WEB CHAPTER B

strategic issues in entrepreneurial ventures and Small Businesses

One night while attending a professional basketball game, Vincent Norment noticed a problem on the court. As the game progressed, sweat-soaked headbands kept creeping down into the players' eyes. The athletes seemed to be constantly adjusting their headbands and were distracted from playing their best. Norment concluded that all that was needed to solve the problem was to put a thick strap across the top of the headband. The strap could be made of the same super-absorbent material as the rest of the headband. With this strap, a headband would not only absorb more of the athlete's sweat but also stay in place. With a background in sports-related products, Norment suggested his idea to headband manufacturers. "They looked at the product and said it wouldn't work," reported Norment.

When a patent search found nothing similar on the market, Norment patented his idea for DBands and planned to sell them through his own company, DApparel, Inc. Knowing that the key to success was getting the product used by athletes, Norment promoted DBands at the three-point shooting contest of the 2003 March Madness collegiate basketball playoffs. He asked players for their opinions and persuaded one player to wear the headband on ESPN. Thanks to the exposure, Norment got endorsements from Ron Artest of the Indiana Pacers and Brad Miller of the Sacramento Kings, among others. Now that DBands was starting to get the attention of the market, the next step was securing distribution.

DBands arrived in sporting goods stores such as The Athlete's Foot and Foot Locker in spring 2005, priced between $9.99 and $14.99. Norment expected to sell 50,000 to 100,000 DBands by December 2005. His goal was to make the DApparel brand a household name, one head at the time.[1]

Learning Objectives

After reading this chapter, you should be able to:

- Differentiate between an entrepreneurial venture and a small business
- Use the strategic decision-making process to form a new venture
- Differentiate between an idea and an opportunity
- Identify sources of innovative concepts
- List the characteristics of the typical entrepreneur
- Understand the importance of moving through the substages of small-business development
- Avoid pitfalls in assessing the financial statements of a small, privately owned company

B.1 Importance of Small Business and Entrepreneurial Ventures

Strategic management as a field of study typically deals with large, established business corporations. However, small business cannot be ignored. There are approximately 23 million small businesses—over 99% of all businesses—in the United States. They generate 60% to 80% of net new jobs annually and produce almost 30% of known export value. Studies by the Global Entrepreneurship Monitor have found a strong correlation between national economic growth and the level of entrepreneurial activity in prior years.[2] Research reveals that not only do small firms spend almost twice as much of their R&D budget on fundamental research as do large firms, but also, small companies are roughly 13 times more innovative per employee than large firms.[3] The National Science Foundation estimates that 98% of "radical" product developments result from the research done in the labs of small companies.[4] Nevertheless, not every country is as supportive of new ventures as is the United States. See the **Global Issue** feature to learn how different countries support entrepreneurship.

Despite the overall success of small businesses, however, every year tens of thousands of small companies fail. Figures from the U.S. Small Business Administration indicate that 50% of businesses founded in any one year are not in business four years later.[5] Similar rates occur in the United Kingdom, the Netherlands, Japan, Taiwan, and Hong Kong.[6] Although an increasing number of studies are more positive regarding the survival rate of new entrepreneurial ventures, new businesses are definitely considered risky.[7] The causes of small-business failure (depending on the study cited) range from inadequate accounting systems to inability to cope with growth. The underlying problem appears to be an overall lack of strategic management—beginning with an inability to plan a strategy to reach the customer and ending with a failure to develop a system of controls to keep track of performance.[8]

GLOBAL issue

ENTREPRENEURSHIP: SOME COUNTRIES ARE MORE SUPPORTIVE THAN OTHERS

Entrepreneurship is becoming increasingly important throughout the world. True to economist Joseph Schumpeter's view of entrepreneurship as "creative destruction," much of the world from Eastern Europe to South America to Asia envisions entrepreneurial ventures as the means to build successful free market economies. New entrepreneurial ventures are emerging daily in these countries. Unfortunately, not every country makes it easy to start a new business.

According to the World Bank, countries range from easy to difficult in terms of starting an entrepreneurial venture. The amount of difficulty is usually a function of government requirements and paperwork and can be measured in the number of days it takes to start a new venture. The *quickest* in days are Australia (2), Canada (3), New Zealand (3), Denmark (4), the United States (4), Puerto Rico (6), Singapore (8), Hong Kong (11), Latvia (11), and the Netherlands (11). The *slowest* in days are Zaire (215), Haiti (203), Laos (198), Indonesia (168), Mozambique (153), Brazil (152), Angola (146), Burkina Faso (136), Zimbabwe (122), and Venezuela (119). Not surprisingly, the World Bank analysis of 130 countries concludes that onerous regulation retards economic growth.

Even though entrepreneurship is more difficult in many other parts of the world than in the United States, the situation is changing. For example, investors are flocking to young, fast-growing companies in Europe. Politicians are beginning to see entrepreneurs as part of a solution to unemployment rather than as grasping exploiters. Venture capital is becoming more available. The EASDAQ, founded in 1996, is Europe's version of the NASDAQ. Companies can be listed on the EASDAQ regardless of size or history, so long as they agree to international accounting standards and U.S.-style financial reporting.

There is still an ingrained cultural aversion to the risk-taking so necessary to entrepreneurship. The contradiction between the Marxist ideology and private ownership in China means that business entrepreneurs are not perceived as legitimate. The social stigma attached to business failure is deeply entrenched in many countries. According to Christophe Sapet, the French founder of a computer game company called Infogrames, "When you earn money, (French) people are jealous. They think you have done something wrong."

SOURCES: "Down to Business," *The Economist* (October 11, 2003), p. 9; J. Kahn, "Suddenly, Startups Are Chic," *Fortune* (February 15, 1999), p. 110; "Financial Indicators," *The Economist* (October 16, 1999), p. 109; "Emerging-Market Indicators," *The Economist* (September 23, 2000), p. 128; E. W. K. Tsang, "In Search of Legitimacy: The Private Entrepreneur in China," *Entrepreneurship Theory and Practice* (Fall 1996), pp. 21–30.

DEFINITION OF SMALL-BUSINESS FIRMS AND ENTREPRENEURIAL VENTURES

The most commonly accepted definition of a small-business firm in the United States is one that employs fewer than 500 people and that generates sales of less than $20 million annually.

Although the meanings of the terms *small business* and *entrepreneurship* overlap considerably, the concepts are different. A **small-business firm** is independently owned and operated, is not dominant in its field, and does not engage in innovative practices. An **entrepreneurial venture**, in contrast, is any business whose primary goals are profitability and growth and that can be characterized by innovative strategic practices.[9] The basic difference between a small-business firm and an entrepreneurial venture, therefore, lies not in the type of goods or services provided, but in their fundamental views on growth and innovation. According to Donald Sexton, an authority on entrepreneurship, this explains why strategic planning is more likely to be present in an entrepreneurial venture than in a typical small-business firm:

Most firms start with just a single product. Those oriented toward growth immediately start looking for another one. It's that planning approach that separates the entrepreneur from the small-business owner.[10]

THE ENTREPRENEUR AS STRATEGIST

Often defined as a person who organizes and manages a business undertaking and who assumes risk for the sake of a profit, an **entrepreneur** is the ultimate strategist. He or she makes all the strategic as well as operational decisions. All three levels of strategy—corporate, business, and functional—are the concerns of this founder and owner–manager of a company. This is typical of a new venture, which is usually a Stage I company (discussed in **Chapter 9**, in the stages of corporate development section). As one entrepreneur puts it: "Entrepreneurs are strategic planners without realizing it."

