Entrepreneurship : theory, process, practice

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Asia pacific edition

ENTREPRENEURSHIP: THEORY PROCESS PRACTICE

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Entrepreneurship
Theory, process and practice
Asia–Pacific edition

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and Richard M. Hodgetts

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brief contents

contents

contents

contents

Preface

The spirit of enterprise is one of the most powerful forces known to mankind! The 'entrepreneurial revolution' that captured our imagination during the last decade has now permeated every aspect of business thinking and social planning. There are social entrepreneurs, governmental entrepreneurs, sports entrepreneurs, music entrepreneurs, even military entrepreneurs. The applications of creativity, risk-taking, innovation, and passion lead the way to progress of all forms.

The famous poet William Butler Yeats likened this process to the gyre or vortex. Like steps in a lighthouse, the gyre moves from its base progressively higher and narrower. We could call this the 'mind to market' process. It is just an illusion that we are tracing our steps when in reality through education we are reaching higher levels of achievement. That's the path of the entrepreneur and we hope this textbook leads you higher towards your goal.

The process of transforming creative ideas into commercially viable businesses continues to be our major challenge. Successful entrepreneurship requires more than merely luck and money. It is a cohesive process of creativity, risk-taking, and planning. Entrepreneurs are born and made. Learners today need courses and programs that set forth a basic framework for understanding the process of entrepreneurship. We wrote *Entrepreneurship: Theory, process and practice, Asia–Pacific edition* to structure and illustrate the discipline of entrepreneurship in a manner that is as unique and creative as entrepreneurship itself.

We believe it will be valuable for our region's nascent entrepreneurs, founders of new ventures, owners of growth businesses, policymakers, social and governmental entrepreneurs and corporate leaders both in the private or the public sector who wish to (re)-develop an entrepreneurial culture within their organisations.

This new text takes students on the journey to become sole proprietors of the rest of their lives. It places a unique and special emphasis on developing a successful business idea. This text encourages learners to think like successful entrepreneurs. It also pushes them to think globally.

The text provides students with a comprehensive introduction to entrepreneurship useful to both business and social entrepreneurs. The authors include numerous case studies and examples relating particularly to Australia, New Zealand, Singapore, Taiwan, Indonesia, Hong Kong and China. Real world applications are stressed throughout. The text provides students with a solid foundation to the entrepreneurial landscape of the Asia–Pacific region.

This is a complete revision of one of the most successful entrepreneurship texts in North America.[1] All chapters have been fully re-written with the Asia–Pacific entrepreneur in mind. This text covers two semester-length courses found in typical upper-level and graduate university environments:

- **Foundations of entrepreneurship:** Students will acquire a broad overview of the principles, theories and practice of entrepreneurship, together with an understanding of the key tools, skills, attitudes and ethics required to operate in this environment. The course focuses on developing the roles of the entrepreneur, innovator, and new venture developer. Teachers like to mix and match, but we recommend chapters 1–8, 17 and 20.
- **New venture creation:** Students will learn the knowledge skills and develop an awareness of the critical aspects of creating a new venture. This includes developing and testing a business concept; analysing the market; making strategic choices; planning for growth; comparison of business models; financing start-up; and managing change in entrepreneurial organisations that aspire to implement globalisation, high growth, innovation, or entrepreneurial strategies. Here we recommend chapters 9–16 and 18–19.

WHY WE WROTE THIS BOOK

Each of us has published a variety of scholarly books and articles elsewhere, but we didn't write this textbook for reasons of academic advancement. Strangely, textbooks simply do not count for a professor's promotion and tenure in the academic performance-based research scheme.

Our reason for putting together *Entrepreneurship: Theory, process and practice, Asia–Pacific edition* is to compact and synthesise an immense body of knowledge for the budding entrepreneur and enterprising spirit of all types. Our aims are to simplify, condense, organise and translate a vast and sometimes complex body of knowledge into a form useful for building commercially viable projects of all sorts. We have taken ideas from multiple sources and repackaged them to make a new whole. As the American Historical Association says, textbooks are different from other scholarly writing in the 'form of attribution, and the permissible extent of dependence on prior scholarship'.[2] Within our organisation and cumulation of knowledge on Asia–Pacific entrepreneurship, we have cited literally hundreds of colleagues in the field and to the best of our ability we aim to provide ready access to works on which we have drawn.

ORGANISATION

The chapter sequence is systematically organised around the creation, assessment, growth development, and operation of new and emerging ventures. Each major part of the text contains chapters that specifically address these pertinent concepts of entrepreneurship.

Part 1 (chapters 1–3) introduces the emerging world of entrepreneurship. Examining the entrepreneurial revolution throughout the world, this part reveals the evolving nature of entrepreneurship and its importance to the entire world economy. It looks at entrepreneurship and national culture and overviews the entrepreneurial activity of countries in the Asia–Pacific. Finally, the concept of intrapreneurship is introduced as an emerging strategy to foster entrepreneurial creativity within a larger organisation.

Part 2 (chapters 4–6) addresses the entrepreneurial edge that resides within individuals. This part explores creativity for individuals and the concept of innovation. It also focuses on the ethical and social perspective that entrepreneurs need to take in developing a more socially conscious approach to business.

Part 3 (chapters 7–10) focuses on the development of an entrepreneurial plan. This part includes a discussion of the assessment of regulatory, competitive and local environments and their effect on new and emerging ventures. The issues of entrepreneurial marketing that affect the preparing, planning and operating of entrepreneurial start-ups as well as the financial tools that entrepreneurs need are also discussed. Finally, the development of a clear and comprehensive business plan is examined. A complete sample business plan appears in the appendix.

Part 4 (chapters 11–14) examines the initiation of entrepreneurial ventures. The methods of assessing new ventures and business opportunities are presented. The legal structures of organisations (sole proprietorships, partnerships and corporations) as well as certain critical legal issues such as proprietary protections (patents, copyrights and trademarks) and bankruptcy laws are examined – all within the Asia–Pacific context. This part concludes with a thorough examination of the sources of finance available to entrepreneurs.

Part 5 (chapters 15–17) focuses on the growth and development of entrepreneurial ventures, which are diverse yet interrelated areas. The need for strategic planning, the challenge of managing entrepreneurial growth, and the global opportunities available to entrepreneurs are all discussed within this part.

Part 6 (chapters 18–20) is devoted to some contemporary issues in the world of entrepreneurship. Final challenges facing growing entrepreneurial ventures from a family business perspective are discussed. First, the valuation process needed to acquire a business venture (or sell an existing firm) is discussed. Second, the critical considerations of management succession and continuity are explored. Third, the powerful emergence of women and Indigenous entrepreneurs is examined.

FEATURES The text comprehensively covers topics, ranging from planning and finance to global and women's issues, in a succinct and real-world way. More than an academic approach, the text follows the philosophy that learning for entrepreneurs is best done through experience.

Chapter objectives preview what students will earn in each chapter.

Side-bars called 'Entrepreneurial edge' and 'Entrepreneurship in practice' give real-world illustrations of the text material. Conceptual material is linked to the plans, problems and solutions that real entrepreneurs have encountered in their own businesses.

End-of-chapter summaries provide a review of each chapter's important concepts.

Key concepts, listed at the end of each chapter and highlighted within the chapter, are defined in the glossary at the end of the book. These will help students grasp new terminology.

Questions for review and discussion enable students to test their comprehension of the key concepts in the chapter.

There are short case studies at the end of chapters that provide a narrowly focused case study for examination and discussion. Also, cases from Harvard Business School are reviewed. These cases help students to pull together concepts covered in multiple chapters of the text.

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END NOTES

1 Donald F. Kuratko and Richard M. Hodgetts, *Entrepreneurship: Theory, Process, Practice*, 6th edn (Mason, Ohio: Thomson South-Western, 2004).

2 American Historical Association, 'Statement on standards of professional conduct', Approved by Professional Division, 9 December 2004 and adopted by Council, 6 January 2005 [www.historians.org/PUBS/free/professionalstandards.cfm?pv=y] accessed 10 September 2005.

about the authors

HOWARD H. FREDERICK is a Stanford graduate with broad European, Latin American, and Asia–Pacific experience. Professor Frederick is recognised as an authority in the field of ICT, business innovation and economic growth. He is the author of New Zealand's first *Knowledge Economy* report (1999), the *Global Entrepreneurship Monitor New Zealand* reports as well as numerous articles and books. He is New Zealand's only Professor of Innovation and Entrepreneurship, based at the School of Management and Entrepreneurship at Unitec New Zealand, where he teaches Global Entrepreneurship, e-Business, New Business Environment, Market Research, International Marketing and Political Communication. After the fall of the Berlin Wall, Frederick launched a dot.com high-tech start-up in the eastern German State of Saxony called the Saxony Telematics Development Corporation. Professor Frederick's current commercial activities focus on Ten3 New Zealand Limited. With partners in China, Korea, Japan, Germany, Russia, India, Philippines, Vietnam and Latin America, Ten3 assists start-up ventures worldwide and acts as a global matchmaker and online initiation/implementation service for distance partners. Recent successes include the spin-off of Ten3 Ventures (NZ) Ltd. Professor Frederick has previously served twice as Fulbright Professor, once in Austria (1989) and once in Mexico (1993). He was also an IREX scholar (US International Research and Exchanges Board) in the German Democratic Republic, where he studied small business operations under communism. He currently serves as Director of the Global Entrepreneurship Monitor New Zealand, part of a 45-country consortium that benchmarks New Zealand's entrepreneurial activity with the rest of the world. The author's website is located at [www.ten3.co.nz/learning].

DONALD F. KURATKO is considered a prominent scholar and national leader in the field of entrepreneurship. He has authored over 170 books and articles on aspects of entrepreneurship, new venture development, and corporate entrepreneurship. In addition, Dr Kuratko has been consultant on Corporate Entrepreneurship and Entrepreneurial Strategies to a number of major corporations. The Jack M. Gill Chair of Entrepreneurship; Professor of Entrepreneurship; and Executive Director of the Johnson Center for Entrepreneurship and Innovation at the Kelley School of Business, Indiana University, Bloomington. Previously he was the Stoops Distinguished Professor of Entrepreneurship and Founding Director of the Entrepreneurship Program, Miller College of Business, Ball State University. In addition, he was the Executive Director of The Midwest Entrepreneurial Education Center. Dr Kuratko was the first professor ever to be named a Distinguished Professor for the College of Business at Ball State University and held that position for 15 years. Dr Kuratko was a recipient of Ball State University's four major lifetime awards which include: Outstanding Young Faculty (1987); Outstanding Teaching Award (1990); Outstanding Faculty Award (1996); and Outstanding Researcher Award (1999). Dr Kuratko was named the Entrepreneur of the Year for the state of Indiana (sponsored by Ernst & Young, *Inc.* magazine, and Merrill Lynch) and was inducted into the Institute of American Entrepreneurs Hall of Fame (1990).

RICHARD M. HODGETTS (1942–2001) was the Suntrust Professor of Strategic Management at Florida International University (FIU). He earned a PhD from the University of Oklahoma, an MBA from Indiana University, and a BS from New York University. Dr Hodgetts published more than 125 articles and papers on a variety of topics ranging from entrepreneurship to strategic management to total quality management. His articles appeared in a host of journals, including the *Academy of Management Journal*, *Academy of Management Executive*, *Organizational Dynamics*, *Business Horizons*, *Personnel*, *Personnel Journal*, and the *Journal of Small Business Management*. He was also the author or coauthor of 49 books. Some of the most recent include International Business, *International Management*, *Modern Human Relations at Work*, *Measures of Quality and High Performance*, and *Effective Small Business Management*, 7th edn, which he wrote with Dr Kuratko. Dr Hodgetts consulted for a number of Fortune 500 firms and provided training for a wide variety of companies, including AT&T Technologies, Delco Electronics, Eastman Kodak, General Electric, IBM, Motorola, Texas Instruments, and Wal-Mart. He also lectured in Mexico, Venezuela, Peru, Chile, Jamaica, Trinidad, Denmark, Kuwait, and at a host of US colleges and universities. Professor Hodgetts was a Fellow of the Academy of Management and a past member of the Academy's Board of Governors. He served on three academic review boards and wrote a biweekly column on small business and entrepreneurship in the F Lauderdale *Sun Sentinel*.

acknowledgments

It is often said that writing a book is like a long-term relationship with an obsessive partner. Throughout the more-than-a-year that it took me to write this book, my life went on: foreign residencies, student advisement, committees and conferences, even gardening and cooking. Throughout it all, the book demanded constant attention. So in the first instance I need to thank the people that made it possible to focus on the book to the (near) exclusion of everything else. My wife Dr Hanna Frederick always gave me space even when she demanded me to cook her dinner. She has been a loving a supportive partner throughout this whole ordeal. I also owe a debt of gratitude for the people at Ten3 New Zealand and Unitec New Zealand who constantly provided me with advice and assistance. My business partners Dean Prebble, Linda Beamer, Anton de Waal and Vadim Kotelnikov gave me lots of material that I have incorporated in the book. My boss Professor Pieter Nel helped move mountains so that I could concentrate on the task at hand. My Vice President, Research, Professor Gael McDonald supported me a good deal through a Professorial Allowance that gave me the opportunity to concentrate on the book. In fact, Unitec's generous allowance made it possible for me to spend three wonderful uninterrupted months writing this book at the Leonard Greif Center for Entrepreneurial Management, Marshall School of Business, University of Southern California, Los Angeles. My colleagues there, Professors Kathy Allen and Tom Omalia, welcomed me with scholarly and practical resources that I needed to make this book as up-to-date as possible. Throughout all of this time my research assistants Ingvild Rytter and Graeden Chittock helped me tremendously on this project as well as on my other full-time projects! In the final stretches I could not have survived without the help of my copy-editor Beth Coleman. My publisher Thomson Learning Australia has put muscle behind this effort and I'd like to thank particularly Michael Tully, Publishing Manager Higher Education, and Penelope Goodes, Developmental Publishing Editor, Higher Education, for their constant support. Finally, I need to thank my students at Unitec New Zealand in the Innovation and Entrepreneurship program and in the Business program as well as at Christchurch Polytechnic Institute of Technology, who were the first students to test drive this material. It has been a massive job, one where I had to contribute a lifetime's experience and knowledge. I hope that readers will also say I contribute good judgement too. But I'm reminded of that old maxim from Mark Twain when the boy asks: 'Where does good judgement come from?' 'It comes from experience, son.' 'But where does experience come from?' 'Son, experience comes from bad judgement.' Entrepreneurs! Try and try yet again, for failure leads to ever greater wisdom.

