GROUP EXERCISES

### *Interview an Entrepreneur*

Early in this course, every person in the class should interview an entrepreneur. You have wide flexibility as to the types of entrepreneurs you select. However, each entrepreneur must be the original founder of the business or the current owner and should not be your

close relative. Prepare a report on the entrepreneur you interviewed. The report should be no more than three typed, double-spaced pages long, and cover three primary areas. First, discuss the background and characteristics of the entrepreneur, as well as the history and nature of the business. Second, discuss lessons

learned by the entrepreneur as he or she related to you. Third, include your evaluation of the entrepreneur, and state what you can personally take away from the

experience. You should plan to make a short (five- to seven-minute) presentation on this individual to the rest of the class.

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## chapter

## 2

Amble Design/Jetta Productions/Blend Images/Shutterstock

# Individual Leadership and Entrepreneurial Start-Ups

## learning objectives

*After studying this chapter, you will be able to:*

- LO2-1** Explain how entrepreneurial founders impact the business world as a whole.
- LO2-2** Discuss the importance of an entrepreneurial orientation.
- LO2-3** List the triggers that encourage new business formations.

**LO2-4** Compare and contrast various types of new business supports.

**LO2-5** Explain how you can evaluate those things that you enjoy the most and discover how they may lead to business opportunities.

## SMATHERS & BRANSON

**SMATHERS & BRANSON**®

Source: [www.smathersandbranson.com](http://www.smathersandbranson.com)

Fascinated by a couple of needlepoint belts they were given by girlfriends when they were in college back in 2004, Austin Branson and Peter Smathers Carter went on a search for how to buy other needlepoint belts that they thought would add to their preppy look. It turned out that the needlepoint process was so complex (designs were typically done by hand and customized) and took so long to produce (often six months or more from order to delivery), that no major suppliers existed. The team felt that there was a market hole which could be an entrepreneurial opportunity. The two wanted to develop a business plan to market needlepoint belts (and later other needlepoint merchandise) to retailers looking for unique items without the huge wait and expense. They immersed themselves into everything needlepoint including doing an independent study together for one of their classes.

After graduation they moved into the basement of Austin's parents' home in Bethesda, Maryland. Though they took summer jobs—Carter taught tennis, Branson was a caddy—they had decided to start the business and created their first product, the flag belt

(which remains the company's best-selling item) as well as a variety of other designs. They found a partner in Vietnam that employed local villagers to stitch. The pair asked their parents for frequent flier miles as Christmas presents so that Carter and Branson could fly there and teach the villagers to stitch the belts properly.

The partners entered the market in 2005 and did just under \$300,000 in sales that year. Their primary avenue of sales was via retail outlets with a variety of products including their signature belts, dog collars, hats, and even key fobs. They were anxious to get into selling on the Internet and developed a web page; but they quickly realized the web page was not working. In a bold move, they took it down for almost a year while getting it completely redesigned and relaunched it in 2013.

In the meantime, the pair aggressively sought out agreements with Major League Baseball® (MLB) teams, National Hockey League® teams, and National Football League® teams, as well as college fraternities and sororities. In addition, they moved into custom group sales for schools, clubs, and organizations as well as monogrammed products. By 2020 their products were in more than 700 country clubs and over 100 colleges and universities.

They knew that they did not want to have any investors, so they grew the business as they were able with their own funds. To

this day, they own the business 50–50. By 2017 their sales were \$15 million and growing. They hit the jackpot when the Chicago Cubs won the World Series in 2016. While they had a full line of products available for all teams, the Cubs' president held the trophy up high while wearing his Cubs needlepoint belt. The business sold more Cubs products that year than they did for the rest of the MLB.

Carter and Branson had developed a strong list of clients and even though catalogs seemed to be a thing of the past, the two decided to try their hand at direct mail marketing. They now mail out almost half a million catalogs a year. Their business is about 70 percent retail and about 30 percent online and catalog.

Today they employ literally thousands of artisans in Vietnam. Raw materials are shipped directly to the artisans and their production is shipped to a warehouse in Bethesda, Maryland. The company employs more than 30 people who put finishing touches on products and ship them directly to customers. The two founders share all tasks together (human resources, production, design, shipping, etc.) and have a rule that they do not proceed unless both agree. They have hired nine salespeople who are on the road constantly to increase business opportunities.

This process has been a huge success and a lot of fun for two founders who knew what they wanted.