The development of DBands described earlier captures the key elements of an entrepreneurial venture: a basic business idea that has not yet been successfully tried and a gutsy entrepreneur who, while working on borrowed capital and a shoestring budget, creates a new business through a lot of trial and error and persistent hard work. Similar stories can be told of other people, such as Debbie Fields, who created Mrs. Fields Cookies, and Will Parish, who founded National Energy Associates. Both were ridiculed at one time or another for their desire to start businesses. Friends and family members told Fields that starting a business to sell chocolate chip cookies "was a stupid idea." Will Parish, who built a power plant in California's Imperial Valley that burns "pasture patties," was called an "entre-manure." Every day the plant burned 900 tons of manure collected from nearby feedlots to generate 15 megawatts of electricity—enough to light 20,000 homes. The power was sold to Southern California Edison. Parish got the idea from a trip to India, where the fuel used to heat a meal was cow dung. Once the plant was earning a profit, Parish planned to build a larger plant nearby that would burn wheat straw and other crop wastes. The plants provide an environmentally sound as well as profitable way to dispose of waste. Very interested in conservation, Parish says, "I wanted to combine doing well with doing good."[11]

B.2 Use of Strategic Planning and Strategic Management

Research shows that strategic planning is strongly related to small-business financial performance.[12] A survey of the high-growth *Inc. 500* firms revealed that 86% performed strategic planning. Of those performing strategic planning, 94% reported improved profits.[13] Nevertheless, many small companies still do not use the process.[14] A study of 131 firms filing for bankruptcy revealed that 72% lacked mission statements and objectives for their businesses.[15] Around 40% of existing small family-owned businesses do not have written strategic plans.[16] The reasons often cited for the apparent lack of strategic planning practices in many small-business firms are fourfold:

- **Not enough time:** Day-to-day operating problems take up the time necessary for long-term planning. It's relatively easy to justify avoiding strategic planning on the basis of day-to-day crisis management. Some will ask: "How can I be expected to do strategic planning when I don't know if I'm going to be in business next week?"
- **Unfamiliar with strategic planning:** A small-business CEO may be unaware of strategic planning or may view it as irrelevant to the small-business situation. Planning may be viewed as a straitjacket that limits flexibility.

- **Lack of skills:** Small-business managers often lack the skills necessary to begin strategic planning and do not have or want to spend the money necessary to import trained consultants. Future uncertainty may be used to justify a lack of planning. One entrepreneur admits, "Deep down, I know I should plan. But I don't know what to do. I'm the leader, but I don't know how to lead the planning process."
- **Lack of trust and openness:** Many small-business owner–managers are very sensitive regarding key information about the business and are thus unwilling to share strategic planning with employees or outsiders. For this reason, boards of directors are often composed only of close friends and relatives of the owner–manager—people unlikely to provide an objective viewpoint or professional advice.

DEGREE OF FORMALITY

Research generally concludes that the strategic planning process can be far more informal in small companies than it is in large corporations.[17] Some studies have even found that too much formalization of the strategic planning process may actually result in reduced performance.[18] Strategic planning is often forced on an entrepreneur by banks and venture capitalists when the entrepreneur is searching for capital to launch or expand the new venture. It is possible that a heavy emphasis on structured, written plans can be dysfunctional to the small entrepreneurial firm because it detracts from the very flexibility that is a benefit of small size. The process of strategic planning, not the plan itself, is probably the key to improving business performance. Research does show, however, that as an entrepreneurial firm matures, its strategic planning process tends to become more formal.[19]

These observations suggest that new entrepreneurial ventures begin life in Mintzberg's *entrepreneurial mode* of strategic planning (explained in **Chapter 1**) and move toward the *planning mode* as the company becomes established and wants to continue its strong growth. If, after becoming successfully established, the entrepreneur instead chooses stability over growth, the venture moves more toward the *adaptive mode* so common to many small businesses.

USEFULNESS OF THE STRATEGIC MANAGEMENT MODEL

The model of strategic management (presented in **Figure 1–2** in **Chapter 1**) is also relevant to entrepreneurial ventures and small businesses. This basic model holds for both an established small company and a new entrepreneurial venture. As the research mentioned earlier concluded, small and developing companies increase their chances of success if they make a serious attempt to work through the strategic issues embedded in the strategic management model. The key is to focus on what's important—the set of managerial decisions and actions that determines the long-run performance of the company. The list of informal questions presented in **Table B–1** may be more useful to a small entrepreneurial company than their more formal counterparts used by large, established corporations.

USEFULNESS OF THE STRATEGIC DECISION-MAKING PROCESS

As mentioned in **Chapter 1**, one way in which the strategic management model can be made action oriented is to follow the strategic decision-making model presented in **Figure 1–5**. The eight steps presented in that model are just as appropriate for small companies as they are for large corporations. Unfortunately, the process does not fit new

TABLE B–1 Informal Questions to Begin the Strategic Management Process in a Small Company or Entrepreneurial Venture

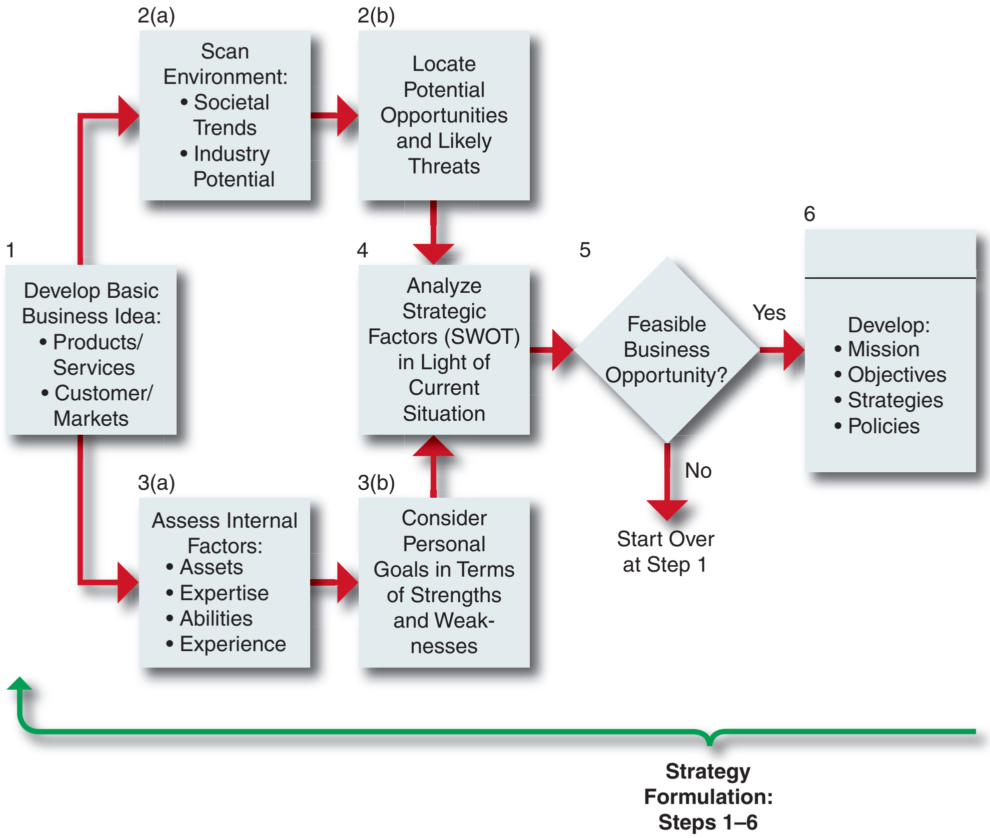
Formal	Informal
Define mission	What do we stand for?
Set objectives	What are we trying to achieve?
Formulate strategy	How are we going to get there? How can we beat the competition?
Determine policies	What sort of ground rules should we all be following to get the job done right?
Establish programs	How should we organize this operation to get what we want done as cheaply as possible with the highest quality possible?
Prepare pro forma budgets	How much is it going to cost us and where can we get the cash?
Specify procedures	In how much detail do we have to lay things out, so that everybody knows what to do?
Determine performance measures	What are those few key things that will determine whether we can make it? How can we keep track of them?

entrepreneurial ventures. Such a company must develop a new mission and new objectives, strategies, and policies out of a comparison of its external opportunities and threats to its potential strengths and weaknesses. Consequently, we propose in **Figure B–1** a modified version of the strategic decision-making process; this version more closely suits a new entrepreneurial venture.