PART ONE:
ENTREPRENEURSHIP IN THE TWENTY-FIRST CENTURY

CHAPTER

1

THE ENTREPRENEURIAL REVOLUTION

> Wealth is created only by doers in the arena who are marred with dirt, dust, blood, and sweat. These are producers who strike out on their own, who know high highs and low lows, great devotions, and who overextend themselves for worthwhile causes. Without exception, they fail more than they succeed and appreciate this reality even before venturing out on their own. But when these producers of wealth fail, they at least fail with style and grace, and their gut soon recognises that failure is only a resting place, not a place in which to spend a lifetime. Their places will never be with those nameless souls who know neither victory nor defeat, who receive weekly pay checks regardless of their week's performance, who are hired hands in the labour in someone else's garden. These doers are producers and no matter what their lot is at any given moment, they'll never take a place beside the takers, for theirs is a unique place, alone, under the sun. They are entrepreneurs!
>
> Joseph R. Mancuso, Center for Entrepreneurial Management[1]

CHAPTER OBJECTIVES

1 To explain the importance of entrepreneurs for economic growth

2 To introduce the concept of an entrepreneurial edge within individuals

3 To examine the entrepreneurial revolution taking place today

4 To illustrate the entrepreneurial environment

5 To highlight some of the latest trends in entrepreneurial research

6 To underscore the trends that are occurring in entrepreneurship education

ENTREPRENEURS CHALLENGING THE UNKNOWN

Entrepreneurs are individuals who recognise opportunities where others see chaos or confusion. They are aggressive catalysts for change within the marketplace. They have been compared to Olympic athletes challenging themselves to break new barriers, to long-distance runners dealing with the agony of the kilometres, to symphony orchestra conductors who balance the different skills and sounds into a cohesive whole, or to top-gun pilots who continually push the envelope of speed and daring. Whatever the passion, because they all fit in some way, entrepreneurs are the heroes of today's marketplace. They start companies and create jobs at a breathtaking pace. Economies around the world have been revitalised because of the efforts of entrepreneurs and the world has turned now to **free enterprise** as a model for economic development. The passion and drive of entrepreneurs move the world of business forward. They challenge the unknown and continuously create the future. It is their savings, investment and innovation that lead to development. They are the ones who can alleviate poverty by contributing to **economic growth** and **job creation**. One anonymous quote sums up the realities for entrepreneurs:

> Anyone [can be an entrepreneur] who wants to experience the deep, dark canyons of uncertainty and ambiguity; and who wants to walk the breathtaking highlands of success. But I caution, do not plan to walk the latter, until you have experienced the former.[2]

ENTREPRENEURSHIP AND ENTERPRISE: AN ASIA–PACIFIC PERSPECTIVE

Entrepreneurship is more than the mere creation of business. Although that is certainly an important facet, it is not the complete picture. The characteristics of seeking opportunities, taking risks beyond security and having the tenacity to push an idea through to reality combine into a special perspective that permeates entrepreneurs. Entrepreneurs are born and made. An entrepreneurial edge can be developed in individuals. There are entrepreneurs inside and outside of organisations, in profit or not-for-profit enterprises and in business or non-business activities for the purpose of bringing forth creative ideas. Star Trek's crew were entrepreneurs of space: 'The mission of the Starship Enterprise is to boldly go where no [one] has gone before'. Today,

TABLE 1.1: 'ENTERPRISING' AND 'ENTREPRENEURIAL' IN 13 LANGUAGES

English	enterprising	entrepreneurial
Czech	podnikavý	podnikatelský
Dutch	ondernemend	bedrijfsgericht
French	entreprenant	entreprenant
German	unternehmungslustig	unternehmerisch
Greek	τολμηρός	επιχειρηματικός
Italian	na	imprenditoriale
Japanese	企業的	企業家
Polish	przedsiębiorczy	przedsiębiorca
Portuguese	empreendedor	na
Russian	предприимчиво	na
Spanish	emprendedor	emprendedor
Swedish	företagsam	egen företagare

Source: Interglot.com, babelfish.altavista.com, smx.cz, portalwiedzy.onet.pl

we still use the word enterprise as an 'attitude to life, an attitude of exploring, of developing, of leading and of taking initiatives'. Enterprise – as in an enterprising individual – is the process of identifying, developing and bringing a vision to life, be it an innovative idea or simply a better way of doing something. Enterprise applies not only to business ventures, but also to political and social decisions.[3] The English language is fortunate in having two complementary words. *Enterprising* means 'marked by imagination, initiative and readiness to undertake new projects'. *Entrepreneurial* means 'willing to take risks in order to create value'. Anyone can be enterprising, from an architect to a zoologist. Entrepreneurship has a more business connotation. Both terms, whether inside or outside of business, mean that a person is the sole proprietor of the rest of their lives, of their own destiny.

Our perspective is an **Asia–Pacific** one. We use this as a political and economic term used to designate the economies on the edges of the Pacific Ocean as well as the various island nations within the region. The region is hugely diverse – with the economic dynamism of Hong Kong, Taiwan and Singapore; the advanced technology in Japan and Korea; the natural resources of Australia; the human resources of China and Indonesia; the agricultural productivity of New Zealand and the Philippines. Specifically, in this book we include the following countries of the Asia–Pacific region: China, Japan, Australia, New Zealand, the Asian NICs (newly industrialised countries) of Singapore, South Korea, Taiwan and Hong Kong, and the ASEAN (Association of Southeast Asian Nations) countries of Brunei, Indonesia, Malaysia, Philippines and Thailand as well as the island nations of Polynesia and Melanesia. However, when we say an 'Asia–Pacific perspective on entrepreneurship', we mean a view of free economies in this region.

FIGURE 1.1 THE ASIA–PACIFIC PERSPECTIVE

OUR ENTREPRENEURIAL ECONOMY

Entrepreneurship is the symbol of business tenacity and **achievement**. Entrepreneurs are the pioneers of today's business successes. Their sense of opportunity, their drive to innovate and their capacity for accomplishment have become the standard by which free enterprise is now measured. This standard is taking hold throughout the entire world within the free and open economies.

In the new millennium, the entrepreneurial spirit is more alive than ever before. Today's current younger generation has sometimes been referred to as *Generation X* because they feel 'X-ed' out of traditional opportunities. Yet throughout the world, young entrepreneurs have become known as **Generation E** for entrepreneurship. And not just in Europe and North America. The poor, whether in Thailand or Australia, can and do get richer through enterprise. With their peers around the world, these young people are now part of one of the most entrepreneurial generations since the Industrial Revolution.[4]

Entrepreneurs will continue to be essential contributors to economic growth through their leadership, management, innovation, research and development effectiveness, job creation, competitiveness, productivity and formation of new industry.

To understand the nature of entrepreneurship, it is important to understand the two perspectives in which entrepreneurial firms operate. The first perspective is statistical, providing actual aggregate numbers to emphasise the importance of small firms in our economy. The second perspective examines some of the trends in entrepreneurial research and education so as to reflect the emerging importance of entrepreneurship in academic developments.

Predominance of new ventures in the economy

The past decade has witnessed the powerful emergence of entrepreneurial activity throughout the world. It is increasingly new and small firms, rather than large ones, that are the major providers of job creation engines.

Our region has some of the highest and lowest rates of **start-up** activity in the world. Compare the sluggish 2.2 per cent of Japan's entrepreneurial environment to the red-hot start-up rate of 20.7 per cent in Thailand. New Zealand for years has had the highest rate of early-stage entrepreneurship in the so-called 'developed' world. China and Australia consistently have distinguished themselves in their entrepreneurial capacity. Countries exhibiting a greater increase in entrepreneurship rates tend to exhibit greater subsequent decreases in unemployment rates. Over the past 15 years, fast-growing entrepreneurial firms contributed considerably to the economic growth rate. Research

TABLE 1.2: ENTREPRENEURSHIP MEASURES

COUNTRY	START-UP RATE 2005 (%)	UNEMPLOYMENT 2004 (%)	GDP GROWTH RATE 2005 (%)
Thailand	20.7	1.9	7.3
New Zealand	17.5	3.9	2.1
China	13.7	4.4	0.9
United States	12.4	5.5	4.7
Australia	10.5	5.5	0.7
Singapore	7.2	4.0	3.1
Hong Kong	3.0	6.8	4.6
Japan	2.2	4.7	4.0

Source: Start-up rates 2005. Percentage of adults 18–64 currently involved in early-stage entrepreneurship. Maria Minniti with William D. Bygrave and Erkko Autio *Global Entrepreneurship Monitor: 2005 Executive Report* (Babson College and London Business School, 2006).

suggests that entrepreneurship provides a positive contribution to job creation and economic growth.[5] About half of all new jobs come from fast-growing new companies.[6] New entrepreneurial initiatives, either starting a new firm or reorienting an existing one, boost productivity. They increase competitive pressure, forcing other firms to react by improving efficiency or introducing innovation. Increased efficiency and innovation within firms, whether in organisation, processes, products, services or markets, enhances the competitive strength of an economy as a whole. This process offers consumers benefits through greater choice and lower prices.

Millions upon millions of people are engaged in entrepreneurial endeavours around the globe. The Global Entrepreneurship Monitor, the premier benchmarking project, in 2005 estimates that around the world about one in 11 adults is either starting a new business or managing a young business of which they are owner. Young people tend to be more involved in entrepreneurial activity in every country regardless of the level of GDP per capita. Low-income countries actually have the highest level of entrepreneurial activity. Across all countries, men are about twice as likely to start new businesses as women. Unfortunately, a lot of entrepreneurial activity is ‘low ambition’. Only 3 per cent of all start-ups qualify as businesses with high potential (those with few competitors intend to bring innovations to the market and use state-of-the-art technology).[7] Most entrepreneurs would rather exploit existing equilibrium opportunities and optimise supply and demand in established markets than exploit innovative venture opportunities and create new markets at home and abroad.

High growth versus lifestyle

During the past few years, the number of new venture start-ups in Australasia has been consistently high. Evidence shows that entrepreneurial start-ups lead to high growth, wealth and jobs. Around the world, generally 8–9 per cent of the adult population is involved in start-ups. However, only about 1–2 per cent of the adult population (10–20 per cent of all entrepreneurs) in countries as diverse as Australia and China are involved in high-growth start-ups, defined as a new venture that ‘expects to create 19 or more jobs within 5 years after the business has started’.[8] These are the ones that we hear so much about.

Though they may be the backbone of an economy, most entrepreneurs only want to achieve modest goals. They fund their lifestyles and families but do not actively contribute to the growth of the dynamic economy. Many may never achieve anything new nor create any wealth; they merely optimise supply and demand in established markets and add nothing of value. The ability to identify a good potential opportunity does not automatically guarantee a successful business, let alone a value-creating business. They are more interested in the ‘three Bs’ (boat, beach house and BMW).

TABLE 1.3: HIGH-GROWTH ENTREPRENEURS IN THE ASIA–PACIFIC, 2005

COUNTRY	% OF ALL ENTREPRENEURS
Singapore	20.50
China	12.00
United States	11.40
Hong Kong	11.30
Australia	9.30
Thailand	9.20
New Zealand	8.10
Japan	7.60

Source: *Global Entrepreneurship Monitor* (2006).

ENTREPRENEURIAL EDGE

THE TROUBLE WITH LIFESTYLE ENTREPRENEURS

Anyone who wants to schedule a meeting with the founders of Burke Publishing had better be flexible. The textbook publishing company is run by Rory and Sandra Burke, a husband-and-wife team who operate the business from a 35-foot sailboat, the *Pacific Voyager*, in the coastal waters off New Zealand. Their floating headquarters has on occasion anchored miles beyond cell phone or email range. It's a fabulous lifestyle, but one that severely limits their company's growth potential.

To really ramp up sales, Rory says, they'd need to dry-dock the boat, move to a land-based office, and start hiring employees. And to the Burkes, that sounds like a lousy trade-off. 'We're lifestyle entrepreneurs', Rory says. 'We try to strike the balance between income, possessions, the time we work, and where we work.' If that means Burke Publishing remains the same size, that's okay with them …

When New Zealanders do talk about celebrating business success, they often use a phrase drawn from agriculture: 'tall poppy syndrome'. When farmers raise poppies, they routinely lop off the tops of any that are growing too fast, in an attempt to maintain uniformity. In New Zealand, the thinking goes, those who appear too successful feel pressure to cloak their wealth. 'If people make it, they don't let anyone know they've made it', says Jana Matthews, a Colorado-based entrepreneurial leadership expert who puts together workshops that teach growth strategies to New Zealand businesses.

Americans' willingness to fail is another quality that the growth-minded New Zealanders admire from afar. While a stint at a failed start-up can be a badge of honour on an American résumé, New Zealanders remain fearful of the stigma of having a business falter. This attitude partly explains the country's lack of serial entrepreneurs. Having risked everything and succeeded once, why take that risk again?