### Questions

1. What kind of business model is important to you personally?
2. How do you feel about other investors in your business?
3. If having fun is a part of your motivation to start a business, what is it that you find fun?

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### organizational slack

Excess resources in an organization that allow for redundancy and the quick deployment of personnel in crisis.

In large, well-established organizations, no one person is crucial to the survival of the business, even the president of the company. The lack of dependence of large organizations on any one individual is due to the strong structures in the large firm including extensive written procedures, clear lines of responsibility, and the presence of other individuals or units to step in when some failure occurs. Large organizations also have wide dispersion of knowledge throughout the business; in other words, there are multiple people who know about any given aspect of the business. As a result, if any single person leaves the organization, it has the ability to continue with minimal interruption. Finally, large organizations have greater excess resources, including financial resources, which allow them to hire outside experts to fill any critical need that arises. These excess resources are referred to as **organizational slack**; they allow large organizations flexibility that is not available to the typical entrepreneurial venture.

In contrast an entrepreneurial business is generally dependent on a single individual or a few individuals for the business to survive. A new entrepreneurial business starts as the brainchild of a single person or a small group of people, each of whom has an ownership stake in the business. The new business has few formal procedures, a concentration of knowledge in those individuals who start the business, and limited slack resources.<sup>1</sup> The absence of slack financial resources means the new firm has limited flexibility in responding to emergency issues such as the need to hire replacements if the company loses key individuals. As a result, the founders of an entrepreneurial business and the leadership they provide play a far more critical role in the business's success than does the senior leadership of the typical large organization. The importance of the individual in the



*Understanding and collaborating in small groups can be an essential part of new business success. What are some of the key characteristics you would look for in a partner?*

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founding and managing of a new business leads to the focus in this chapter on the individual who starts a business and his or her leadership. The prior discussion of lean start-up in Chapter 1 stresses this fact—the new entrepreneurial venture must be lean to survive as it changes and evolves.

This chapter includes a discussion of why individuals are so important to the success of a new business. It also provides ways for you to understand your own predisposition to start a business. The examination of your orientation includes an examination of your risk tolerance and the boundaries that may exist in your perception of events in the environment. It also includes an exercise to test your own entrepreneurial orientation.

Every individual brings a unique set of supports that can be used to help in the founding process; these supports are critical in the success of a new business. Therefore, we will examine those supports, the most important of which is the family. In some businesses the family is a more valuable support than in others as the family may all work in the firm. These businesses are referred to as **family businesses**. Family businesses have unique issues that extend beyond those of the normal new entrepreneurial business. We will address family businesses more at the end of this chapter.

The authors of the text have had extensive experience working with entrepreneurs as they start and run their businesses. Throughout this text you will find that many of these firms are used as examples. In particular, we will follow two specific start-up businesses throughout the text. The first one we will see in this chapter is John and Bob's Barbershop. This venture was the outcome of three friends' discussions about how they could work for themselves.

The three potential entrepreneurs completed the exercise. John and Bob realized from the exercise they were far more frugal in their lives than Betty. From this insight John and Bob realized that they were more compatible as partners than either was with Betty. They realized that if they went into business with Betty, they would soon have significant conflicts regarding both the approach to and the actual finances of the new business. The result would most likely be a loss of their friendship with her and the potential failure of the business. The discussions among the three friends also brought these issues home more clearly to Betty, who ultimately decided that a business was not for her. She realized that because of her current debt, if the business needed more money, she would not be able to put any more money into it; also, if the business failed, she had so few resources to fall back upon that she might have to file for bankruptcy.

### family business

A business in which ownership and employment are centered around the family.

## Founders Are the Reason Why Entrepreneurial Businesses Work So Well

New businesses have some significant advantages over large businesses. For example, the very fact that entrepreneurial businesses start out small means that these firms have greater flexibility. Smaller firms can also respond quickly to changes around them, whereas a large firm tends to use many committees or project teams to approve the work of other committees or project teams. This feature alone allows the smaller firm led by the aware entrepreneur to respond quickly to opportunities or threats as they arise. Entrepreneurial firms also fill niches that large firms simply cannot afford to fill. Large firms do have an advantage in those situations where there are economies of scale; that is, the large firms have the ability to produce a service or product more cheaply because it is done on a large scale.<sup>2</sup> However, in small niches, the large firms' systems are not able to perform effectively at small volumes of a particular activity because of their large fixed costs and overhead. These niches are ideal for new businesses.

### LO2-1

Explain how entrepreneurial founders impact the business world as a whole.