The proposed **strategic decision-making process for entrepreneurial ventures** is composed of the following eight interrelated steps:

1. **Develop the basic business idea—a product and/or service that has target customers and/or markets:** An **idea** is a concept for a product or service that currently doesn't exist or is not currently available in a market niche. It may be a brand-new concept (radical innovation) or an improvement to a current product or service (incremental innovation). The idea can be developed from a person's experience or generated in a moment of creative insight. For example, Vincent Norment conceived of a headband with a stay-on strap while attending a basketball game.
2. **Scan and assess the external environment to locate factors in the societal and task environments that pose opportunities and threats:** The scanning should focus particularly on market potential and resource accessibility.
3. **Scan and assess the internal factors relevant to the new business:** The entrepreneur should objectively consider personal assets, areas of expertise, abilities, and experience, all in terms of the organizational needs of the new venture.
4. **Analyze the strategic factors in light of the current situation, using SWOT:** The venture's potential strengths and weaknesses must be evaluated in light of opportunities and threats. This analysis can be done with an SFAS Matrix (see **Figure 6–1**) of the strategic factors.
5. **Decide go or no go:** If the basic business idea appears to be a feasible business opportunity, the process should be continued. An **opportunity** is an idea for a new product or service with a market that is willing to pay for that product or service so that it can form the basis of a profitable business. Otherwise, further development of the idea should be canceled unless the strategic factors change.

FIGURE B–1 Strategic Decision-Making Process for New Ventures



6. **Generate a business plan that specifies how the opportunity will be transformed into reality:** See **Table B–2** for the suggested contents of a strategic **business plan**. The proposed venture's mission, objectives, strategies, and policies, as well as its likely board of directors (if a corporation) and key managers should be developed. Key internal factors should be specified and performance projections generated. The business plan serves as a vehicle through which financial support is obtained from potential investors and creditors. It increases a new venture's probability of survival and facilitates new product development.[20] Firms using business plans tend to have higher revenue and

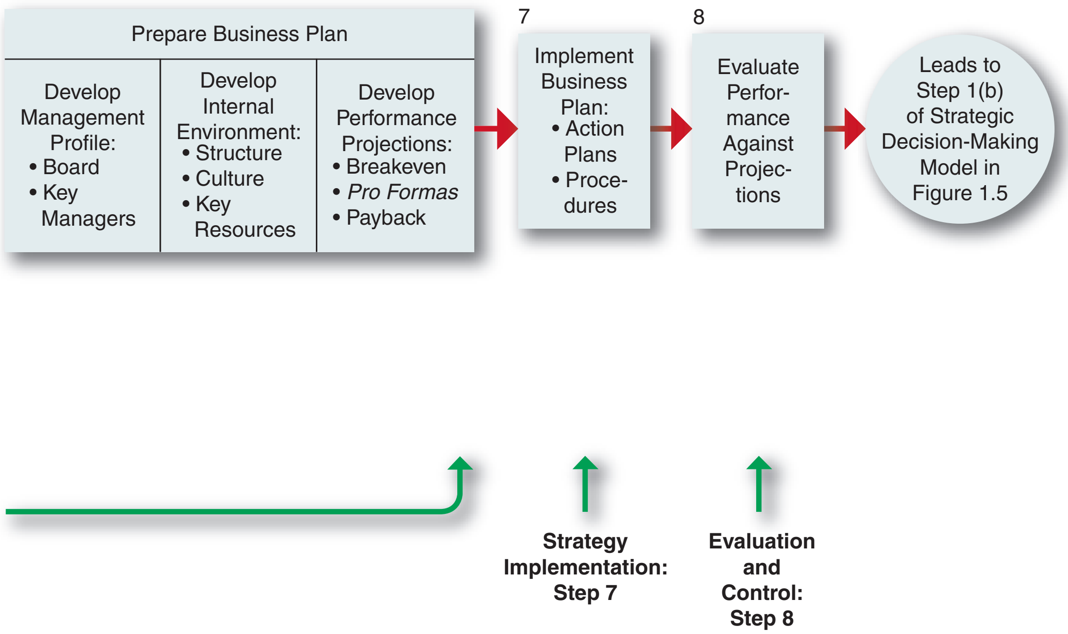
TABLE B–2

Contents of a Strategic Business Plan for an Entrepreneurial Venture

I.	Table of Contents	X.	Human Resources Plan
II.	Executive Summary	XI.	Ownership
III.	Nature of the Business	XII.	Risk Analysis
IV.	Strategy Formulation	XIII.	Timetables and Milestones
V.	Market Analysis	XIV.	Strategy Implementation—Action Plans
VI.	Marketing Plan	XV.	Evaluation and Control
VII.	Operational Plans—Service/Product	XVI.	Summary
VIII.	Financial Plans	XVII.	Appendixes
IX.	Organization and Management		

NOTE: The Strategic Audit in Appendix 1.A can be used to develop a business plan. It provides detailed questions to serve as a checklist.

SOURCE: Thomas L. Wheelen, "Contents of a Strategic Business Plan for an Entrepreneurial Venture." Copyright © 1988 and 2005 by Thomas L. Wheelen. Reprinted by permission.



SOURCE: *T. L. Wheelen and C. E. Michaels, Jr., "Model for Strategic Decision-Making Process for New Ventures." Copyright © 1987 and 2005 by T. L. Wheelen. Reprinted by permission.*

sales growth than do those without them.[21] Starting a business without a business plan is the quickest way to kill a new venture.[22] For example, one study of 270 clothing retailers found that 80% of the successful stores had written business plans, whereas 65% of the failed businesses had not.[23]

A strategic audit (see **Appendix 1.A** at the end of **Chapter 1**) can be used to develop a formal business plan. The audit's sections and subsections, along with the questions within them, can be re-aligned to fit the model depicted in **Figure B–1**. Instead of analyzing the historical events of an existing company, one can use the questions to project the proposed company's future. The questions can be reoriented to follow the outline in **Appendix 1.A**. A crucial building block of a sound business plan is the construction of realistic scenarios for the pro forma financials. The pro formas must reflect the impact of seasonality on the cash flows of the proposed new venture.

7. **Implement the business plan:** Do this through the use of action plans and procedures.
8. **Evaluate the implemented business plan through comparison of actual performance against projected performance results:** This step leads to step 1(b) of the strategic decision-making process shown in **Figure 1–5**. To the extent that actual results are less than or much greater than the anticipated results, the entrepreneur needs to reconsider the company's current mission, objectives, strategies, policies, and programs, and possibly make changes to the original business plan.

B.3 Issues in Corporate Governance

Corporate governance is much simpler in small entrepreneurial ventures than in large, established corporations. For one thing, the owners and the managers are usually the same people—the company founders (or their close relatives). If a venture is not incorporated, there is no need for a board of directors. It may be a sole proprietorship or a simple partnership. Those entrepreneurial ventures wishing to grow quickly or to limit the liability of the owners often incorporate the business. Once incorporated, the company can sell shares of stock to others (such as venture capitalists) to finance its growth. When the company is owned by shareholders (even if the shareholders are composed of only the founding owners who also manage the firm), the company must have a board of directors.

BOARDS OF DIRECTORS AND ADVISORY BOARDS

The boards of directors of entrepreneurial firms are likely to be either very passive or very active. Passive boards exist when the stock is closely held by the founding owners (and their immediate families) who manage the company on a day-to-day basis. As the only stockholders, they elect themselves to board offices and call meetings only when the law requires it—usually as a social occasion. There is no need for an active board since there are no other stockholders and thus no agency problems. The board typically has few or no external directors.[24] In most instances, the primary role of the board is simply to be a figurehead to satisfy the law. This places it on the far left end of the board of directors' continuum shown in Chapter 2's **Figure 2–1**.