One final difference between American entrepreneurs and New Zealanders is that Americans have a passion to keep expanding their businesses, no matter how large they get. Successful New Zealanders prefer to stand pat. 'We despise the growth mania that we hear Americans talk about, the compulsion to get more customers', says Howard Frederick, who tracks the country's small businesses at Unitec New Zealand, another Auckland university. 'Here it's "More customers? That's a bother".'

Bottom line: New Zealand company builders like the Burkes have trouble getting off their boat to rev up sales, and American entrepreneurs have trouble getting out of the office and onto a boat in the first place. It seems each culture could take some lessons from the other.

Source: Daniel McGinn, 'The trouble with lifestyle entrepreneurs', *Inc. Magazine* (USA) (July 2005).

Entrepreneurs' contribution to the economy

Entrepreneurial firms make two indispensable contributions to the economy. First, they are an integral part of the renewal process that pervades and defines market economies. Entrepreneurial firms play a crucial role in the innovations that lead to technological change and productivity growth. In short, they are about change and competition because they change market structure. The economies of our region are dynamic entities always in the process of 'becoming'. It is about prospects for the future, not about the inheritance of the past.

Second, entrepreneurial firms are the essential mechanism by which millions enter the economic and social mainstream of society. Small businesses enable millions of people, including women, ethnic minorities, indigenous peoples and immigrants, to find prosperity for themselves and their families. Another benefit is the way that entrepreneurship can also play a positive role in delivering health, education and welfare services efficiently. Social economy enterprises encourage the participation of stakeholders in the management and delivery of such services, enhancing innovation and client-orientation. Such an approach can supplement public resources and extend the range of services offered to consumers.

ENTREPRENEURSHIP IN PRACTICE

TRENDS FOR THE NEW MILLENNIUM

Entrepreneurs are known to live in the future. And while the future is not certain, it is predictable. Thus, it forces and allows entrepreneurs to stay on top of the game – to be agents of change. Here are some top 10 lists to watch as technological advances continue to shape society economically, commercially, and socially for years to come.

TOP 10 INNOVATIONS IN HOME COMFORT AND CONVENIENCE IN 2012

- Personalised health monitoring and care, including circulatory, heart or kidney testing transmitting your results to your doctor via the internet.
- Home environmental quality through advanced fans and filters that remove allergens from the air including pollens and moulds, pet dander and other particulates.
- Integration of the TV, telecommunications and computing through TVs, cable or satellite.
- Voice recognition and activation in security systems for cars and homes and into a computer, which will translate voice patterns into digital text.
- Personalised energy from miniaturised fuel cells to increase energy efficiency and density of storage.
- Environmentally friendly and sustainable materials from derived fibres, including genetically engineered trees, plants and crops.
- Home waste treatment including a new generation of trash compactors and pre-treatment of wastewater.
- Personalised identification and security from biochips carrying health and medical records as a piece of jewellery or as an implanted chip; home zone temperature, humidity and lighting in houses with sensors automatically turning appliances on and off as you enter and leave the room.

TEN EMERGING CAREERS AND JOB OPPORTUNITIES

- Tissue engineers growing skin, cartilage, intestines, livers, hearts and kidney tissue.
- Gene programmers who write customized prescriptions and alter individual genes; farmers raising genetically engineered vegetables and animals.
- Eco-scouts on the lookout for so-called Trojan gene effects, and bounty hunters helping eliminate transgenic species that get out of hand.
- Data miners who extract useful titbits from mountains of data.
- Hot-line handymen carrying out remote diagnostics on your home electronics.
- Virtual-reality actors performing on a pay-per-play basis.
- Narrowcasters working with advertisers to create content just for you.
- Turing testers (from British mathematician Alan Turing) helping you know whether you're talking to a person or a machine.
- Knowledge engineers, artificial-intelligence brokers will translate your expertise into software.

TEN INVESTMENT OPPORTUNITIES

- Hybrid vehicles
- Gene therapy
- Optical computers
- High-speed trains
- Ceramic engines
- Nanotechnology
- Intelligent agents
- Superconducting materials
- Hypersonic planes
- Computer sensory recognition

Sources: 'Top ten innovations in home comfort and convenience in 2012' [www.battelle.org/news/02/07-09-02Healthy.stm] 9 July 2002; 'What Will Be the 10 Hottest Jobs?', *Time Magazine* [www.time.com/time/reports/v21/work/mag_ten_hottest_jobs.html]; 'Forecasts for the Next 25 Years', *The Futurist: Special Report* (1999): 4–8.

ENTREPRENEURSHIP AND NATIONAL CULTURE

As we begin our examination of entrepreneurship in Asia–Pacific, let's keep three principles in mind:

- a certain portion of the adult population can be classified as entrepreneurs
- we can measure that proportion

- a country, a culture or even an ethnic group can be rated higher or lower in entrepreneurial activity than another.

Cultural and social norms can encourage or discourage entrepreneurs. The literature of the impact of both **national culture** and ethnicity on entrepreneurship and economic development has long focused on characteristics that might promote or inhibit entrepreneurship. Many of these works have focused on the supposed unique 'ideal type' of entrepreneurship from the perspectives of sociology, economics, political science, management and journalism.[9] For example, Lam and Paltiel argue that Confucianism is correlated with economic development and entrepreneurship in Taiwan and Japan.[10] Other literature describes cultural characteristics that explain why Singapore might lack a spirit of entrepreneurship.[11] One interesting study focuses on why Māori New Zealanders are more entrepreneurial than European New Zealanders.[12]

One dominant school of thought examines the relationship of culture and personality traits.[13] For example, Cowling found that gender and education variables varied in the strength of explaining entrepreneurship across countries.[14] Frederick believes that New Zealand entrepreneurs are lifestylers and do not feel an urgency to succeed nor are they ego-driven.[15]

Well-known is Hofstede's argument that cultural dimensions such as **power distance**, **uncertainty avoidance**, **individualism**/**collectivism** and masculinity/femininity affect national wealth and economic growth.[16] Morris & Davis showed that entrepreneurship declines the more collectivism is emphasised.[17] Trompenaars showed how different cultures respond to different management approaches, how organisations have different meanings to different cultures.[18] Many authors reinforce the view that characteristics such as these comprise the salient dimensions of culture insofar as entrepreneurship is concerned.[19] In this tradition, Lee and Peterson, drawing as well upon Lumpkin and Dees,[20] propose that *a society's propensity to generate autonomous, risk-taking, innovative, competitively aggressive and proactive entrepreneurs and firms depends on its cultural characteristics*.[21] Countries with these specific cultural tendencies will engender a strong 'entrepreneurial orientation', hence higher total entrepreneurial activity. They posit that:

> [Entrepreneurial] cultures are less tolerant of power distance, willing to accept living with uncertainty, are more individualistic, masculine, achievement oriented, and universalistic. In contrast, societies that express concern about class structure, commitment to the hierarchy, job security, consensus decision making, and entitlement thinking will likely readily accept power distance, have a strong uncertainly avoidance, be more collective, feminine, ascription oriented, and particularistic.

Lee and Peterson put these into six cultural dimensions:

- uncertainty avoidance – degree to which a culture or ethnic group accepts uncertainty or is willing to take risks
- power distance – degree to which a culture or ethnic group tolerates hierarchical or unequal relationships
- **materialism** – degree of stress placed on materialism and wealth rather than on harmony and relationships
- individualism – degree of emphasis placed on individual accomplishment rather than collectivism or group accomplishment
- achievement – how power and status are achieved, either earned through competition and hard work or ascribed by birthright, age or gender
- behaviour regulation – degree to which a culture or ethnic group applies norms universally to all or whether certain individuals enjoy special rights or privileges because of their status.[22]

Specifically, 'ideal type' entrepreneurs would: generally accept uncertainty and risk; not tolerate unequal relationships; stress materialism and wealth; emphasise individual accomplishment; believe that power and status are earned through competition and hard work; believe that a code of laws exists equally for all.

But as we look around the world, entrepreneurial cultures sometimes do not fit this ideal type.

TRENDS IN ENTREPRENEURSHIP RESEARCH

As we continue our study of entrepreneurship, it is important to note the research and educational developments that have occurred over the past few years. The major themes that characterise recent research about entrepreneurs and new-venture creation can be summarised as follows:

- The boundaries of entrepreneurship as a field are permeable and cross-disciplinary but there is a growing culture and knowledge base within the field.[23] Nonetheless, since it is an 'emerging' field, it has a reputation for 'accumulative fragmentalism'.[24]
- Entrepreneurs may actually use different cognitive process than other people to identify and evaluate opportunities. Research on cognition is looking at how they make mental leaps and develop viable hunches before these can be methodologically explained.[25] Entrepreneurs are excellent at combining (sometimes scarce) resources to start new ventures. They are different from the general population in that crucial ability to find the necessary inputs.[26]
- Entrepreneurs are masters at 'know-who', meaning access to networks and processing information. In chaotic markets, entrepreneurs somehow become alert and develop knowledge by making information investments that others do not.[27]
- Venture financing, including classic venture capital, angel capital financing and informal financing, emerged in the 1990s with unprecedented strength, peaked at the beginning of the millennium and has grown back to 1998 levels.
- **Intrapreneurship** (that is, entrepreneurship within large organisations) and the need for entrepreneurial cultures have gained much attention during the past few years.[28]
- Entrepreneurial entry strategies have been identified that show some important common denominators, issues and trade-offs.[29]
- The risks and trade-offs of an entrepreneurial career – particularly its demanding and stressful nature – have been a subject of keen research interest relevant to would-be and practising entrepreneurs alike.[30]
- Women, minority, immigrant and indigenous entrepreneurs have emerged in unprecedented numbers. They appear to face obstacles and difficulties different from those that other entrepreneurs face.[31]
- Demographic trends are producing a large cohort of **senior-preneurs** (also known as grey, older, Third Age, or elderly entrepreneurs).[32]
- Entrepreneurial education has become an increasingly sought-after subject at universities. The number of schools teaching a new-venture or similar course has grown from as few as two dozen 20 years ago to more than 2000 at this time.
- The interest in entrepreneurship at business schools grows unabated. It is largely student and alumni-driven. There is a shortage of entrepreneurship faculty, and courses are heavily staffed with part-timers, who provide 'war stories' but little theory and context.[33]
- The entrepreneurial spirit is universal among the free economies, judging by the enormous growth of interest in entrepreneurship around the world in the past few years.[34]

- The economic and social contributions of entrepreneurs, new companies and family businesses have been shown to make immensely disproportionate contributions to job creation, innovation and economic renewal, compared with the contributions that the largest companies make.[35]

TRENDS IN ENTREPRENEURSHIP EDUCATION

Entrepreneurship education is one of the fastest growing disciplines in the world today. The growth and development in curricula and programs devoted to raising the level of enterprise and new venture creation has been remarkable. American research shows that students – be they in art or architecture, sport or health – who have had just one course in entrepreneurship or personal enterprise are more likely to be self-employed, to start successful businesses and to launch social enterprises.[36] Evidence suggests that many of the best ideas in business plan competitions come from non-business majors. Many of the strongest contributors are non-business students and some of the most innovative entrepreneurial initiatives do not involve business schools.[37]

The trend towards **proprietorship** and **self-employment** is impressive. While we do not have comparable figures for the Asia–Pacific countries, in the United States accurate figures of self-employment among the various job categories have been kept.[38] Table 1.4 shows the percentage of self-employment of many favoured new-millennium professions.

Graduates from the performing arts are remarkably high in self-employment rates. As many as half of all artists and photographers, a third of writers and authors, musicians and singers and a quarter of actors and directors become self-employed. From management analysts to architects, many of today's professions are increasingly self-employed.

TABLE 1.4: PROFESSIONS, PERCENTAGE OF SELF-EMPLOYED

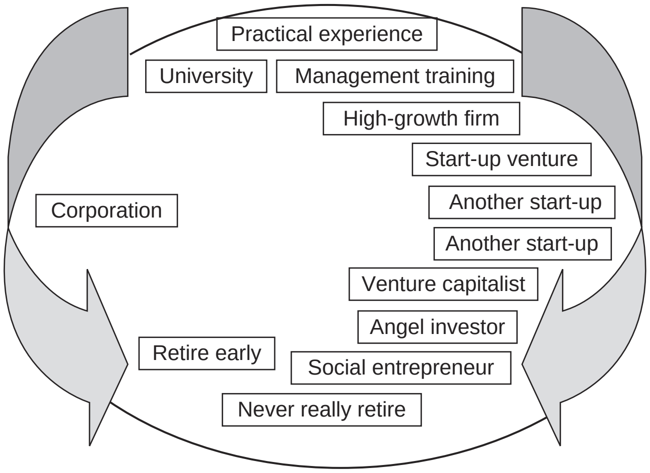
Artists	50%
Photographers	50%
Construction managers	50%
Property, real estate and community association managers	46%
Writers and authors	33%
Musicians, singers and related workers	33%
Designers	33%
Carpenters	30%
Management analysts	30%
Veterinarians	28%
Athletes, coaches, umpires,	27%
Actors, producers and directors	25%
Architects	20%
Dancers and choreographers	20%
Television, video and motion picture camera operators and editors	20%
Automotive service technicians	16%
Economists	11%
Accountants	10%
Travel agents	10%
Electricians	10%

The field of entrepreneurship education has accelerated in the last two decades.[39] The phenomenon has reached many countries. For example, Germany is particularly active in new forms of entrepreneurship education with the creation of more than 30 chairs in entrepreneurship in the years 1997 to 2004.[40] These developments are not limited to the developed world: Latin American universities are seeing a growing commitment to developing entrepreneurial abilities among students and graduates.[41] The trend toward university-wide entrepreneurship education is strong and gaining momentum.[42] This text is evidence to the interest in the Asia–Pacific region.