## JOHN AND BOB'S BARBERSHOP

Bob, John, and Betty had become good friends in recent years. They initially met in a Facebook group for barbers and hair stylists. A barber typically is associated with male hair and a hair stylist with female hair; another key difference is that the two have different licenses from the state where they operate. The core difference for the license is that a barber works with razors, which are considered potentially deadly weapons, either by cutting someone or having a contaminated razor. The three friends were all barbers and focused on male hair.

The three friends had grown increasingly frustrated with their jobs over the years. Each worked for a different franchise (a concept examined in Chapter 13). The three had incomes—whether based on salary or percentage of haircut cost—of about \$25,000 per year. The amount they could earn was largely determined by how many hours they were scheduled by the franchise manager. Thus, the three could have months when they were well short of their expected income if the manager of the franchise chose to schedule someone else for more hours or to limit the hours of one or more of the three for some disagreement with that manager.

The result of this situation was that the three friends started to think about opening their own barbershop. The basic idea was to make money for themselves rather than others. The process of investigating what was needed to open a barbershop became a reason for the trio to meet at least once a week. As they discussed more about opening the barbershop, they felt they needed to talk to an experienced entrepreneur to get some insights on how best to proceed with the venture. Therefore, the three potential entrepreneurs had a conversation with Betty's aunt Mena who had started several successful businesses.

Mena advised them to spend more time investigating their motivations and personal risk orientation before they actually considered going into business together.

She related the story of her first business, which she had started with her best friend. The two had been lifelong friends and thought they knew all there was to know about each other. Not only had they been friends since childhood, but also each had been the maid of honor in the other's wedding. Although the lifelong friends thought they knew all there was to know about each other, when it came to money and the level of risk they were capable of handling, they were substantially different people. Whereas Mena was very frugal, her partner believed that money needed to be enjoyed today. Ultimately, their business partnership fell apart.

Although the financial loss was significant, even more devastating was the loss of the friendship between the two women and their families. Mena has always felt the experience was a significant failure and not one she wanted to repeat. She has had other businesses and partnerships since that initial failure and now believes that although she needs to like a person in order to work closely with him or her, it is much more important that the partners agree on such key issues as money and risk. Therefore, she suggested the three friends discuss four simple issues among themselves:

1. How each person prepares his or her family budget.
2. How much debt each is willing to take on using credit cards.
3. Whether each is willing to lend family members money and the reasons for his or her answer.
4. What each would do with an inheritance of \$250,000.

The outcome of this exercise for our three potential business owners will be discussed after Exercise 1 in text.

### QUESTION

1. What other issues for potential partners to discuss would you add to those Mena suggested?

### EXERCISE 1

1. Evaluate your own views on the issues raised in John and Bob's Barbershop. Discuss your results with others in your class. What is the range of answers that were given?
2. Have you ever lent money to a relative? Or have you heard stories from others who have? Would it be different if it were a close friend with whom you went into business?

Even though these advantages can be substantial, the greatest advantage for an entrepreneurial business is that it is owned and run by the same person(s). Contrast this to most large corporations, where there is a division between owners and managers. The individuals who manage the operations of a large, established corporation do not typically have substantial ownership in the company. The managers (agents of the owners) may own some stock, but in a large business such as General Motors they own a very small percentage of the total stock.

**Agency theory** suggests that individuals act to maximize their own individual benefit.<sup>3</sup> The result in a large corporation is that the manager of a business will tend to act to maximize his or her own benefit, not necessarily that of those who own the firm (typically the shareholders). This does not mean that the manager seeks to steal from the firm; instead, in subtle but pervasive ways, the manager will act for his or her own benefit. In contrast, the individual who owns the business will always act to maximize the value of the business, since the interest of the owner and that of the business itself are aligned: If the business makes money, the owner makes money.

To illustrate, the manager of a large firm can easily justify why it is important to fly nonstop, first class across the country for a meeting in New York City or Los Angeles. That manager might argue the need to have room to work and rest on the flight in order to arrive fresh. This trip may easily cost \$3,500 if the ticket is bought on short notice. This comes out of the corporation's income, money that really belongs to the shareholders (the owners).