Entrepreneurial ventures financed by venture capitalists typically have very active boards of directors. The venture capitalists expect to obtain seats on the board in exchange for their investment.[25] Once on the board, venture capitalists tend to be very powerful members of the board and are highly involved in strategic management.[26] The boards of directors of fast-growth entrepreneurial firms have around five directors, of whom about three are external. Almost 80% of them have written strategic plans with a time horizon of 12 to 24 months.[27] Venture capitalists usually require three years or more of pro forma financial statements broken out on a monthly cash flow basis for the first two years and on a quarterly basis thereafter.

Since closely held entrepreneurial ventures and small businesses tend to have relatively passive boards composed primarily of insiders, this type of business should use an advisory board to provide advice to the owner–managers. An **advisory board** is a group of external business people who voluntarily meet periodically with the owner–managers of the firm to discuss strategic and other issues. The members are usually invited to join the board by the president of the company. The advisory board has no official capacity but is expected to provide management with useful suggestions and act as a sounding board. Since the members typically receive no compensation for serving, quarterly business meetings are often followed by cocktails and dinner at a nearby country club, hotel, or prestigious restaurant. It is important to staff the advisory board with knowledgeable people who have significant business experience or skills who can complement the background and skills of the company's owner–managers. Using an advisory board is an easy way to obtain free professional consulting advice. Research indicates that advisory boards improve the performance of small businesses.[28]

IMPACT OF THE SARBANES-OXLEY ACT

Complying with the Sarbanes-Oxley Act is becoming a cost burden for small publicly held U.S. companies. Companies face higher audit and legal fees, new internal control systems, and higher directors' and officers' liability insurance premiums, among other expenses. Compliance costs are estimated at $500,000 for a small firm and in the millions for a large one.[29] As a result, 198 firms "went dark" in 2003 by delisting their stock from stock exchanges. By only trading via "pink sheets" in over-the-counter stocks, these firms do not have to comply with the act's minimum requirements, and they do not have to file with the Securities and Exchange Commission (SEC). Under SEC rules, a company may choose to terminate its registration if the corporation's securities have fewer than 300 holders of record or if there are fewer than 500 holders of record and the company's total assets don't exceed $10 million. A research study of firms going dark indicated that the firms delist their stock not only to avoid compliance costs but also to evade the outside monitoring and additional scrutiny required by Sarbanes-Oxley. According to Christian Leuz, co-author of the study: "We basically find that going dark can serve as a way to conserve cash, but it may also be exploited by insiders trying to avoid the scrutiny of the market. Whether insiders succeed, and whether the decision to go dark is a good or bad one therefore depends on the governance in place."[30]

B.4 Issues in Environmental Scanning and Strategy Formulation

Environmental scanning in small businesses is much less sophisticated than it is in large corporations. The business is usually too small to justify hiring someone to do only environmental scanning or strategic planning. Top managers, especially if they are the founders, tend to believe that they know the business and can follow it better than anyone else. A study of 220 small rapid-growth companies revealed that the majority of CEOs were actively and personally involved in all phases of the planning process, especially in the setting of objectives. Only 15% of the companies used a planning officer or formed a planning group to assist in the planning process. In the rest of the firms, operating managers who participated in strategic planning provided input only to the CEO, who then formulated the plan.[31] Unfortunately, the literature suggests that most small business owner–managers rely more on internal as opposed to external sources of information.[32] Conducting a periodic industry analysis using Porter's forces is just as important for a small business as for a large one. Nevertheless, few small businesses do much competitor analysis. If they do analyze competition, typical small business owners often only look locally, without considering competitors across town or in a nearby city.

A fundamental reason for differences in strategy formulation between large and small entrepreneurial companies lies in the relationship between owners and managers. The CEO of a large corporation has to consider and balance the varied needs of the corporation's many stakeholders. The CEO of a small business, however, is very likely also to be the owner—the company's primary stakeholder. Personal and family needs can thus strongly affect a small business's mission and objectives and can overrule other considerations.[33]

Size can affect the selection of an appropriate corporate strategy. Large corporations often choose growth strategies for their many side benefits for management as well as for shareholders. A small company may, however, choose a stability strategy because the entrepreneur is interested mostly in (1) generating employment for family members, (2) providing the family a "decent living," and (3) being the "boss" of a firm small enough that he or she can manage it comfortably. Some business owners don't pursue a growth strategy because they do not want the loss of control that results from bank debt or the sale of stock to outsiders. Some may even fear that growth will attract attention from larger competitors that might want to take over the company or drive it out of business.[34] Thus the goals of a small business are likely to be the same as the goals of the owner–manager.

Basic SWOT analysis is just as relevant to new entrepreneurial businesses as it is to established large ones. Both the greatest strength and the greatest weakness of a small firm, at least in the beginning, rest with the entrepreneur—the owner–manager of the business. The entrepreneur is the manager, the source of product/market strategy, and the dynamo who energizes the company. That is why the internal assessment of a new venture's strengths and weaknesses focuses in **Figure B–1** on the founder's personal characteristics—his or her assets, expertise, abilities, and experience. Research reveals that founder competencies, motivations, and connections plus the firm's competitive strategies are direct predictors of new venture growth and success.[35] Intangible assets, such as leadership, strategy, and human and intellectual capital, were found to be more important than traditional financial measures for a venture's success in going public through an IPO.[36]

Just as an entrepreneur's strengths can be the key to company success, personal weaknesses can be a primary cause of failure. For example, the study of clothing retailers mentioned earlier showed that the owner–managers of 85% of the failed stores had no prior retailing experience.

SOURCES OF INNOVATION

Peter Drucker, in his book *Innovation and Entrepreneurship*, proposes seven sources for innovative opportunity that should be monitored by those interested in starting an entrepreneurial venture, either within an established company or as an independent small business.[37] The first four **sources of innovation** lie within the industry itself; the last three arise in the societal environment. These seven sources are:

1. **The Unexpected:** An unexpected success, an unexpected failure, or an unexpected outside event can be a symptom of a unique opportunity. When Don Cullen of Transmet Corporation spilled a box of very fine aluminum flakes onto his company's parking lot, he discovered that their presence in the asphalt prevented it from turning sticky in high temperatures. His company now produces aluminum chips for use in roofing. Sales have doubled every year since the product's introduction, and Cullen's company will soon dominate the business.
2. **The Incongruity:** A discrepancy between reality and what everyone assumes it to be, or between what is and what ought to be, can create an opportunity for innovation. For example, a side effect of retailing via the Internet is the increasing number of packages being delivered to homes. Since neither FedEx nor UPS can leave a package unless someone is home to sign for it, many deliveries are delayed. Tony Paikeday founded zBox Company to make and sell a hard plastic container that would receive deliveries from any delivery service and would be accessible only by the owner and the delivery services. "We're amazed that it doesn't exist yet," says Paikeday.[38]
3. **Innovation Based on Process Need:** When a weak link is evident in a particular process but people work around it instead of doing something about it, an opportunity is present for the person or company willing to forge a stronger one. Tired of having to strain to use a too-small keyboard on his personal computer, David Levy invented a keyboard with 64 normal-sized keys cleverly put into an area the size of a credit card.[39]
4. **Changes in Industry or Market Structure:** A business is ready for an innovative product, service, or approach to the business when the underlying foundation of the industry or market shifts. Black Entertainment Television, Inc. (BET), was born when Robert Johnson noticed that no television programmer was targeting the increasing number of black viewers. The BET brand has expanded into magazines and is now known by more than 90% of African-Americans.[40]
5. **Demographics:** Changes in the population's size, age structure, composition, employment, level of education, and income can create opportunities for innovation. For example, Pam Henderson started a company called Kids Kab to shuttle children and teenagers

to private schools, doctor and dentist appointments, lessons, and extracurricular activities. With the trend to dual careers, parents were no longer always available to provide personal transportation for their own children and needed such a service.