Kuratko believes that entrepreneurship is the future of business schools and that entrepreneurship faculty are beginning to move into leadership roles.[43] There's an interesting dialectic in the business education field between control and creativity/compliance and innovation, which are conflicting approaches that might be classified as divergent thought-systems.[44] There is an 'ideological chasm' between the compliance-oriented management disciplines, such as finance and accounting and the entrepreneurship teachers who value creativity and innovation. In fact, Australian entrepreneurship professor Kevin Hindle believes that entrepreneurship education is located in the wrong building! It is fundamentally at odds with the orientation of the typical university-based business school, both in terms of the way material is taught and in the way that it is evaluated.[45] The new field would need to extend beyond the boundaries of schools of management or engineering, perhaps even beyond universities.[46] Legendary entrepreneurship educator David Birch believes that 'business schools teach you exactly the opposite of entrepreneurship … Basically, business schools teach you to work for somebody'.[47] Hindle even questions whether entrepreneurship should be taught in the business school. He says that entrepreneurship belongs 'wherever you want to put it so long as the key condition of imaginative transcendence of the immediately vocational is met. You teach it wherever the right mindset prevails'.

Has entrepreneurship education 'truly arrived'? We can measure this by looking at the usual milestones of a discipline. According to Kuratko, entrepreneurship education is one of the fastest growing academic disciplines of all time.[48] Vesper and Gartner's inventory of entrepreneurship education programs has ballooned.[49] It is now estimated that the number of schools teaching a new venture creation or similar course has grown from about 20 only two decades ago to more than 1600

FIGURE 1.2 THE CIRCLE OF LIFE: WHICH WAY FOR YOU?



ENTREPRENEURSHIP IN PRACTICE

ASIA–PACIFIC ENTREPRENEURSHIP SCHOOLS

AUSTRALIA

- Australian Centre for Family Business, School of Business, Bond University, Australia
- Australian Graduate School of Entrepreneurship (AGSE), Swinburne University of Technology, Melbourne, Australia
- Centre for Entrepreneurial Management and Innovation (CEMI), Graduate School of Management, University of Western Australia, Australia
- Centre for SME Research and Development (CSRD), University of Wollongong, Australia
- Centre for Women and Business, Graduate School of Management, University of Western Australia, Australia
- Family and Small Business Research Unit (FSBRU), Monash University, Australia
- Institute of Industrial Economics (IIE), Graduate School of Business, University of Newcastle, Australia
- School of Commerce, Flinders University of South Australia, Australia
- Small and Medium Enterprise Research Centre (SMERC), School of Management, Edith Cowan University, Australia
- Small Business Research Unit (SBRU), Victoria University, Australia
- Technology and Innovation Management Centre (TIMC), University of Queensland, Australia

NEW ZEALAND

- ICEHOUSE (International Centre for Entrepreneurship), University of Auckland
- New Zealand Centre for SME Research, Massey University, New Zealand
- Master of Entrepreneurship (MEntr), Otago, University, Dunedin
- Entrepreneurship program, Christchurch Polytechnic Institute of Technology
- Unitec´s New Zealand Centre for Innovation and Entrepreneurship, Unitec New Zealand

SINGAPORE

- Centre for Research on Small Enterprise Development (CRSED), Nanyang Technological University, Singapore
- Nanyang Technopreneurship Center (NTC), Nanyang Technological University, Singapore
- NUS Entrepreneurship Centre, National University of Singapore (NUS), Singapore

in the United States alone. Hisrich estimates that there are some 564 professorships in the field of entrepreneurship, 72 per cent of them in the USA.[50]

The academic literature in the fields of enterprise and entrepreneurship is vast and deep with at least 45 dedicated refereed academic journals. There are now respected conferences on how to teach entrepreneurship. In 1970 there was one textbook, now there are dozens. The movement is growing so fast that it is now expanding outside the Business School. Hundreds of campuses are launching new kinds of ‘e-ships’: engineering entrepreneurship, nursing entrepreneurship, music entrepreneurship, nutrition entrepreneurship, even statistics entrepreneurship.

SUMMARY

This chapter provides a brief, broad perspective on the entrepreneurial revolution that is happening around the world in free economies. The chapter looks at some important statistics that demonstrate the entrepreneurial economy. Entrepreneurs are doers who see opportunity where others see chaos. New ventures started by entrepreneurs are revitalising and stimulating economies through job creation and wealth creation. All entrepreneurs are enterprising individuals, but enterprising individuals go far beyond the realm of business. What unites them whether they are in business or zoology is their desire to be ‘sole proprietor of the rest of their lives’. Our perspective is on Asia–Pacific. We include China, Japan, Australia, New Zealand, Singapore, South Korea, Taiwan, Hong

Kong, Brunei, Indonesia, Malaysia, Philippines and Thailand as well as the island nations of Polynesia and Melanesia. This includes some of the most and the least entrepreneurial countries in the world and we see that high rates of new venture start-ups are associated with low unemployment rates and high job creation rates. Millions upon millions of young (and old) entrepreneurs make up what we call Generation E, perhaps the most entrepreneurial generation since the Industrial Revolution. They are helping to shape and benefiting from **new millennium trends** in lifestyle and technology. Countries and cultures differ in terms of the total entrepreneurial activity. Ethnicity and culture affect the motivations and opportunities that people have to become entrepreneurs. Some cultures encourage an entrepreneurial orientation while others may discourage it. We enumerate trends that have been well researched in the literature. We also describe some of the important developments in entrepreneurship education.

KEY TERMS AND CONCEPTS

achievement
Asia–Pacific
collectivism
economic growth
entrepreneurship education
Generation E
free enterprise
individualism
intrapreneurship
job creation
materialism
national culture
new millennium trends
power distance
proprietorship
self-employment
senior-preneurs
start-up
uncertainty avoidance

REVIEW AND DISCUSSION QUESTIONS

1. Briefly describe what is meant by the term entrepreneurship.
2. Describe the predominance of new ventures in the economy.
3. Identify some of the innovative products and investment opportunities for the new millennium.
4. What is the difference between entrepreneurship and enterprise?
5. How do we define Asia–Pacific?
6. Which countries are highest and which are lowest in Asia–Pacific in terms of their start-up rates?
7. What is the relationship between entrepreneurship (referred to as start-up rate) and unemployment?
8. What indispensable contribution do entrepreneurs make to the economy?
9. What are the six cultural dimensions that we use to describe national culture and entrepreneurship?
10. What are some of the latest trends in entrepreneurship research?
11. What are some of the latest trends in entrepreneurship education?
12. What are the professions that have the highest proportion of self-employed people?

EXPERIENTIAL EXERCISE

ARE YOU A HIGH ACHIEVER?

One of the most important characteristics of a successful entrepreneur is the desire to be a high achiever. The following 10 questions are designed to help identify your achievement drive. Select the letter that best matches your answer and write it in the blank to the left of each question. Scoring information is provided at the end of the exercise.

1. An instructor in one of your college classes has asked you to vote on three grading options. Which of these options would you choose?
    - a Study the course material, take the exams and receive the grade I earn
    - b Roll a die and get an A if I roll an odd number and a D if I roll an even number
    - c Show up for all class lectures, turn in a short term paper and get a C
2. How would you describe yourself as a risk-taker?
    - a High
    - b Moderate
    - c Low

3 You have just been asked by your boss to take on a new project in addition to the many tasks you are already doing. What would you tell your boss?

- **a** Since I'm already snowed under, I can't handle any more.
- **b** Sure, I'm happy to help out; give it to me.
- **c** Let me look over my current workload and get back to you tomorrow about whether I can take on any more work.

4 Which one of these people would you most like to be?

- **a** Steve Jobs, founder of Apple Computers
- **b** Donald Trump of 'Apprentice' TV show fame
- **c** Rupert Murdoch, CEO of News Corporation

5 Which one of these games would you most like to play?

- **a** Monopoly
- **b** Bingo
- **c** Roulette

6 You have decided to become more physically active. Which one of these approaches has the greatest attraction for you?

- **a** Join a neighbourhood sports team
- **b** Work out on my own
- **c** Join a local health club

7 With which one of these groups would you most enjoy playing poker?

- **a** Friends
- **b** High-stake players
- **c** Individuals who can challenge me

8 Which one of these persons would you most like to be?

- **a** A detective solving a crime
- **b** A politician giving a victory statement
- **c** A millionaire sailing on their yacht

9 Which one of these activities would you prefer to do on an evening off?

- **a** Visit a friend
- **b** Work on a hobby
- **c** Watch television

10 Which one of these occupations has the greatest career appeal for you?

- **a** Computer salesperson
- **b** Corporate accountant
- **c** Criminal lawyer

SCORING

Transfer each of your answers to the following scoring key by circling the appropriate number (for example, if your answer to question 1 is c, you will circle the number 2 in row 1). Then total all three columns to arrive at your final score.

INTERPRETATION

1 High achievers take personal responsibility for their actions. They do not like to rely on luck. The third option (c) assumes the class time saved by not having to study for exams will be used to study for other classes; otherwise the answer would be a zero.

2 High achievers are moderate risk-takers in important situations.

3 High achievers like to study a situation before committing themselves to a course of action.

TABLE 1.5: SCORING KEY

QUESTION NUMBER		YOUR SELECTION		
	a	b	c	
1	10	0	2	
2	2	10	2	
3	6	2	10	
4	7	10	5	
5	10	0	0	
6	2	10	6	
7	4	2	10	
8	10	7	4	
9	4	10	4	
10	10	5	10	
Totals				

4 Jobs is a high-achieving individual but is more interested in design and engineering than in goal accomplishment. Trump is an extremely high-achieving salesperson/executive. Murdoch is more driven by the need for power than the need to achieve.

5 Monopoly allows the high achiever to use their skills. Bingo and roulette depend on luck.

6 The high achiever would work out on their own. The second-best choice is to join a health club, which allows less individual freedom but gives the chance to get feedback and guidance from individuals who understand how to work out effectively.

7 High achievers like challenges but not high risks. If you are a very good poker player and you chose (b), you then can raise your score on this question from 2 to 10.

8 Because high achievers like to accomplish goals, the detective would have the greatest appeal for them. The politician is more interested in power and the millionaire is simply enjoying life.

9 High achievers like to do constructive things that help them improve themselves, so working on a hobby would be their first choice.

10 The computer salesperson and the criminal lawyer have a much higher need to achieve than does the corporate accountant.

CASE 1.1:
PAUL CAVE

‘Our job is to enable our customers to make heroes of themselves.’

Using creative thought and determination, Paul Cave, founder and chairman of BridgeClimb, has created a $50 million dollar business in just a few years, effectively monopolising an internationally famous Australian icon brand he doesn’t own, capitalising on huge advertising he doesn’t pay for and sending a personally delivered word-of-mouth recommendation through one million customer heroes to arguably 100 million prospects around the world. And this is just the beginning. Paul Cave made no less than 52 presentations in the late 1990s in an attempt to raise $12 million to fund a business that would enable millions of people to climb the Sydney Harbour Bridge. The predominantly merchant banking targets thought it was a fascinating opportunity, but not for their money. In the end, it was another entrepreneur, Brett Blundy, who Cave says ‘put money into this within 60 seconds of my telling him about it and became my first major shareholder’. Analytical minds struggle where there is no precedent to rely upon. Clearly Blundy, like Cave, searches for opportunities where there is no precedent.

Just three years after BridgeClimb opened the Bridge to climbers, Cave says the business is climbing 300 000 people per annum (two-thirds of them international visitors) and achieving a turnover of $50 million. He talks privately of a bottom line that would make Warren Buffet green with envy. Since commencement, the company has distributed over one million dollars in special thank-you bonuses to its 280 staff. Cave isn't really surprised at the success of BridgeClimb. Since he first conceived the idea about a decade ago while on a bridge climb with his YPO (Young Presidents Organisation) forum, he was forced to take plenty of time to think the concept through.

'As an entrepreneur, you couldn't have found anything [the barriers] more frustrating. The first letter from the government gave basically 64 reasons why not', he says. Having been on the receiving end of so many 'No' answers has made Cave decidedly a 'Yes' man. Having now made it possible for blind and deaf people to make the climb, the next challenge to be overcome is to climb people in wheelchairs and he is confident of success.

Fortunately, Paul Cave's analytical economics background has not masked his creative marketing ability – not only to sense a basic business opportunity that has been staring Australians in the face since 1932, but also to see beyond the simple climb to the higher order monopolisable value that is already generating extraordinary wealth for the company. BridgeClimb projects that it will pay an estimated $130 million to the Roads and Traffic Authority of New South Wales over 20 years for exclusive tourism rights to arguably Australia's most internationally recognised built icon. This cost pales into insignificance when one considers the real value of the asset 'leased'.

While the Harbour Bridge itself is perhaps worth a billion dollars as a structure, its value as an established international brand and icon is far greater, probably in the order of tens of billions. The brand is being built further and maintained by word of mouth and advertising in an extraordinary manner. Being a world-first consumerised bridge-climbing experience gives a powerful first-mover advantage. But being on an already world-famous bridge in the centre of Australia's largest and most visited tourist city is another monopoly.

But that's by no means all, says Cave: 'The Australian Tourist Commission has spent some $20–30 million showing commercials featuring BridgeClimb to the rest of the world to bring people here. Eleven hundred journalists climbed the bridge during the 2000 Olympic Games and the publicity they generated could have reached an estimated 2.5 billion people worldwide. That advertising and publicity has come to us at no cost'.