Compare this with the typical behavior of an entrepreneur. Just as it is for a corporation, the airline ticket is an expense; however, in this case, every dollar spent comes directly out of the pocket of the entrepreneur. She or he is more likely to go on the Internet and find the cheapest ticket possible. Although the entrepreneur would also like to arrive fresh and be able to work during the flight, she or he is more likely to fly economy class through a hub airport to save \$2,500 or more. If the large, established business is doing poorly, the manager still collects a salary and benefits, although the shareholders (owners) are getting few rewards. The manager will move on to another firm if the business collapses, having no significant stake in the financial failure of the previous company. In contrast, if an entrepreneurial business is doing poorly, the owner may ultimately have to close the business and be responsible for any debts that it has accumulated. As a result, the entrepreneur will treat the costs of the business very differently than will the manager of a firm. (When we deal with the legal structure of entrepreneurial business in Chapter 7, we specify in greater detail if and when an entrepreneur is responsible for the debts of the business.) If the managers of a large business had to spend their own money or were responsible for the debt of the organization, agency theory would argue that the manager would behave in a thriftier manner.

Thus, one of the greatest assets of the new business is the owner of the business due to her or his personal involvement in, and dedication to, the business. It is because of the owner's importance to the business that students need to consider their own abilities and resources early as they begin to look at building an entrepreneurial business.

### agency theory

A managerial theory that believes individuals act to maximize their own benefit. Thus, in settings where there is a split between ownership and control (as in most publicly traded corporations), the agents (managers) must be monitored or they will act to maximize their own benefit, not necessarily the benefit of those who own the firm (the shareholders).



*The cost of luxuries such as first-class airfare is an extravagance few entrepreneurial businesses can afford and as a result, most owners must choose crowded and noisy economy class. How would you, as an entrepreneur, decide what constitutes a luxury and what is a necessity?*

Matej Kastelic/kasto/123RF

## EXERCISE 2

1. What will you do if the business you are considering fails?
2. How much time are you willing to dedicate to the success of the venture?
3. How much of your personal assets are you willing to put into the venture?

## Evaluating Your Entrepreneurial Orientation

There are a number of issues that potential entrepreneurs need to consider about themselves as they look at starting a new business. Examined with some depth, these issues will shape the entrepreneur's analysis of the potential of any business idea. These include (1) risk tolerance, (2) prior experience, and (3) personality orientation of the individual.

### LO2-2

Discuss the importance of an entrepreneurial orientation.

## Risk Tolerance

Potential entrepreneurs must determine their own individual level of tolerance to risk. You are probably familiar with the concept from dealing with your own financial expenditures. The typical advice provided to most individuals is to spend no more than your personal risk tolerance.<sup>4</sup> Thus, if you have a low risk tolerance, you need to spend less and save more for that proverbial rainy day. If you have a high risk tolerance, you will spend more, assuming there will not be as many rainy days. We use a similar concept here, but we use it more broadly, asking you to consider your tolerance to a wide range of potential risks that extend far beyond just financial considerations. Initially, you need to evaluate whether you have the risk tolerance to actually start a new business. The next step is to evaluate what level of risk you will accept in a given business situation.

### break-even point

The time when a new business has reached a level where revenue coming into the firm is sufficient to cover expenses.



*Reliance on others increases the risk profile of a business.*

Andrew Cutraro/Afp/Getty Images

To illustrate, if you work for a large corporation, you have relatively low individual financial risk. In a normal economic environment, even if a large corporation has a poor year and loses money, it will still meet payroll, pay the workers' benefits, and not close its doors on short notice. On the other hand, the entrepreneur is faced with a substantially different situation. A start-up business takes time to reach a level where the revenue coming into the firm is sufficient to cover expenses. (We examine this in significant detail in Chapter 6;

the point where the revenue coming into the firm is sufficient to cover expenses is referred to as a **break-even point**.) However, the new business may quickly reach a point where the funds have run out and the business needs to close its doors quickly. If the business does close, then the entrepreneurs may find that they have to pay the debts of the firm that are left because they had to sign personal guarantees for the loans of the business. Thus, the financial risk for the entrepreneur can be quite high. As a potential entrepreneur, you will need to consider how much debt you are willing to take on. In general, the greater the debt you are willing to take on to start your business, the higher your risk tolerance.

Potential new business owners need to determine their willingness to accept personal risk in a new business and let that information help decide which business to pursue.<sup>5</sup> There is not one correct answer as to what level of

risk tolerance new business owners should be willing to take on. Instead, the key is that individual entrepreneurs must be aware of their tolerance of risk and

establish their business in a manner that is consistent with that tolerance. New business owners need to be sure that the level of risk is consistent with their background, values, and family situation. Evaluation of the risk profile for a particular type of business is more art than science.