6. **Changes in Perception, Mood, and Meaning:** Opportunities for innovation can develop when a society's general assumptions, attitudes, and beliefs change. For example, the increasing dominance of a few national brewers have caused beer drinkers to look for alternatives to the same old national brands. By positioning Yuengling, a local Pennsylvania beer, as a full-flavored beer and providing it with an artsy, nostalgic-looking label, the small company was able to catch the fancy of young, trendy consumers who viewed it as Pennsylvania's version of Anchor Steam, the successful San Francisco beer.
7. **New Knowledge:** Advances in scientific and nonscientific knowledge can create new products and new markets. Advances in two different areas can sometimes be integrated to form the basis of a new product. For example, Medical Foods was formed to make foods that act like medicine to treat conditions from diabetes to arthritis. Its first product, NiteBite, is a chocolate-flavored snack bar designed to help diabetics manage nocturnal hypoglycemia, caused by low blood sugar. NiteBite gradually releases glucose into the bloodstream, where it lasts for six hours or more.[41]

FACTORS AFFECTING A NEW VENTURE'S SUCCESS

According to Hofer and Sandberg, three factors have a substantial impact on a new venture's performance. In order of importance, these **factors affecting new venture success** are (1) the structure of the industry entered, (2) the new venture's business strategy, and (3) behavioral characteristics of the entrepreneur.[42]

Industry Structure

Research shows that the chances for success are greater for entrepreneurial ventures that enter rapidly changing industries than for those that enter stable industries. In addition, prospects are better in industries that are in the early, high-growth stages of development.[43] Competition is often less intense. Fast market growth also allows new ventures to make some mistakes without serious penalty. New ventures also increase their chances of success when they enter markets in which they can erect entry barriers to keep out competitors.

Contrary to popular wisdom, however, patents may not always provide competitive advantage, especially for new ventures in a high-tech or hypercompetitive industry. A well-financed competitor could examine a newly filed application for a patent, work around the patent, and beat the pioneering firm to market with a similar product. In addition, the time and cost of filing and defending a patent may not be worth the effort. According to Connie Bagley, author of *The Entrepreneur's Guide to Business Law*:

> *It might take 18 months to get a patent on a product that has a 12-month life cycle. By the time you finally get the damn thing litigated, it's meaningless. So people are focusing less on proprietary assurance and more on first-mover advantage. . . . The law is just too slow for this high-speed economy.*[44]

Most new ventures enter industries that have a low degree of industry concentration (that is, no dominant competitors).[45] Industry concentration is not necessarily bad. It may create market niches being ignored by large firms.[46] Hofer and Sandberg found that a new venture is more likely to be successful entering an industry in which one dominant competitor has a 50% or more market share than entering an industry in which the largest competitor has less than a 25% market share. To explain this phenomenon, Hofer and Sandberg point out that when an industry has one dominant firm, the remaining competitors are relatively weak and are easy prey for an aggressive entrepreneur. To avoid direct competition with a major rival, the new venture can focus on a market segment that is being ignored.

Industry product characteristics also have a significant impact on a new venture's success. First, a new venture is more likely to be successful when it enters an industry with heterogeneous (different) products than when it enters one with homogeneous (similar) products. In a heterogeneous industry, a new venture can differentiate itself from competitors with a unique product; or, by focusing on the unique needs of a market segment, it can find a market niche. Second, a new venture is, according to research data, more likely to be successful if the product is relatively unimportant to the customer's total purchasing needs than if it is important. Customers are more likely to experiment with a new product if its cost is low and product failure will not create a problem.

Business Strategy

According to Hofer and Sandberg, the keys to success for most new ventures are (1) to differentiate the product from those of other competitors in the areas of quality and service and (2) to focus the product on customer needs in a segment of the market in order to achieve a dominant share of that part of the market. Adopting guerrilla-warfare tactics, these companies go after opportunities in market niches too small or too localized to justify retaliation from the market leaders.[47] It is crucial, however, that a new venture analyze its competitors to assess their likely response to the company's entry into the market.

To continue its growth once it has found a niche, an entrepreneurial firm can emphasize continued innovation and pursue natural growth in its current markets. The firm can also expand into related markets in which the company's core skills, resources, and facilities offer the keys to further success. It can leverage its resources by engaging in strategic alliances with other firms. Sixty-three percent of U.S. small business owners report that they are involved in strategic alliances, especially in marketing and distribution. Of those using strategic alliances, half maintain three or more.[48]

Some studies do indicate, however, that new ventures can also be successful following strategies other than going after an undefended niche with a focus strategy. A narrow-market approach may leave the new firm vulnerable and preordained to only limited sales. One possible approach would be to offer products that are substitutable to, but differentiated from, those offered by bigger firms.[49] For some practical suggestions for locating an opportunity and formulating a business strategy, see **Strategy Highlight B.1**.

Entrepreneurial Characteristics

Four **entrepreneurial characteristics** are key to a new venture's success. Successful entrepreneurs have:

1. **The ability to identify potential venture opportunities better than most people:** Entrepreneurs focus on opportunities—not on problems—and try to learn from failure. Entrepreneurs are goal oriented and have a strong impact on the emerging culture of an organization. They are able to envision where the company is going and are thus able to provide a strong overall sense of strategic direction. As a result, their firms have a strong entrepreneurial orientation (EO)—that is, are innovative, proactive, and willing to take risks.[50]
2. **A sense of urgency that makes them action oriented:** They have a high need for achievement, which motivates them to put their ideas into action. They tend to have an internal locus of control that leads them to believe that they can determine their own fate through their own behavior. They also have a significantly greater capacity to tolerate ambiguity and stress than do many in established organizations.[51] They also have a strong need for control and may even be viewed as "misfits who need to create their own environment." They

STRATEGY highlight B.1

SUGGESTIONS FOR LOCATING AN OPPORTUNITY AND FORMULATING A BUSINESS STRATEGY

Given that differentiation and focus are the most popular and effective competitive strategies for a new venture, what are some of the ways to identify a new opportunity in which these strategies can be used? *Entrepreneur* magazine provides four interesting approaches:

1. **Tap the countertrend:** For every trend, there is likely to be a potentially lucrative countertrend waiting to be discovered. When a trend is hot, look for its opposite in a small but potentially growing market niche. Note how Hardee's successfully responded to the trend to low-fat and low-carb diets with it own monster-size bacon cheeseburger with more calories, carbs, and fat than its competitors. Because the idea was so outrageous, the Hardee's product received free coverage in newspapers and on television.
2. **Eat off the established company's plate:** Trend-watching.com coined the term "feeder business" for companies that feed off giants such as Amazon or eBay. When Eric Cohen and Joyce Shulman noticed that the typical blank pizza box was 16 inches of available advertising space, they decided to partner with the box makers to print paid advertisements on them for pizzerias. They then branched out into coffee cups and ice bags.
3. **Switch the niche:** A company may be able to identify a successful product or service that caters to a particular market and tailor it to fit a different market niche. For example, when Una Cassidy encountered numerous women looking for beauty products for use during pregnancy, she founded Selph. Cassidy removed all the usual ingredients found in beauty products that would be harmful to a fetus during pregnancy and replaced them with superior products that were gentle on the skin.
4. **Borrow a business model:** Netflix developed a novel business model in which members are charged a set monthly fee to borrow an unlimited number of DVDs by mail. This model was picked up quickly by other entrepreneurs such as GameFly, which rents video games by mail, Booksfree.com, which rents paperbacks by mail, and Bag Borrow Or Steal, which rents designer purses by mail.