The way Cave has harnessed so far more than a million climbers as compelling promoters of his company's message further exemplifies the man's intuitive ability to market without money through customer word of mouth. The value delivery system – company culture, defined procedure, staff training, climber preparation, climber satisfaction measure, etc. – is designed, as Cave puts it, to delight the customer: 'Every climber, every time and there is no exception to that'. Climbing, now permitted 24 hours a day seven days per week, happens as often as every 10 minutes whether it is hot, cold, raining or foggy and the customer ratings (excellent plus good) average more than 99 per cent in all conditions.

Price is not an issue, but providing extraordinary value is, Cave insists. The average price per person is $145 and a further $30 is spent on merchandise. He admits that the value people ascribe to the 'Climb of Your Life' experience is a voyage of discovery for him. Once discovered, however, his mind pursued the value like a dog with a bone. For example, 400 (known) proposals of marriage have been made on BridgeClimb, with only one rejection. A technique has been devised so that the ring can be passed safely and securely down a piece of cord to seal the acceptance. Integrated value indeed!

The advice that Paul Cave offers budding entrepreneurs is deceptively simple when one considers the depths to which he has gone to implement his formula.

Be clear about what it is and don't stray from that course. Keep driving in pursuit of that goal. He admits that BridgeClimb having the Sydney Harbour Bridge is 'a dream come true' and his international team is working on other icon bridges around the world.

Don't try to be all things. Be famous for just one thing says Cave: 'We are doing a very simple thing. We are a facilitator only, taking people to the top of the bridge. Our job is to enable our customers to make heroes of themselves'.

'If prospective staff find that unreasonable (that is, the every climber, every time, constant measurement philosophy), please don't come here', Cave says.

Source: John C. Lyons and Edward de Bono, *Marketing Without Money* (Niddrie, Victoria, Aus: Pennon Publishing, POB 136, 2003), 37–40 [www.lyonsanddebono.com/docs/excerpt.pdf].

QUESTIONS

1 What was the opportunity that Cave saw that allowed him to market someone else's product without any money?

2 Cave gives meaning to the I Ching's hexagram 'in adversity, it furthers one to be persevering'. Give your own interpretations to this. What does Cave mean about enabling the customers to become heroes?

3 What entrepreneurial traits did Cave exhibit in starting this business?

RECOMMENDED CASES FROM HARVARD BUSINESS SCHOOL ONLINE

HARVARD BUSINESS
SCHOOL PUBLISHING

www.hbsp.harvard.edu

Entrepreneurial Mindset Tool

Publication date: 28 June 2001
Author(s): Lynda M. Applegate, Meredith Collura
Product number: 9-801-233

Enables companies and individuals to understand better whether they have the mindset and traits to think and act like an entrepreneur. Consists of an exercise that allows executives to rate themselves (or others in the organisation) along seven dimensions: commitment and determination; leadership; opportunity obsession; tolerance of risk, ambiguity and uncertainty; creativity, self-reliance and the ability to adapt; support from significant others; and motivation to excel.

Magdalena Yesil

Publication date: 15 March 2000
Author(s): Myra M. Hart, Mary Teichert Rotelli
Product number: 9-800-350

Magdalena Yesil, investor and former entrepreneur, must decide whether to become a venture partner at US Venture Partners. This case discusses career progression, entrepreneurship and deciding among career alternatives. Yesil's entrepreneurial experiences include UUNET, CyberCash and MarketPay.

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2

ENTREPRENEURSHIP: AN EVOLVING CONCEPT

> Entrepreneurship needs no justification to study it on the grounds of its importance to humanity. It is a well-spring of economic growth, social renewal and personal development. Such an important subject is worthy of deep research, significant reflection and sustained dialogue. When a subject – any subject – has the depth of importance which entrepreneurship possesses, I believe it is capable of being the foundation for great education.
>
> Prof. Kevin Hindle, Australian Graduate School of Entrepreneurship, Melbourne[1]

CHAPTER OBJECTIVES

1 To examine the historical development of entrepreneurs and of entrepreneurship

2 To explore and debunk the myths of entrepreneurship

3 To define and explore the major schools of entrepreneurial thought

4 To explain the process approaches to the study of entrepreneurship

5 To set forth a comprehensive definition of entrepreneurship

THE EVOLUTION OF 'UNDERTAKING'

The word **entrepreneur** is derived from the French **entreprendre**, meaning 'to undertake'. We use the French word in English because unfortunately **undertaker** is already used by another profession! Seriously, though, the entrepreneur is someone who undertakes to organise, manage and assume the risks of a business. The definition is broadened so that today an entrepreneur is considered to be an innovator or developer who recognises and seizes opportunities; converts those opportunities into workable/marketable ideas; adds value through time, effort, money, or skills; assumes the risks of the competitive marketplace to implement these ideas; and realises the rewards from these efforts.[2]

The entrepreneur is the aggressive catalyst for change in the world of business. They are independent thinkers who dare to be different in a background of common events. The research reveals that all entrepreneurs have certain characteristics in common, including the ability to consolidate resources, management skills, a desire for autonomy and risk-taking. Other characteristics include aggressiveness, competitiveness, goal-oriented behaviour, confidence, opportunistic behaviour, intuitiveness, reality-based actions, the ability to learn from mistakes and the ability to employ human relations skills.[3]

Although no single definition of entrepreneur exists and no one profile can represent today's entrepreneur, research is providing an increasingly sharper focus on the subject. A brief review of the history of **entrepreneurship** illustrates this.

ENTREPRENEURSHIP THROUGH THE AGES

Throughout history, there have always been enterprising individuals who spotted and exploited smart opportunities. But as humans evolved from collective units and developed a sense of individualism, these 'dreamers who do', as Pinchot has called them, have often faced daunting, even life-threatening, challenges to realise their dreams.

In today's language, we would perhaps say that a primitive hunter-gatherer with a new weapon was seeking 'niche advantage in the wild marketplace'. As hunting technology developed, some people started to accumulate a surplus and then turned from a struggle for mere survival to use their accumulated wealth and knowledge to start settled communities. Some clever ones must also have decided to lend their capital and knowledge to others for personal gain or the benefit of the clan, but in a collective society it was better to hide such individual gain.

Data from anthropology inform us that entrepreneurial wealth creation has existed for millennia. Excavated business tablets show that innovation and entrepreneurship were key aspects in civilisations that have long disappeared.[4] Ancient Assyrians carried out innovation transfer, had a corps of knowledge workers, and developed business communication.[5] The Assyrians had inherited a system of private enterprise from Sumer and Babylon. Wingham believes that entrepreneurship as we know it today developed in the eleventh century BC in ancient Phoenicia.[6] A sailing nation of merchants and traders, they peacefully connected a commercial empire that ranged from Syria in the east to Spain in the west. These were truly entrepreneurs who took risks, explored the unknown, and faced chaos on a daily basis. Certainly they returned profit to investors, merchants and themselves. This peaceful trading nation was swept aside for two thousand years by the bellicose and avaricious Persian Empire, and with it, the concept of the risk-taking 'undertaker'.

In Biblical times, an enterprising individual with high ability and independence faced the prejudices that societies had against **usury** (charging a fee for the use of money), which in the Bible was viewed as a great crime. Ezekiel 18:13 says, 'He lends at usury and takes excessive interest. Will such a man live? He will not! Because he has done all these detestable things, he will surely be put to death and his blood will be on his own head'. Imagine looking for niche advantage in those times.

The Romans did permit usury, but, curiously, not by Romans themselves. Any business enterprise by a nobleman actually led to loss of prestige. Wealth accumulation was highly valued *as long as it did not involve participation in industry or commerce*.[7] In Rome, there was no absence of wealth creation, only of commerce. Landholding and usury were the usual routes to wealth creation. 'Money poured in from booty, indemnities, provincial taxes, loans and miscellaneous extractions.'[8] Fortunately for some, this aversion to commerce among the nobility left the way open for entrepreneurial freedmen, former slaves who were set up by their masters to run the businesses. Slavery may have been one of the few avenues to commercial advancement for people of the lower classes.

Innovation and profit were completely disconnected. To be sure, Romans made considerable advances in technology, but this was divorced from commerce. Pliny writes that one day an inventor came before Emperor Tiberius to show him his invention of unbreakable window glass and to beseech him for an inventor's fee. Tiberius asked whether anyone else knew yet of the formula. The man assured him that the invention was absolutely secret, whereupon the emperor immediately cut his head off 'lest gold be reduced to the value of mud'. The sad lesson of this story is that the inventor had to turn to the emperor for a reward rather than to a venture capitalist for investment.[9]

Turning to Medieval China, how could an entrepreneur begin a venture when the monarch owned all property? When the emperor needed cash, he simply seized it from his wealthy noblemen. This meant that no one would invest in a productive enterprise for fear of losing it so easily. Only scholarship and officialdom were the routes to success and value was tied up in land, not enterprise. Wealth came to those who passed examinations and gained government positions.

In Europe of the Middle Ages, great wealth and power came not from business acumen but from military conquest. Innovations such as armour, crossbow and gunpowder were needed for military campaigns, not retail shops. In King Arthur's Court, boys learned warfare as the accepted means for accumulating wealth. Indeed, Mark Twain's *A Connecticut Yankee in King Arthur's Court* skewers the Roundtable when a Yankee entrepreneur magically transported back to the past sets up an enterprise academy.

But as Europe changed from a feudal economy to nascent capitalism, conditions finally began to change. Merchant entrepreneurs exploited technological advances in shipbuilding and built global trading networks and they used advanced weaponry to protect it. Forms of usury appeared, such as loans to rulers, leased monopolies, buying on credit, fixed exchange rates and so forth. Merchant entrepreneurs became major players in European politics and the owners of shipping fleets and banks produced descendants who, like the Medici, could become secular rulers or even popes.[10] By the late Middle Ages, the revival of towns saw tax-free zones and emancipated serfs leading to the growth of an entrepreneurial spirit.

So, until the **Industrial Revolution** of the late eighteenth and early nineteenth centuries, we must observe that an entrepreneur's life could lead to decapitation, death on the battlefield or appropriation by the emperor. Hardly a conducive environment!

Yet as perilous as the profession may have been, throughout history, the entrepreneurial spirit has driven many of humanity's achievements. Indeed, some say not much has really changed. Multinational corporations existed in Assyria. Ancient Greeks had brand-name competitions. Business travel was not unknown. There were industry clusters in Phoenicia. Creative innovative forms of free enterprise endured sometimes for centuries.[11] Humanity's progress from caves to campuses has been explained in numerous ways. But central to virtually all of these theories has been the role of the 'agent of change', the force that initiates and implements material progress. Today we recognise that the agent of change in human history has been and most likely will continue to be the entrepreneur.[12]

Rugged individualists, those who cherish individual liberty and self-reliance, frequently found themselves opposed to authority and to controls over the individual. At the core of it, entrepreneurs 'mind their own business' (as in take charge of or look after themselves). Entrepreneurs today may well be the proto-typical **sovereign individuals**. In *The Sovereign Individual*, Davidson and Rees-Mogg see history as roughly 500-year cycles – from Athens's glory and decline (500 BC), to the dawn of Christianity and the fall of Rome (AD 500), to feudalism's emergence (AD 1000) and its collapse around 1500. Each cycle sees the rigid grip of the governmental system ultimately breaking down and the (temporary) liberation of individuals from undesirable controls. In the modern age, citizens no longer need be beholden to a nation–state, the authors say. Tomorrow's entrepreneurs will reside on the Internet and select where to reside and do business based on cost versus profit. They will comparison-shop for services (utilities, police protection, even currency) in a marketplace no longer dominated by state monopolies.[13]

EARLY DEFINITIONS OF ENTREPRENEURSHIP

The recognition of entrepreneurs as a class dates back to eighteenth-century France when economist Richard Cantillon associated the entrepreneurs with 'risk-bearing' activity in the economy.[14] In England during the same period, the Industrial Revolution was growing and the entrepreneur played a visible role in risk-taking and the transformation of resources.[15]

Economists have long claimed the word as their own. In fact, until the 1950s the majority of definitions and references to entrepreneurship had come from economists. For example, Cantillon (1725), just mentioned; Jean Baptiste Say (1803), the renowned French economist; and Joseph Schumpeter (1934), the twentieth-century economic genius, all wrote about entrepreneurship and its impact on economic development.[16] Over the decades writers have continued to try to describe or define what entrepreneurship is all about. Here are some examples:

> Entrepreneurship … consists in doing things that are not generally done in the ordinary course of business routine; it is essentially a phenomenon that comes under the wider aspect of leadership.[17]
>
> Entrepreneurship, at least in all non-authoritarian societies, constitutes a bridge between society as a whole, especially the non-economic aspects of that society, and the profit-oriented institutions established to take advantage of its economic endowments and to satisfy, as best they can, its economic desires.[18]
>
> In … entrepreneurship, there is agreement that we are talking about a kind of behavior that includes: (1) initiative taking, (2) the organizing or reorganizing of social economic mechanisms to turn resources and situations to practical account, and (3) the acceptance of risk of failure.[19]

Significant writers have long argued and those disagreements centre around whether or not an entrepreneur creates equilibrium or disequilibrium, must be risk-bearing, capital-owning, exceptional, a leader or just a combiner of factors, innovative or more alert than the general population.[20] After reviewing the evolution of entrepreneurship and examining its varying definitions, Ronstadt put together a summary description:

> Entrepreneurship is the dynamic process of creating incremental wealth. This wealth is created by individuals who assume the major risks in terms of equity, time, and/or career commitment of providing value for some product or service. The product or service itself may or may not be new or unique but value must somehow be infused by the entrepreneur by securing and allocating the necessary skills and resources.[21]

In the twentieth century, the word has become closely linked with free enterprise and **capitalism.** Also, it was generally recognised that entrepreneurs serve as agents of change; provide creative, innovative ideas for business enterprises; and help businesses grow and become profitable.