One well-known entrepreneur provides valuable advice on risk tolerance. He suggests that entrepreneurs never do anything that does not allow them to sleep at night. This rule of thumb can help businesspeople determine the risks with which they will be most comfortable. In future chapters we will return to the evaluation of risk as we look at specific risks, such as financial, strategic, and market retaliation risks.

## EXERCISE 3

To help you determine your own tolerance for risk, answer the following questions.

1. How much debt would you be willing to undertake to provide a foundation for your business idea?
2. How much of your personal savings would you be willing to risk on your business idea?
3. If you were the recipient of a \$100,000 inheritance, what portion would you be willing to invest in your business?

Given your answers to these questions, how would you rate your financial risk tolerance?

## Prior Experience

The second element of entrepreneurial orientation is prior experience. Every individual brings to a new business his or her own view of the world. This view places boundaries on what a decision maker will consider as he or she makes decisions. These boundaries are set by experiences, history, culture, and family values, among other things. Boundaries help each of us make sense of the world. For example, in the United States, when you see a red octagonal sign at a corner, you typically assume it is a stop sign. You assume that it is a stop sign because of your history and experience.

However, if you were in another country, such an octagonal sign may not be a stop sign; it might be another highway warning. Our experiences, history, culture, and values not only help us interpret the world, but they also place boundaries on how we see that world. Thus, our experiences, history, culture, and values also establish what we consider to be both possible and practical. This is referred to as the individual's **bounded rationality**. It is the presence of bounded rationality that often leads young people to be pioneers in an area because they are not limited by the restrictions of the past.

Bounded rationality is the reason individuals from outside an industry are able to establish a new business in a manner not previously considered. To illustrate, cattle processing historically was done by large, established firms in meat processing centers such as Chicago, Fort Worth, and Kansas City. The cattle were shipped there and processed by well-trained butchers from the moment of slaughter until they were ready for packaging. An entrepreneur had an idea for viewing the entire process differently. Rather than shipping cattle to a central location, why not process the cattle where they are raised? In addition, instead of hiring well-trained butchers, why not use individuals who make the same cut repeatedly, in an assembly-line manner? This new approach grew quickly, others copied the model; today virtually all beef is processed this way. Those individuals who had grown up in the beef industry believed that cattle processing had to be done in a specific way. Others came from outside the industry and saw new ways to do things. Their analysis was not bounded by history in the industry.

In a similar vein consider Shangpin, a furniture firm in Shunde, China (suburb to Guangzhou in South China). For years the furniture industry has been based on a model that required customers to go to a store or look online for existing furniture. They might get to choose some design elements of the furniture as they pick one piece of furniture versus another, but fundamentally they are choosing among furniture that already exists. Shangpin changed the model to allow customers to go online and design their own furniture. Customers specify that they want a piece that is X height with Y depth. They can pick the unit's color, hardware, and even the number of drawers and doors.

The company has a code for every part available. Once the customer has ordered, the firm takes all the orders and with its programming system arranges pieces in the most productive manner so there is minimal waste from any piece of wood. The parts are then sorted based on the code assigned to them and are packaged together and shipped to the customer's home. Shangpin actually has a crew go with the furniture to assemble the furniture in the client's home. Essentially, everyone gets custom-designed furniture from Shangpin. Part of why Shangpin completely rethought the furniture process was that it was founded by computer scientists—not furniture manufacturers who had a bias about what it meant to be in the furniture business.

It is important for individuals to understand how their decision making is bounded by their own version of rationality.<sup>6</sup> It is important to know your

### bounded rationality

Rational decision making that is constrained by the background and history of the person making the decision.



*There are varying aspects to everyone's personalities. How might knowing your strengths and weaknesses impact business decisions?*

Odua Images/Shutterstock

potential partners' backgrounds and how their decision making is impacted by their history. These issues will impact how you and your partners act both as you run the firm, and as you analyze problems that arise in the development of the business.

## Personality Orientation of the Individual

The third element of entrepreneurial orientation is an examination of your own personality. There is a wide variety of personality tests available to assist individuals in analyzing their traits and tendencies. These tests should not be used, however, to determine whether you are capable of starting a new business. There are successful businesspeople in all personality categories. In general, you as an individual will probably score differently on the same test if you take it on different occasions.