SOURCES: K. Axelton, "Fever Pitch," *Entrepreneur* (December 2004), p. 74; N. L. Torres, "Think Outside the Box," *Entrepreneur* (February 2004), pp. 108–111; A. Pennington, "Una Cassidy," *Entrepreneur* (November 2003), p. 24.

tend to distrust others and often have a need "to show others that they amount to something, that they cannot be ignored."[52]

3. **A detailed knowledge of the keys to success in the industry and the physical stamina to make their work their lives:** Successful entrepreneurs have better-than-average education and significant work experience in the industry in which they start their businesses. They often work with partners to form a new venture. (Seventy percent of new high-tech ventures are started by more than one founder.[53]) More than half of all entrepreneurs work at least 60 hours per week in the startup year, according to a National Federation of Independent Business study.[54]
4. **Access to outside help to supplement their skills, knowledge, and abilities:** Over time, entrepreneurs develop a network of people who have key skills and knowledge, whom the entrepreneurs can call on for support. Through their enthusiasm, these entrepreneurs are able to attract key investors, partners, creditors, and employees. For example, the founders of eBay did not hesitate to bring in Meg Whitman as CEO because Whitman had the managerial skills that eBay needed to expand.

In summarizing their conclusions regarding factors affecting the success of entrepreneurial ventures, Hofer and Sandberg propose the guidelines presented in **Table B–3**.

TABLE B–3

Some Guidelines for New Venture Success

- Focus on industries facing substantial technological or regulatory changes, especially those with recent exits by established competitors.
- Seek industries whose smaller firms have relatively weak competitive positions.
- Seek industries that are in early, high-growth stages of evolution.
- Seek industries in which it is possible to create high barriers to subsequent entry.
- Seek industries with heterogeneous products that are relatively unimportant to the customer's overall success.
- Seek to differentiate your products from those of your competitors in ways that are meaningful to your customers.
- Focus such differentiation efforts on product quality, marketing approaches, and customer service—and charge enough to cover the costs of doing so.
- Seek to dominate the market segments in which you compete. If necessary, either segment the market differently or change the nature and focus of your differentiation efforts to increase your domination of the segments you serve.
- Stress innovation, especially new product innovation, that is built on existing organizational capabilities.
- Seek natural, organic growth through flexibility and opportunism that builds on existing organizational strengths.

SOURCE: C. W. Hofer and W. R. Sandberg, "Improving New Venture Performance: Some Guidelines for Success," *American Journal of Small Business* (Summer 1987), pp. 17, 19.

B.5 Issues in Strategy Implementation

Two key implementation issues in a small company are organizing and staffing the growing company and transferring ownership of the company to the next generation.

SUBSTAGES OF SMALL BUSINESS DEVELOPMENT

The implementation problems of a small business change as the company grows and develops over time. Just as the decision-making process for entrepreneurial ventures is different from that of established businesses, the managerial systems in small companies often vary from those of large corporations. Those variations are based on their stage of development. The stages of corporate growth and development discussed in **Chapter 9** suggest that all small businesses are either in Stage I or trying to move into Stage II. These models imply that all successful new ventures eventually become Stage II, functionally organized, companies. This is not always true, however. In attempting to show clearly how small businesses develop, Churchill and Lewis propose five **substages of small business development**: (a) existence, (b) survival, (c) success, (d) take-off, and (e) resource maturity.[55] A review of these small-business substages shows in more detail how a company can move through the entrepreneurial Stage I into a functionally oriented, professionally managed Stage II.

Stage A: Existence

At this point, an entrepreneurial venture faces the problems of obtaining customers and delivering the promised product or service. The organizational structure is simple. The entrepreneur does everything and directly supervises subordinates. Systems are minimal. The owner is the business.

Stage B: Survival

Those ventures able to satisfy a sufficient number of customers enter this stage; the rest close when their owners run out of startup capital. Those reaching the survival stage are concerned about generating the cash flow needed to repair and replace capital assets as they wear out and to finance the growth to continue satisfying the market segment they have found.

At this stage, the organizational structure is still simple, but it probably has a sales manager or general supervisor to carry out the owner's well-defined orders. A major problem of many small businesses at this stage is finding a person who is qualified to supervise the business when the owner can't be present but who is still willing to work for a very modest salary. An entrepreneur usually tries to use a family member rather than hire an outsider who lacks the entrepreneur's dedication to the business and (in the words of one owner–manager) "steals them blind." A company that remains in this stage for a long time is often called a "mom and pop" firm. It earns marginal returns on invested time and capital (with lots of psychic income!) and eventually goes out of business when "mom and pop" give up or retire. This type of small business is viewed more as a **lifestyle company** in which the firm is purely an extension of the owner's lifestyle. More than 94% of small private companies are in this category.[56]

Stage C: Success

By this point, the company's sales have reached a level where the firm is not only profitable but has sufficient cash flow to reinvest in itself. The key issue at this stage is whether the company should be used as a platform for growth or as a means of support for the owners as they completely or partially disengage from the company. The company is transforming into a functionally structured organization, but it still relies on the entrepreneur for all key decisions. The two options are disengagement and growth.

Stage C(1): Disengagement. The company can now successfully follow a stability strategy and remain at this stage almost indefinitely—provided that environmental change does not destroy its niche or poor management reduce its competitive abilities. By now functional managers have taken over some of the entrepreneur's duties. The company at this stage may be incorporated, but it is still primarily owned by the founder or the founder's family. Consequently, the board of directors is either a rubber stamp for the entrepreneur or a forum for family squabbles. Growth strategies are not pursued because either the market niche will not allow growth or the owner is content with the company at a size he or she can still manage comfortably. Strategic decisions make limited use of objective information and tend to be intuitive—based on personal desires and the founder's background.[57]

Stage C(2): Growth. The entrepreneur risks all available cash and the established borrowing power of the company in financing further growth. Strategic and operational planning are extensive and deeply involve the owner. Managers with an eye to the company's future rather than for its current situation are hired. This is an entrepreneurial high-growth firm aiming to be included in the *Inc. 500*. The emphasis now is on teamwork rather than on the entrepreneur's personal actions and energy. The personal values and philosophy of the founder are slowly transferred into a developing corporate culture.

Stage D: Take-Off

The key problems in this stage are how to grow rapidly and how to finance that growth. By now the firm is incorporated and has sold or is planning to sell stock in its company via an initial public offering (IPO) or via a direct public offering (DPO).[58] The entrepreneur must learn to delegate to specialized professional managers or to a team of managers who now form the top management of the company.[59] Delegation is a key issue for a company at this stage of development. A functional structure of the organization should now be solidly in place. Operational and strategic planning greatly involve the hired managers, but the company is still dominated by the entrepreneur's presence and stock control. Vertical and horizontal growth strategies are being seriously considered as the firm's management debates when and how to grow. The company is now included in the *Inc. 500* select group of firms.

At this point, the entrepreneur either is able to manage the transition from a small to a large company or recognizes personal limitations, sells his or her stock for a profit, and leaves the firm. The composition of the board of directors changes from dominance by friends and relatives of the owner to a large percentage of outsiders with managerial experience who can help the owner during the transition to a professionally managed company. The biggest danger facing the firm in this stage is the owner's desire to remain in total control (not willing to delegate) as if it were still a small entrepreneurial venture, even though he or she lacks the managerial skills necessary to run an established corporation. One study of small businesses found that fewer than one-third had written succession plans to replace the current owners.[60]

Stage E: Resource Maturity

It is at this point that the small company has adopted most of the characteristics of an established, large company. It may still be a small- or medium-sized company, but it is recognized as an important force in the industry and a possible candidate for the *Fortune 500* someday. The greatest concerns of a company at this stage are controlling the financial gains brought on by rapid growth and retaining its flexibility and entrepreneurial spirit. In terms of the stages of organizational growth and development discussed in **Chapter 9**, the company has become a full-fledged Stage II functional corporation.