Whatever the specific activity they engage in, entrepreneurs in the twenty-first century are considered the heroes of free enterprise. Many of them have used innovation and creativity to build multimillion-dollar enterprises from fledgling businesses – some in less than a decade. These individuals have created new products and services and have assumed the risks associated with these ventures. Many people now regard entrepreneurship as 'pioneership' on the frontier of business.

In recognising the importance of the evolution of entrepreneurship into the twenty-first century, we have developed an integrated definition that acknowledges the critical factors needed for this phenomenon.

> Entrepreneurship is a dynamic process of vision, change, and creation. It requires an application of energy and passion towards the creation and implementation of new ideas and creative solutions. Essential ingredients include the willingness to take calculated risks – in terms of time, equity, or career; the ability to formulate an effective venture team; the creative skill to marshal needed resources; the fundamental skill of building a solid business plan; and, finally, the vision to recognise opportunity where others see chaos, contradiction, and confusion.

THE MYTHS OF ENTREPRENEURSHIP

Throughout the years many myths have arisen about entrepreneurship. As many researchers in the field have noted, the study of entrepreneurship is still emerging, and thus 'folklore' will tend to prevail until it is dispelled with contemporary research findings. Here are ten of the most notable myths with an explanation to dispel each myth.

Myth 1: Entrepreneurs are doers, not thinkers

Although it is true entrepreneurs tend towards action, they are also thinkers. Indeed, they are often very methodical people who plan their moves carefully. The emphasis today on the creation of clear and complete business plans (chapter 10) is an indication that 'thinking' entrepreneurs are as important as 'doing' entrepreneurs.

Myth 2: Entrepreneurs are born, not made

The idea that the characteristics of entrepreneurs cannot be taught or learned, that they are innate traits one must be born with, has long been prevalent. These traits include aggressiveness, initiative and drive, a willingness to take risks, analytical ability and skill in human relations. Today, however, the recognition of entrepreneurship as a discipline is helping to dispel this myth. Like all disciplines, entrepreneurship has models, processes and case studies that allow the topic to be studied and the knowledge to be acquired.

Myth 3: Entrepreneurs are always inventors

The idea that entrepreneurs are inventors is a result of misunderstanding and tunnel vision. Although many inventors are also entrepreneurs, numerous entrepreneurs encompass all sorts of innovative activity.[22] For example, Ray Kroc did not invent the fast-food franchise, but his innovative ideas made McDonald's the largest fast-food enterprise in the world. A contemporary understanding of entrepreneurship covers more than just invention. It requires a complete understanding of innovative behaviour in all forms.

Myth 4: Entrepreneurs are academic and social misfits

There is a widespread belief that entrepreneurs are academic drop-outs and social misfits. This comes from the fact that about 15 per cent of business entrepreneurs dropped out of school or quit a managerial job. One New Zealand property mogul said, 'To the entrepreneur, education becomes an exercise in irrelevance'.[23] This is usually blown out of proportion in an attempt to 'profile' the typical entrepreneur. Historically, in fact, educational and social organisations did not recognise the entrepreneur. They abandoned them as misfits in a world of corporate giants. Business education, for example, was aimed primarily at the study of corporate activity. Today the entrepreneur is considered a hero – socially, economically and academically. No longer a misfit, the entrepreneur is now viewed as a professional. And research shows that education and entrepreneurship are highly correlated.

Myth 5: Entrepreneurs must fit the 'profile'

Many books and articles have presented checklists of characteristics of the successful entrepreneur. These lists were neither validated nor complete; they were based on case studies and on research findings among achievement-oriented people. Today we realise that a standard entrepreneurial profile is hard to compile. The environment, the venture itself, and the entrepreneur have interactive effects, which result in many different types of profiles. Contemporary studies conducted at universities across the United States will, in the future, provide more accurate insights into the various profiles of successful entrepreneurs. As we will show in chapter 4, an 'entrepreneurial edge' within individuals is more understandable than a particular profile.

Myth 6: All entrepreneurs need is money

It is true that a venture needs capital to survive. It is also true that a large number of business failures occur because of a lack of adequate financing. Yet having money is not the only bulwark against failure. Failure due to a lack of proper financing often is an indicator of other problems: managerial incompetence, lack of financial understanding, poor investments, poor planning and the like. Many successful entrepreneurs have overcome the lack of money while establishing their ventures. To those entrepreneurs, money is a resource but never an end in itself.

Myth 7: All entrepreneurs need is luck

Being at 'the right place at the right time' is always an advantage. But *luck happens when preparation meets opportunity* is an equally appropriate adage. Prepared entrepreneurs who seize the opportunity when it arises often seem 'lucky'. They are, in fact, simply better prepared to deal with situations and turn them into successes. What appears to be luck really is preparation, determination, desire, knowledge and innovativeness.

Myth 8: Ignorance is bliss for entrepreneurs

The myth that too much planning and evaluation lead to constant problems – that over-analysis leads to paralysis – does not hold up in today's competitive markets, which demand detailed planning and preparation. Identifying a venture's strengths and weaknesses, setting up clear timetables with contingencies for handling problems and minimising these problems through careful strategy formulation, are all key factors for successful entrepreneurship. Thus careful planning – not ignorance of it – is the mark of an accomplished entrepreneur.

Myth 9: Entrepreneurs seek success but experience high failure rates

It is true that many entrepreneurs suffer failures before they are successful. They follow the adage 'if at first you don't succeed, try, try, again'. In fact, failure can teach many lessons to those willing to learn and often leads to future successes. This is clearly shown by the **corridor principle**, which states that with every venture launched, new and unintended opportunities often arise. The 3M Corporation invented Post-it® notes using glue that had not been strong enough for its intended use. Rather than throw away the glue, the company focused on finding another use for it and, in the process, developed a multimillion-dollar product. Yet, the statistics of entrepreneurial failure rates have been misleading over the years. In fact, one researcher has reported that the 'high failure rate' most commonly accepted may be misleading. Tracing 814 000 businesses started in 1977, Kirchoff found that more than 50 per cent were still surviving under their original owners or new owners. Additionally, 28 per cent voluntarily closed down, and only 18 per cent actually 'failed' in the sense of leaving behind outstanding liabilities.[24]

Myth 10: Entrepreneurs are extreme risk-takers (gamblers)

As we will show in chapter 4, the concept of risk is a major element in the entrepreneurial process. However, the public's perception of the risk most entrepreneurs face is distorted. Although it may appear that an entrepreneur is 'gambling' on a wild chance, the fact is the entrepreneur is usually working on a moderate or 'calculated' risk. Most successful entrepreneurs work hard through planning and preparation to minimise the risk involved in order to control the destiny of their vision better.

These ten myths have been presented to provide a background for today's current thinking on entrepreneurship. By sidestepping the 'folklore', we can build a foundation for critically researching the contemporary theories and processes of entrepreneurship.

APPROACHES TO ENTREPRENEURSHIP

To understand the nature of entrepreneurship, it is important to consider some of the theory development in order better to recognise the emerging importance of entrepreneurship. The research on entrepreneurship has grown dramatically over the years. As the field has developed, research methodology has progressed from empirical surveys of entrepreneurs to more contextual and process-oriented research. As yet, no comprehensive theory base has emerged.

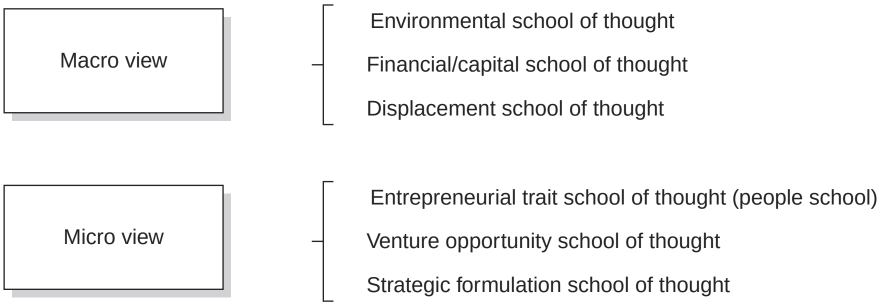
A **theory** of entrepreneurship is defined as a verifiable and logically coherent formulation of relationships, or underlying principles that explain entrepreneurship. These principles predict entrepreneurial activity (for example, by characterising conditions that are likely to lead to new profit opportunities and the formation of new enterprises), or provide normative guidance (that is, prescribe the right action in particular circumstances).[25] As we are now in the new millennium, it has become increasingly apparent that we need to have some cohesive theories or classifications to better understand this emerging field.

In the study of contemporary entrepreneurship, one concept recurs: Entrepreneurship is **interdisciplinary.** As such, it contains various approaches that can increase one's understanding of the field.[26] Thus we need to recognise the diversity of theories as an emergence of entrepreneurial understanding. One way to examine these theories is with a 'schools of thought' approach that divides entrepreneurship into specific activities. These activities may be within a 'macro' view or a 'micro' view, yet all address the conceptual nature of entrepreneurship.

The schools of thought in entrepreneurship

A school of thought is a body of belief, literature or theory that is accepted as authoritative by some group of scholars or writers. In this section we will highlight the ideas emanating from the macro

FIGURE 2.1 **ENTREPRENEURIAL SCHOOLS OF THOUGHT APPROACH**



(meaning 'wide-scale' perspective) and micro (meaning 'small-scale') views of entrepreneurial thought. We will further break down these two major views into six distinct schools of thought, three within each entrepreneurial view (see figure 2.1). Although this presentation does not purport to be all-inclusive, neither does it claim to limit the schools to these six, for a movement may develop for unification or expansion.

The macro view

The **macro view of entrepreneurship** presents a broad array of factors that relate to success or failure in contemporary entrepreneurial ventures. This array includes external processes that are sometimes beyond the control of the individual entrepreneur, for they exhibit a strong **external locus of control** point of view. Three schools of entrepreneurial thought represent a breakdown of the macro view. The first of these is the broadest and the most pervasive school.

- The **environmental school of thought**: This school of thought deals with the external factors that affect a potential entrepreneur's lifestyle. These can be either positive or negative forces in the moulding of entrepreneurial desires. The focus is on institutions, values and mores that, grouped together, form a socio-political environmental framework that strongly influences the development of entrepreneurs.[27] For example, if a middle manager experiences the freedom and support to develop ideas, initiate contracts, or create and institute new methods, the work environment will serve to promote that person's desire to pursue an entrepreneurial career. Another environmental factor that often affects the potential development of entrepreneurs is their social group. The atmosphere of friends and relatives can influence the desire to become an entrepreneur.
- The **financial/capital school of thought**: This school of thought is based on the capital-seeking process. The search for seed and growth capital is the entire focus of this entrepreneurial emphasis. Certain literature is devoted specifically to this process, whereas other sources tend to treat it as but one segment of the entrepreneurial process.[28] In any case, the venture capital process is vital to an entrepreneur's development. This school of thought views the entire entrepreneurial venture from a financial management standpoint. This is apparent from table 2.1, where decisions involving finances occur at every major point in the venture process.
- The **displacement school of thought**: This school of thought focuses on group phenomena. It holds that the group affects or eliminates certain factors that project the individual into an entrepreneurial venture. As Ronstadt has noted, individuals will not pursue a venture unless they are prevented or displaced from doing other activities.[29] Three major types of displacement illustrate this school of thought:

TABLE 2.1: **FINANCIAL ANALYSIS EMPHASIS**

VENTURE STAGE	FINANCIAL CONSIDERATION	DECISION
Start-up or acquisition	Seed capital Venture capital sources	Proceed or abandon
Ongoing	Cash management Investments Financial analysis and evaluation	Maintain, increase, or reduce size
Decline or succession	Profit question Corporate buyout Succession question	Sell, retire, or dissolve operations

- *Political displacement:* This is caused by factors ranging from an entire political regime that rejects free enterprise (international environment) to governmental regulations and policies that limit or redirect certain industries.
- *Cultural displacement:* This deals with social groups precluded from professional fields. Ethnic background, religion, race and sex are all examples of factors that figure in the minority experience. Increasingly, this experience will turn various individuals from standard business professions and towards entrepreneurial ventures.
- *Economic displacement:* This is concerned with the economic variations of recession and depression. Job loss, capital shrinkage or simply 'bad times' can create the foundation for entrepreneurial pursuits, just as it can affect venture development and reduction.

These examples of displacement illustrate the external forces that can influence the development of entrepreneurship. Cultural awareness, knowledge of political and public policy and economic indoctrination will aid and improve entrepreneurial understanding under the displacement school of thought. The broader the educational base in economics and political science, the stronger the entrepreneurial understanding.

The micro view

The **micro view of entrepreneurship** examines the factors that are specific to entrepreneurship and are part of the **internal locus of control**. The potential entrepreneur has the ability, or control, to direct or adjust the outcome of each major influence in this view. Although some researchers have developed this approach into various definitions and segments, as shown in table 2.2, our approach presents the entrepreneurial trait theory (sometimes referred to as the 'people school of thought'), the venture opportunity theory and the strategic formulation theory. Unlike the macro approach, which focuses on events from the outside looking in, the micro approach concentrates on specifics from the inside looking out. The first of these schools of thought is the most widely recognised.