Therefore, use these tests to help better understand yourself and your strengths, not as a guide for your career. In general, if you are very outgoing and extroverted, you may wish to focus on a business in which you have extensive interpersonal interactions. In contrast, if you are more introverted, you may wish to focus on a business, such as an Internet-based business, in which interpersonal interactions are more limited. In this section, we review some of the major personality tests that are available. If you enter the names of these tests into a search engine, you will find that there are numerous versions of the tests available online, often for free. In the following we will highlight some of the more established and validated personality tests all of which you can take online.

**Myers-Briggs.** This is one of the most widely used tests for personality evaluations. It was developed by Katherine Briggs and her daughter Isabel Myers. The rationale for the test is drawn from Carl Jung, a Swiss psychoanalyst who sought to incorporate broader issues into his analysis than had Sigmund Freud. The test focuses on four pairs of variables: extroversion-introversion (focus on outward world or internal); sensing-intuiting (how people gather information); thinking-feeling (how they make decisions); and judgment-perception (order vs. flexibility). The different potential arrangements of variables are believed to indicate the different ways that individuals deal with other people and their environments.

**Enneagram.** The underlying philosophy of this test is that a person is the result of all the experiences in his or her life. Thus, the factors in childhood are central in developing who a person is today. A bias in this test is that adults will not change their personality over time because the assumption is that we form that personality as a child.

The test suggests that there are nine different types of personalities. Through a series of questions, the test assigns the person to one of these primary types. These nine types and a few of the characteristics of each type of individual are as follows: reformer (idealist/perfectionist); helper (caring/good interpersonal skills); achiever (competent/driven); individualist (sensitive/dramatic); investigator (cerebral/focused); loyalist (committed/pessimistic); enthusiast (fun-loving/impatient); challenger (action oriented/cynical); and peacemaker (easygoing/passive aggressive).

**Big Five Test.** The Big Five is a popular personality test in universities. It is composed of five factors: open-mindedness, conscientiousness, agreeableness, emotional stability, and extroversion (the factor names vary a little among authors). These are considered by many researchers to be the five key components of an individual's personality.

## ETHICAL CHALLENGE

Most new businesses are started by people currently working for another company. Many new ventures remain part-time operations managed in the off-hours of the entrepreneur. As a business grows, it reaches a tipping point where the founder(s) must decide whether to leave the current employer and work full-time on the business. Figuring out that critical juncture point often leads to ethical dilemmas.

1. Do you take a call about your personal business venture while at work with your current employer?
2. Do any of your current employers' supplies end up in your business effort?
3. You could put in a lot of extra time for your current employer, or do you limit your hours to the minimum to devote time to your business?
4. If you feel "ill-used" by your employer, does this impact how and what you do while still employed?

Once you do decide to leave, there is a question as to where the line between personal and business information exists. If your leaving does something that harms the growth opportunities of the prior employer's business, then can the prior employer seek damages in the courts? The impact of such a lawsuit on a fledgling business can be substantial.

To illustrate, consider an employee who has worked for a large plumbing or electrical firm. In her former position, she had the opportunity to obtain the firm's customer list. She decides to take that list and uses it to generate a customer base for her new business. Might the former employer be able to sue the new business for the revenue lost? What if the entrepreneur starting a new business does not take the list of customers but remembers the names and locations of the customers; is that different from taking the actual list? What if prior customers reach out to the entrepreneur on their own; is this permissible?

There are other ethical questions as you leave an employer. For example, if you know you are leaving your current employer to start your own business, how long can you pursue the venture before you are unfair to your current employer?

### QUESTIONS

1. What are some ways you can build a customer base when you leave a business without having problems with your former employer?
2. After you set up your new company, what things beyond the customer list do you believe you could potentially take from the former employer that would present an ethical problem?

The Big Five test was developed by two independent research teams. These researchers asked thousands of people hundreds of questions and then analyzed the data statistically. The researchers did not set out to identify the five factors; instead, the factors emerged from their analyses of the data.

## Triggers for Starting a Business

Starting a new business is often the result of some particular event or condition within an individual's environment. These triggers encourage the forming of new businesses because they encourage individuals to think creatively. People get comfortable with their lives, and it generally takes a trigger to force them to think in new ways. You may not be faced with such triggers as motivations and still decide to start a new business. However, many people do start their businesses when one of these triggers is present, and therefore, it is useful for you to understand them.<sup>7</sup> The triggers in the formation of a new business can come from either positive or negative stimulus that occurs in an individual's life. Some typical triggers include the following:

1. Being laid off from established employment.
2. Being approached by one or more people with a new business idea.
3. Reaching a point financially where the risk-return level of a proposed new business is tolerable.

### LO2-3

List the triggers that encourage new business formations.