TRANSFER OF POWER AND WEALTH IN FAMILY BUSINESSES

Small businesses are often **family businesses**. Within the United States, family businesses account for approximately 80% of the total 15 million businesses.[61] It is estimated that over one-third of the U.S. *Fortune 500* companies are either family owned or dominated. Of the world's largest firms, the proportion is over one-half.[62] Some of the world's largest family-owned or controlled firms are Wal-Mart, Ford Motor, Samsung, LG Group, Carrefour Group, Fiat Group, IFI, PSA Peugeot Citroen, Cargill, and BMW.[63] Interestingly, the 177 family companies in the 2003 *S&P 500* financially outperformed non-family companies over the previous 10 year period.[64]

Even though the founders of the companies are the primary forces in starting the entrepreneurial ventures, their needs for business support and financial assistance cause them to turn to family members, who can be trusted, over unknown outsiders of questionable integrity who may demand more salary than the enterprise can afford. Sooner or later, the founder's spouse and children are drafted into business operations either because the family standard of living is directly tied to the business or the entrepreneur desperately needs help just to staff the operation. The children are guaranteed summer jobs, and the business changes from dad's or mom's company to "our" company. The family members are extremely valuable assets to the entrepreneur because they are often also willing to put in long hours at low pay to help the business succeed. Even though the spouse and children might have no official stock in the company, they know that they will somehow share in its future and perhaps even inherit the business. The problem is that only 30% of family firms survive to the second generation, and just 15% survive to the third generation.[65] A common saying among European family businesses is: "The first generation creates, the second inherits, and the third destroys."[66] This saying is supported by research indicating that firm performance declines when descendents take over management of a firm.[67]

TABLE B–4

Transfer of Power in a Family Business

Phase 1	**Owner-Managed Business:** Phase 1 begins at startup and continues until the entrance of another family member into the business on a full-time basis. Family considerations influence but are not yet a directing part of the firm. At this point, the founder (entrepreneur) and the business are one.
Phase 2	**Training and Development of New Generation:** The children begin to learn the business at the dining room table during early childhood and then through part-time and vacation employment. The family and the business become one. Just as the entrepreneur identified with the business earlier, the family now begins to identify itself with the business.
Phase 3	**Partnership Between Generations:** At this point, a son or daughter of the founder has acquired sufficient business and managerial competence so that he or she can be involved in key decisions for at least a part of the company. The entrepreneur's offspring, however, has to first gain respect from the firm's employees and other managers and show that he or she can do the job right. Another issue is the lack of willingness of the founder to share authority with the son or daughter. Consequently, a common tactic taken by sons and daughters in family businesses is to take a job in a large, established corporation where they can gain valuable experience and respect for their skills.
Phase 4	**Transfer of Power:** Instead of being forced to sell the company when he or she can no longer manage the business, the founder has the option in a family business of turning it over to the next generation as part of their inheritance. Often the founder moves to the position of Chairman of the Board and promotes one of the children to the position of CEO. Unfortunately, some founders cannot resist meddling in operating affairs and unintentionally undermine the leadership position of the son or daughter. To avoid this problem, the founder should sell his or her stock (probably through a leveraged buyout to the children) and physically leave the company and allow the next generation the freedom it needs to adapt to changing conditions.

SOURCE: N. C. Churchill and K. J. Hatten, "Non-Market-Based Transfer of Wealth and Power: A Research Framework for Family Businesses," *American Journal of Small Business* (Winter 1987), pp. 51–64. Reprinted from *Entrepreneurship Theory & Practice* by permission of Baylor University.

Churchill and Hatten propose that family businesses go through four sequential phases from the time in which the venture is strictly managed by the founder to the time in which the next generation takes charge.[68] These phases are detailed in **Table B–4**. Each of these phases must be well managed if the company is to survive past the third generation. Some of the reasons family businesses may fail to successfully transfer ownership to the next generation are (1) inherited wealth destroys entrepreneurial drive, (2) the entrepreneur doesn't allow for a changing firm, (3) emphasis on business means the family is neglected, (4) the business' financial growth can't keep up with rising family lifestyles, (5) family members are not prepared to run a business, and (6) the business becomes an arena for family conflicts.[69] In addition, succession planning may be ignored because of the founder's or family's refusal to think about the founder's death, the founder's unwillingness to let go of the firm, the fear of sibling rivalry, or intergenerational envy.

According to Joe Astachan of the Cox Family Enterprise Center at Kennesaw State University, families whose businesses survive over time tend to operate on a set of agreed principles that pass from one generation to another. These include the creation of an active board of directors, a process of strategic planning that allows everyone to debate and agree upon the company's direction, and two to four family meetings a year. The surviving businesses tend to have strong boards that usually include a significant proportion of outsiders.[70]

B.6 Issues in Evaluation and Control

As a means by which a corporation's implementation of strategy can be evaluated, the control systems of large corporations have evolved over a long period of time in response to pressures from the environment (particularly the government). Conversely, an entrepreneur creates what is needed as the business grows. Because of his or her personal involvement in decision making, the entrepreneur managing a small business has little need for a formal, detailed reporting system. Thus a founder who has little understanding of accounting and a shortage of cash might employ a bookkeeper instead of an accountant. A formal personnel function might never appear because the entrepreneur lumps it in with simple bookkeeping and uses a secretary to handle personnel files. As an entrepreneurial venture becomes more established, it develops more complex evaluation and control systems, but they are often not the kind used in large corporations and are probably used for different purposes.

Financial statements, in particular, tell only half the story in small, privately owned companies. The formality of the financial reporting system in such a company is usually a result of pressures from government tax agencies, not from management's desire for an objective evaluation and control system. For example, the absence of taxes in Bermuda has been given as the reason why business owners keep little documentation—thus finding it nearly impossible to keep track of inventory, monitor sales, or calculate how much they are owed.[71]

Because balance sheets and income statements do not always give an accurate picture, standard ratios such as return on assets and debt–equity are unreliable. Research reveals systematic differences among liquidity and solvency measures for small compared to large companies. The mean averages of both the current ratio and the debt ratio are systematically larger for the small companies.[72] Cash flow is widely regarded as more important for an entrepreneurial business than is the traditional balance sheet or income statement. Even though a small business may be profitable in the accounting sense, a negative cash flow could bankrupt the company. Levin and Travis provide five reasons why owners, operators, and outside observers should be wary of using standard financial methods to indicate the health of a small, privately owned company[73]:

- **The line between debt and equity is blurred:** In some instances, what appears as a loan is really an easy-to-retrieve equity investment. The entrepreneur in this instance doesn't want to lose his or her investment if the company fails. Another condition is that retained earnings seldom reflect the amount of internal financing needed for the company's growth. This account may merely be a place in which cash is left so that the owner can avoid double taxation. To avoid other taxes, owner–managers may own fixed assets that they lease to the corporation. The equity that was used to buy those assets is really the company's equity, but it doesn't appear on the books.
- **Lifestyle is a part of financial statements:** The lifestyle of the owner and the owner's family is often reflected in the balance sheet. The assets of some firms include beach cottages, mountain chalets, and automobiles. In others, plants and warehouses that are used for company operations are not shown because they are held separately by the family. Income statements may not reflect how well the company is operating. Profitability is not as important in decision making in small, private companies as it is in large, publicly held corporations. For example, spending for recreation or transportation and paying rents or salaries above market rates to relatives put artificially high costs on the books of small firms. The business might appear to be poorly managed to an outsider, but the owner is acting rationally. The owner–manager wants dependable income or its equivalent with the least painful tax consequences. Because the standard profitability measures such as ROI are not useful in the evaluation of such a firm, Levin and Travis recommend return on current assets as a better measure of corporate productivity.