- The **entrepreneurial trait school of thought**: Many researchers and writers have been interested in identifying traits common to successful entrepreneurs.[30] This approach is grounded in the study of successful people who tend to exhibit similar characteristics that, if copied, would increase success opportunities for the emulators. For example, achievement, creativity, determination and technical knowledge are four factors that usually are exhibited by successful entrepreneurs. Family development and educational incubation are also examined. Certain researchers have argued against educational

TABLE 2.2: DEFINITIONS AND CRITERIA OF ONE APPROACH TO THE MICRO VIEW

ENTREPRENEURIAL MODEL	DEFINITION	MEASURES	QUESTIONS
'Great person'	'Extraordinary achievers'	Personal principles Personal histories Experiences	What principles do you have? What are your achievements?
Psychological characteristics	Founder Control over the means of production	Locus of control Tolerance of ambiguity Need for achievement	What are your values?
Classical	People who make innovations bearing risk and uncertainty 'Creative destruction'	Decision making Ability to see opportunities Creativity	What are the opportunities? What is your vision? How do you respond?
Management	Creating value through the recognition of business opportunity, the management of risk-taking … through the communicative and management skills to mobilise …	Expertise Technical knowledge Technical plans	What are your plans? What are your capabilities? What are your credentials?
Leadership	'Social architect' Promotion and protection of values	Attitudes, styles Management of people	How do you manage people?
Intrapreneurship	Those who pull together to promote innovation	Decision making	How do you change and adapt?

Source: Adapted from J. Barton Cunningham and Joe Lischeron, 'Defining Entrepreneurship', *Journal of Small Business Management* (January 1991): 56.

development of entrepreneurs because they believe it inhibits the creative and challenging nature of entrepreneurship.[31] Other authors, however, contend that new programs and new educational developments are increasing because they have been found to aid in entrepreneurial development.[32] The family development idea focuses on nurturing and support that exist within the home atmosphere of an entrepreneurial family. This reasoning promotes the belief that certain traits established and supported early in life will lead eventually to entrepreneurial success.

- The **venture opportunity school of thought**: This school of thought focuses on the opportunity aspect of venture development. The search for idea sources, the development of concepts, and the implementation of venture opportunities are the important interest areas for this school. Creativity and market awareness are viewed as essential. Additionally, according to this school of thought, developing the right idea at the right time for the right market niche is the key to entrepreneurial success.

Another development from this school of thought is the previously described *corridor principle*. New pathways or opportunities will arise that lead entrepreneurs in different directions. The ability to recognise these opportunities when they arise and to implement the necessary steps for action is a key factor. The maxim that preparation meeting opportunity equals 'luck' underlies this corridor principle. Proponents of this school of thought believe that proper preparation in the interdisciplinary business segments will enhance the ability to recognise venture opportunities.

- The **strategic formulation school of thought**: George Steiner has stated that 'strategic planning is inextricably interwoven into the entire fabric of management; it is not something separate and distinct from the process of management'.[33] The strategic formulation approach to entrepreneurial theory emphasises the planning process in successful venture development.[34]

  Ronstadt views strategic formulation as a leveraging of unique elements.[35] Unique markets, unique people, unique products, or unique resources are identified, used, or constructed into effective venture formations. The interdisciplinary aspects of strategic adaptation become apparent in the characteristic elements listed here with their corresponding strategies:

  - Unique markets: Mountain versus **mountain gap strategies**, which refers to identifying major market segments as well as interstice (in-between) markets that arise from larger markets.
  - Unique people: **Great chef strategies**, which refers to the skills or special talents of one or more individuals around whom the venture is built.
  - Unique products: **Better widget strategies**, which refers to innovations that encompass new or existing markets.
  - Unique resources: **Water well strategies**, which refers to the ability to gather or harness special resources (land, labour, capital, raw materials) over the long term.

  Without question, the strategic formulation school encompasses a breadth of managerial capability that requires an interdisciplinary approach.[36]

Schools of entrepreneurial thought: A summary

Although the knowledge and research available in entrepreneurship are in an emerging stage, it is still possible to piece together and describe current schools of thought in the field. From this point we can begin to develop an appreciation for the schools and view them as a foundation for entrepreneurial theory. However, just as the field of management has used a 'jungle' of theories as a basis for understanding the field and its capabilities, so too must the field of entrepreneurship use several theories in its growth and development.

PROCESS APPROACHES

Another way to examine the activities involved in entrepreneurship is through a process approach. Although numerous methods and models attempt to structure the entrepreneurial process and its various factors, we shall examine three of the more traditional process approaches here.[37] First, we will discuss the **integrative approach,** as described by Morris and colleagues.[38] Their model incorporates theoretical and practical concepts as they affect entrepreneurship activity. The second approach is an assessment process based on an entrepreneurial edge developed by Ronstadt. The third process approach, developed by Gartner, is multidimensional and weaves together the concepts of individual, environment, organisation and process. All of these methods attempt to describe the entrepreneurial process as a consolidation of diverse factors, which is the thrust of this book.

An 'integrative' approach

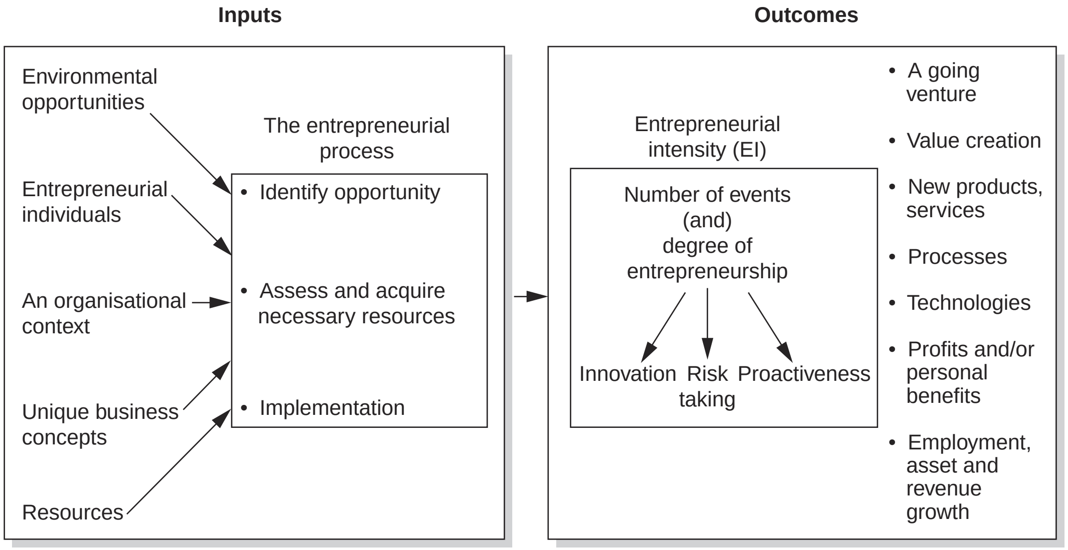
A more integrative picture of the entrepreneurial process is provided by Morris et al.[39] Presented in figure 2.2, this model is built around the concepts of input to the entrepreneurial process and outcomes from the entrepreneurial process. The input component of figure 2.2 focuses on the entrepreneurial process itself and identifies five key elements that contribute to the process.

The first is environmental opportunities, such as a demographic change, the development of a new technology, or a modification to current regulations. Next is the individual entrepreneur, the person who assumes personal responsibility for conceptualising and implementing a new venture. The entrepreneur develops some type of business concept to capitalise on the opportunity (for example, a creative approach to solving a particular customer need). Implementing this business concept typically requires some type of organisational context, which could range from a sole proprietorship run out of the entrepreneur's home or a franchise of some national chain to an autonomous business unit within a large corporation. Finally, a wide variety of financial and non-financial resources are required on an ongoing basis. These key elements are then combined throughout the stages of the entrepreneurial process. Stated differently, the process provides a logical framework for organising entrepreneurial inputs.

The outcome component of figure 2.2 first includes the level of entrepreneurship being achieved. As we shall discuss in more detail in the next chapter, entrepreneurship is a variable. Thus, the process can result in any number of entrepreneurial events and can produce events that vary considerably in terms of how entrepreneurial they are. Based on this level of 'entrepreneurial intensity', final outcomes can include one or more going ventures, value creation, new products and processes, new technologies, profit, jobs and economic growth. Moreover, the outcome can certainly be failure and thereby bring about the economic, psychic and social costs associated with failure.

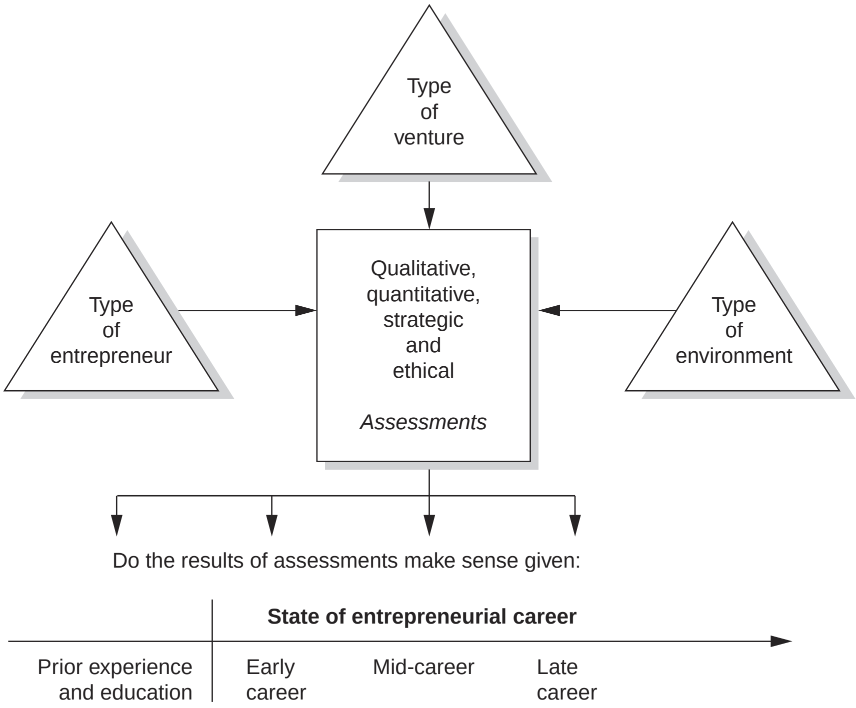
This model not only provides a fairly comprehensive picture regarding the nature of entrepreneurship, but can also be applied at different levels. For example, the model describes the phenomenon of entrepreneurship in both the independent start-up company and within a department, division, or strategic business unit of large a corporation.

FIGURE 2.2 AN INTEGRATIVE MODEL OF ENTREPRENEURIAL INPUTS AND OUTCOMES



Source: Michael H. Morris, P. Lewis and Donald L. Sexton, 'Reconceptualizing entrepreneurship: An input–output perspective', *Advanced Management Journal* 59(1) (Winter 1994): 21–31.

FIGURE 2.3 ENTREPRENEURIAL ASSESSMENT APPROACH



Source: Robert C. Ronstadt, *Entrepreneurship* (Dover, MA: Lord Publishing Co., 1984), 39.

Entrepreneurial assessment approach

Another model – the **entrepreneurial assessment approach** (developed by Ronstadt) – stresses making assessments qualitatively, quantitatively, strategically and ethically in regard to the entrepreneur, the venture and the environment.[40] (Figure 2.3 depicts this model.) To examine entrepreneurship, the results of these assessments must be compared to the stage of the entrepreneurial career – early, mid-career, or late. Ronstadt termed this process 'the entrepreneurial edge'. We focus on this term in chapter 4 when we examine the individual characteristics of entrepreneurship.

Multidimensional approach

A more detailed process approach to entrepreneurship is the **multidimensional approach.**[41] In this view entrepreneurship is a complex, multidimensional framework that emphasises the individual, the environment, the organisation and the venture process. Specific factors that relate to each of these dimensions follow:

- **The individual:**
  - need for achievement
  - locus of control
  - risk-taking propensity
  - job satisfaction

  - previous work experience
  - entrepreneurial parents
  - age
  - education.
- **The environment:**
  - venture capital availability
  - presence of experienced entrepreneurs
  - technically skilled labour force
  - accessibility of suppliers
  - accessibility of customers or new markets
  - governmental influences
  - proximity of universities
  - availability of land or facilities
  - accessibility of transportation
  - attitude of the area population
  - availability of supporting services
  - living conditions.
- **The organisation:**
  - type of firm
  - entrepreneurial environment
  - partners
  - strategic variables
  - cost
  - differentiation
  - focus
  - competitive entry wedges.
- **The process:**
  - locating a business opportunity
  - accumulating resources
  - marketing products and services
  - producing the product
  - building an organisation
  - responding to government and society[42]

Figure 2.4 depicts the interaction of the four major dimensions of this entrepreneurial, or new-venture, process and lists more variables. This type of process moves entrepreneurship from a segmented school of thought to a dynamic, interactive process approach.

KEY CONCEPTS

Before concluding our discussion of the nature of entrepreneurship, we need to put into perspective three key concepts: entrepreneurship, entrepreneur, and **entrepreneurial management**.

Entrepreneurship

Entrepreneurship is the practice of starting new organisations, particularly new businesses. Entrepreneurship is a process of innovation and new-venture creation through four major dimensions – individual, organisational, environmental, process – that is aided by collaborative networks in government, education and institutions. All of the macro and micro positions of entrepreneurial

FIGURE 2.4 VARIABLES IN NEW-VENTURE CREATION

Source: William B. Gartner, 'A conceptual framework for describing the phenomenon of new venture creation', *Academy of Management Review* (October 1985): 702. Reprinted with permission.

thought must be considered while recognising and seizing opportunities that can be converted into marketable ideas capable of competing for implementation in today's economy.