- **Standard financial formulas don't always apply:** Following practices that are in contrast to standard financial recommendations, small companies often use short-term debt to finance fixed assets. The absence of well-organized capital markets for small businesses, along with the typical banker's resistance to making loans without personal guarantees, leaves the private owner little choice. Although a large amount of long-term debt is considered to be a good use of financial leverage by a large publicly held firm, it can drive a smaller firm into bankruptcy by raising its break-even point.
- **Personal preference determines financial policies:** Because the owner is often the manager of the small firm, dividend policy is largely irrelevant. Dividend decisions are based not on stock price (which is usually unknown because the stock is not traded) but on the owner's lifestyle and the tradeoff between taking wealth from the corporation and double taxation.
- **Banks combine personal and business wealth:** Because of the large percentage of small businesses that go bankrupt every year, bank loan officers are reluctant to lend money to a small business unless the owner also provides some personal guarantees for the loan. In some instances, part of the loan may be composed of a second mortgage on the owner's house. If the owner does not want to succumb to this pressure by lenders to include the owner's personal assets as part of the collateral, the owner–manager must be willing to pay high interest rates for a loan that does not put the family's assets at risk.

End of Chapter SUMMARY

Why is it that some entrepreneurial ventures are successful almost immediately and others fail to even reach breakeven? For some, it may be just "dumb luck" or serendipity. For others, it may be a matter of thinking through the idea before taking action. The underlying reason for new venture failure appears to be an overall lack of strategic management—beginning with an inability to plan a strategy to reach the customer and ending with a failure to develop a system of controls to keep track of performance. Many people new to entrepreneurship naively think that all that is needed to start a business is a good idea. Wrong!

An idea is *not* the same as an opportunity. An idea is a concept for a product or service that doesn't exist or is not currently available in a market niche. It may be a brand-new concept or an improvement of a current product or service. The idea can be developed from a person's experience or generated in a moment of creative insight. In contrast, an opportunity is an idea for a new product or service with a market that is willing to pay for that product or service so that it can form the basis of a profitable business.

Research indicates that writing a business plan (an entrepreneur's version of a strategic plan) improves the chances for success. A business plan is the test to see whether an idea is really an opportunity. Research also suggests that differentiation and focus are the competitive strategies that are most likely to lead to success, at least in the startup stage of development. Beyond these suggestions, it is up to the entrepreneur to find the right opportunity that fits the environment and his or her strengths and weaknesses.

One reason a new venture may not get immediate results with a new product or service is because not enough people are willing to try a new product until a sufficient number of others do so. They may be waiting for the tipping point. In epidemiology, the tipping point in an epidemic is the point at which there are enough carriers of a disease to allow an explosion that will infect a large number of people. Malcolm Gladwell proposes that a **tipping point** is also the point in which a situation that may have seemed stable or only very slowly changing suddenly goes through a massive, rapid shift. "It's the boiling point. It's the moment when the line starts to shoot straight upwards," explains Gladwell.[74] Until a product reaches the tipping point, sales may be very slow to develop and usually only to the few people who like to experiment with innovative products or services. The key is to be patient and to cultivate those customers who may influence the larger market that prefers to wait until a new product is perfected or accepted as the standard.[75] This is what happened to the company Research In Motion when it introduced its wireless e-mail gadget, called Blackberry, in 1999. The company hired "evangelists" to lend the devices to executives on Wall Street. Four years later, Blackberry arrived on Oprah Winfrey's "favorite things of 2003" and became an industry wireless standard.[76]

INFO-BITS

- Nations scoring highest on an innovation index measuring human resource skills, market incentive structures, and interaction between business and scientific sectors are the United States, Taiwan, Finland, Sweden, Japan, Israel, Switzerland, Canada, Australia, and Germany.[77]
- Regions in the United States scoring highest on a creativity index measuring technology, talent, and tolerance are Austin (TX), San Francisco (CA), Seattle (WA), Burlington (VT), Boston (MA), Raleigh-Durham-Chapel Hill (NC), Portland (OR), Madison (WI), Boise (ID), and Minneapolis (MN).[78]

DISCUSSION QUESTIONS

1. In terms of strategic management, how does a new venture's situation differ from that of an ongoing small company?
2. How should a small entrepreneurial company engage in environmental scanning? To what aspects of the environment should management pay most attention?
3. What are the characteristics of an attractive industry from an entrepreneur's point of view? What role does innovation play?
4. What considerations should small-business entrepreneurs keep in mind when they are deciding whether a company should follow a growth or a stability strategy?
5. How does being family owned (as compared to being publicly owned) affect a firm's strategic management?

STRATEGIC PRACTICE EXERCISE

Read **Strategy Highlight B.1**, "Suggestions for Locating an Opportunity and Formulating a Business Strategy." Your strategy instructor may form multiple groups of five people each in your strategy class. Each group may be assigned one of the four approaches to identifying some ideas that could be opportunities for an entrepreneurial venture:

1. Tap the countertrend.
2. Eat off the established company's plate.
3. Switch the niche.
4. Borrow a business model.

When your group meets, discuss your assigned approach and identify one or more ideas that could be opportunities. Remember that an idea is a concept for a product or service that doesn't exist or is not currently available in a market niche. An opportunity is an idea for a new product or service with a market that is willing to pay for that product or service so that it can form the basis of a profitable business. This means that the idea has to have the potential to be profitable. Bring your ideas to class and see what your instructor and others in the class think of your ideas. Once all the ideas have been presented, take a vote on which of the ideas have the most likelihood of being opportunities.

(If this concept is not used as a class exercise, you may choose to meet informally with several members of your class over coffee. See if you can come up with an idea for each of the four approaches. Are any of them opportunities?)

KEY TERMS

advisory board (p. B-9)
business plan (p. B-7)
entrepreneur (p. B-4)
entrepreneurial characteristic (p. B-13)
entrepreneurial venture (p. B-3)
factor affecting new venture success (p. B-12)
family business (p. B-17)
idea (p. B-6)
lifestyle company (p. B-16)
opportunity (p. B-6)
small-business firm (p. B-3)
source of innovation (p. B-11)
strategic decision-making process for entrepreneurial venture (p. B-6)
substage of small business development (p. B-15)
tipping point (p. B-20)

NOTES

1. Summarized from N. L. Torres, "No Sweat," *Entrepreneur* (December 2004), p. 126.

2. "Small Business Resources for Faculty, Students, and Researchers: Answers to Frequently Asked Questions," *Small Business Advocate* (May 2004), p. 5.

3. W. J. Baumol, "Entrepreneurial Cultures and Countercultures," *Academy of Management Learning and Education* (September 2004), pp. 316–326; *The State of Small Business: A Report to the President* (Washington, DC: U.S. Government Printing Office, 1987), p. 117.

4. J. Castro, J. McDowell, and W. McWhirter, "Big vs. Small," *Time* (September 5, 1988), p. 49. This is supported by a 2003 study by the U.S. Small Business Administration which found that a small-firm patent is more likely than a large-firm patent to be among the top 1% of most frequently cited patents.

5. B. Headd, "Redefining Business Success: Distinguishing Between Closure and Failure," *Small Business Economics* (August 2003), as reported in "Frequency of Small Business Failure Reassessed by Advocacy Economist," *Small Business Advocate* (October 2003), p. 2.

6. M. J. Foster, "Scenario Planning for Small Businesses," *Long Range Planning* (February 1993), p. 123; M. S. S. El-Namacki, "Small Business—The Myth and the Reality," *Long Range Planning* (August 1990), p. 79.

7. J. Hopkins, "Study: New Company Failure Rate Not So High," *USA Today* (February 18, 2003), p. 1B. This article summarizes Brian Headd's 2003 study for the Small Business Administration. It revealed that after four years, the 50% that had closed included 33% that were considered unsuccessful. The remaining 17% were sold or closed but were considered successful by their founders. According to a study by Dun & Bradstreet of 800,000 small U.S. businesses started in 1985, 70% were still in business in March 1994. Contrary to other studies, this study counted firms as failures only if they owed money at the time of their demise. Also see J. Aley, "Debunking the Failure Fallacy," *Fortune* (September 6, 1993), p. 21.

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