Entrepreneur

The *entrepreneur* is a catalyst for change – be it social or economic – who uses purposeful searching, careful planning and sound judgement when carrying out the entrepreneurial process. Uniquely optimistic and committed, the entrepreneur works creatively to establish new resources or endow old ones with a new capacity, all for the purpose of creating wealth. Harvard University's Howard Stevenson once quipped that an entrepreneur is a person who pursues 'opportunity without regard to resources currently controlled'.

Entrepreneurial management

The underlying theme of this book is the discipline of *entrepreneurial management*, a concept that has been delineated as follows:

> Entrepreneurship is based upon the same principles, whether the entrepreneur is an existing large institution or an individual starting his or her new venture single-handed. It makes little or no difference whether the entrepreneur is a business or a non-business public-service organisation, nor even whether the entrepreneur is a governmental or nongovernmental institution. The rules are pretty much the same, the things that work and those that don't are pretty much the same, and so are the kinds of innovation and where to look for them. In every case there is a discipline we might call Entrepreneurial Management.[43]

The techniques and principles of this emerging discipline will drive the entrepreneurial economy in the twenty-first century.

SUMMARY

This chapter looked at how both the entrepreneur and the concept of entrepreneurship have evolved over the ages. We looked at the 'rugged individualist' and the 'sovereign individual' as prototypes of entrepreneurs. Exploring the early economic definitions as well as selected contemporary ones, the chapter presented a historical picture of how entrepreneurship and entrepreneurs have been viewed.

Major myths of entrepreneurship were discussed to permit a better understanding of the folklore surrounding this newly developing field of study. Contemporary research is broadening the horizon for studying entrepreneurship and is providing a better focus on the what, how and why behind this discipline.

The approaches to entrepreneurship were examined from two different perspectives: schools of thought and process. Six selected schools of thought were presented, and three approaches for understanding contemporary entrepreneurship as a process were discussed. The chapter concluded with definitions of entrepreneurship, entrepreneur and entrepreneurial management.

KEY TERMS AND CONCEPTS

better widget strategies
capitalism
corridor principle
displacement school of thought
entreprendre
entrepreneur
entrepreneurial assessment approach
entrepreneurial management
entrepreneurial trait school of thought
entrepreneurship
environmental school of thought
external locus of control
financial/capital school of thought
great chef strategies
Industrial Revolution
integrative approach
interdisciplinary
internal locus of control
macro view of entrepreneurship
micro view of entrepreneurship

mountain gap strategies
multidimensional approach
rugged individualist
sovereign individual
strategic formulation school of thought
theory
undertaker
usury
venture opportunity school of thought
water well strategies

REVIEW & DISCUSSION QUESTIONS

1. Briefly describe the evolution of the term entrepreneurship.
2. How were entrepreneurs historically viewed? What challenges did they face throughout history?
3. Why do we use the French word instead of an English equivalent?
4. When was the word entrepreneur first used in the economic literature?
5. What are the 10 myths associated with entrepreneurship? Discredit each.
6. What is the difference between macro and micro level schools of thought?
7. What is the macro view of entrepreneurship?
8. What are the schools of thought that use the macro view of entrepreneurship?
9. What is the micro view of entrepreneurship?
10. What are the schools of thought that use the micro view of entrepreneurship?
11. What are the three specific types of displacement?
12. In the strategic formulation school of thought, what are the four types of strategies involved with unique elements? Give an illustration of each.
13. What is the process approach to entrepreneurship? In your answer describe the entrepreneurial assessment approach.
14. What are the major elements in the framework for entrepreneurship presented in figure 2.4? Give an example of each.

EXPERIENTIAL EXERCISE:

YOUR BELIEFS ABOUT SUCCESSFUL ENTREPRENEURS

Read each of the following 10 statements and to the left of each indicate your agreement or disagreement. If you fully agree with the statement, put a 10 on the line at the left. If you totally disagree, put a 1. If you tend to agree more than you disagree, give a response between 6 and 9 depending on how much you agree. If you tend to disagree, give a response between 2 and 5.

1. Successful entrepreneurs are often methodical and analytical individuals who carefully plan out what they are going to do and then do it.
2. The most successful entrepreneurs are born with special characteristics such as high achievement drive and a winning personality and these traits serve them well in their entrepreneurial endeavours.
3. Many of the characteristics needed for successful entrepreneurship can be learned through study and experience.
4. The most successful entrepreneurs are those who invent a unique product or service.
5. Highly successful entrepreneurs tend to have very little formal schooling.
6. Most successful entrepreneurs admit that dropping out of school was the best thing they ever did.
7. Because they are unique and individualistic in their approach to business, most successful entrepreneurs find it hard to socialise with others; they just do not fit in.
8. Research shows that although it is important to have adequate financing before beginning an entrepreneurial venture, it is often more important to have managerial competence and proper planning.
9. Successful entrepreneurship is more a matter of preparation and desire than it is of luck.
10. Most successful entrepreneurs do well in their first venture, which encourages them to continue; failures tend to come later on as the enterprise grows.

Put your answers on the following list in this way:

- enter answers to numbers 1, 3, 8, and 9 just as they appear
- then subtract the answers to 2, 4, 5, 6, 7 and 10 from 11 before entering them here.

Thus, if you gave an answer of 8 to number 1, put an 8 before number 1 here. However, if you gave an answer of 7 to number 2 here, place a 4 before number 2 here. Then add both columns of answers and enter your total in the space provided.

TABLE 2.3: SCORING BLOCK

AS THEY APPEAR		SUBTRACT FROM 11			
________________	1	________________	2		
________________	3	________________	4		
________________	8	________________	6		
________________	9	________________	7		
		________________	5		
		________________	10	________________	Total

INTERPRETATION

This exercise measures how much you believe the myths of entrepreneurship. The lower your total, the stronger your beliefs; the higher your total, the less strong your beliefs. Numbers 1, 3, 8, and 9 are accurate statements; numbers 2, 4, 5, 6, 7 and 10 are inaccurate statements. Here is the scoring key:

- 80–100 – excellent; you know the facts about entrepreneurs.
- 61–79 – good, but you still believe in a couple of myths.
- 41–60 – fair; you need to review the chapter material on the myths of entrepreneurship.
- 0–40 – poor; you need to reread the chapter material on the myths of entrepreneurship and study these findings.

CASE 2.1

PAUL'S FOUR SHORTCOMINGS

Paul Enden has always been very reliable and a hard worker. For the past eight years Paul has been working in a large car service garage. During this time he has made several recommendations to the owner regarding new services that could be provided to customers. One of these is called the 'fast lube'. With this service, people who want to have their oil changed and their car lubricated do not have to leave the car and come back later in the day. Three service racks handle this job. It generally takes less than 10 minutes to take care of a car and most people can have the job completed within 25 minutes of the time they arrive. The service, which has become extremely popular with customers, resulted in an increase in overall profits of 5 per cent last year.

Paul's wife believes he has a large number of ideas that could prove profitable. 'You ought to break away and open your own shop', she has told him. Paul would like to do so, but he believes four things help account for entrepreneurial success and he has none of them. Here is how he explained it to his wife:

'To be a successful entrepreneur, you have to be a thinker, not a doer. I'm a doer. Thinking bores me. I wouldn't like being an entrepreneur. Second, those guys who do best as entrepreneurs tend to be inventors. I'm not an inventor. If anything, I think of new approaches to old ways of doing business. I'm more of a tinkerer than an inventor. Third, you've got to be lucky to be a successful entrepreneur. I'm hard working; I'm not lucky. Fourth, you have to have a lot of money to do well as an entrepreneur. I don't have much money. I doubt whether $50 000 would get me started as an entrepreneur.'

QUESTIONS

1. Does Paul need to be an inventor to be an effective entrepreneur? Explain your answer.
2. How important is it that Paul has a lot of money if he hopes to be an entrepreneur? Explain your answer.
3. What is wrong with Paul's overall thinking? Be sure to include a discussion of the myths of entrepreneurship in your answer.

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ENTREPRENEURIAL HISTORY, A CONCEPTUAL OVERVIEW

Publication date: 09 February 2001
Revision date: 15 October 2002
Author(s): Nancy F. Koehn
Product number: 9-801-368

Analyses HBS cases on five entrepreneurs and the companies they built: Josiah Wedgwood, Henry Heinz, Marshall Field, Howard Schultz of Starbucks and Michael Dell. These five cases and their accompanying teaching notes comprise a course module on entrepreneurial history that is intended for business school faculty teaching entrepreneurship, business history, brand marketing, or general management.

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3

INTRAPRENEURSHIP: DEVELOPING CORPORATE ENTREPRENEURSHIP

There is nothing more difficult to take in hand, more perilous to conduct, than to take a lead in the introduction of a new order of things, because the innovation has for enemies all those who have done well under the old conditions and lukewarm defenders in those who may do well under the new.

Machiavelli, *The Prince*

CHAPTER OBJECTIVES

1. To define the term intrapreneurship in enterprises such as corporations and public institutions in the Asia–Pacific
2. To illustrate the need for intrapreneurship and how ‘entrepreneurial’ management differs from ‘bureaucratic’ management
3. To describe the obstacles preventing innovation in enterprises
4. To understand how established enterprises can renew and revitalise themselves
5. To identify the relevance of purpose and organisation concepts of an intrapreneurial strategy
6. To profile intrapreneurial characteristics and myths
7. To illustrate the interactive process of intrapreneurship

INTRODUCTION

In this chapter we look at how entrepreneurship inside corporations and other institutions can lead to innovation, new product development, greater wealth creation and economic development. Twenty-first century companies must have continuous innovation to compete effectively in international markets. **Corporate entrepreneurship** is a process that can facilitate firms' efforts to innovate constantly and cope effectively with the competitive realities that companies encounter when competing in international markets. Entrepreneurial attitudes and behaviours are necessary for firms of all sizes to prosper and flourish in competitive environments.[1]

Today, a wealth of literature describes a new **corporate revolution** taking place thanks to the infusion of entrepreneurial thinking into large bureaucratic structures.[2] While some insist that there are differences between the two,[3] we use corporate entrepreneurship and **intrapreneurship** interchangeably.

The global economy is creating profound and substantial changes for institutions, businesses and industries throughout the world. Firms and enterprises everywhere must re-examine their purposes and strategies carefully to satisfy their multiple stakeholders. In response to rapid, discontinuous and significant changes, many established companies have restructured their operations in fundamental and meaningful ways. In fact, after years of restructuring, some of these companies bear little resemblance to their ancestors in their business scope, culture, or competitive approach.[4]

It is not just a 'big business' phenomenon; it is happening at every level of the economy. Throughout the world, significant numbers of people are starting a business for their employers. Here are the 'intrapreneurship rates' for some Asia–Pacific countries in comparison to the United States.[5]

Another measure of intrapreneurial activity is the astounding finding that one-quarter of new start-ups each year in the United States come about through corporate entrepreneurship.[6] Corporate entrepreneurship is one of the major ways that economies can innovate, revitalise and economise. It helps the job market grow, contributes to national output, adds to innovation and most importantly, helps companies stay at the top of their games.

This interest in entrepreneurial thinking in large organisations started to develop in the mid-1980s.[7] Lately, entrepreneurship as a major force in world business has led to an increased desire for this type of activity inside enterprises. Although some researchers have concluded that entrepreneurship and bureaucracies are mutually exclusive and cannot coexist,[8] others have described entrepreneurial ventures within the enterprise framework.[9] Intrapreneurial techniques have been used (with success and with failure) throughout the world in companies such as Hawker De Havilland, 3M, Rubbermaid, Sony and General Electric.

TABLE 3.1: ARE YOU STARTING A BUSINESS FOR YOUR EMPLOYER? (2005)

COUNTRY	PERCENTAGE OF ADULT POPULATION
China	10.59
United States	8.13
Thailand	7.76
New Zealand	5.95
Singapore	3.17
Australia	3.10
Hong Kong (2004)	1.53
Japan	0.06

Source: *Global Entrepreneurship Monitor: 2005.*

Why is the concept of intrapreneurship so popular? One reason is that it helps corporations and other large institutions to tap the innovative talents of their own workers and managers. Steven Brandt puts it this way:

> Ideas come from people. Innovation is a capability of the many. That capability is utilised when people give commitment to the mission and life of the enterprise and have the power to do something with their capabilities. Non-commitment is the price of obsolete managing practices, not the lack of talent or desire.
>
> Commitment is most freely given when the members of an enterprise play a part in defining the purposes and plans of the entity. Commitment carries with it a de facto approval of and support for the management. Managing by consent is a useful managing philosophy if more entrepreneurial behaviour is desired.[10]

In this chapter, we look at how entrepreneurship inside corporations and other institutions can lead to innovation, new product development, greater wealth creation and economic development. Twenty-first century companies must have continuous innovation to compete effectively in international markets. Corporate entrepreneurship is a process that can facilitate firms' efforts to innovate constantly and cope effectively with the competitive realities that companies encounter when competing in international markets. Entrepreneurial attitudes and behaviours are necessary for firms of all sizes to prosper and flourish in competitive environments.[11]

The need to be entrepreneurial and innovative applies as well for institutions such as governments and other public sector organisations. Drucker once observed that 'public service institutions … need to be entrepreneurial and innovative fully as much as any business does'.[12] Research exploring the role of entrepreneurship in the public sector is still in its infancy. Throughout the world, and especially since the fall of the Berlin Wall, governments and other public institutions have been struggling with how to become more entrepreneurial. This is not easy considering the centuries-long system of entrenched bureaucracies that resist change.

THE NATURE OF INTRAPRENEURSHIP

Intrapreneurship is a term used to describe the entrepreneurial behaviour of people within large firms and organisations. Other related terms include corporate entrepreneurship, innovation or venturing. What is called in the popular press 'the corporate revolution' is really about how to re-make firms in an entrepreneurial fashion ready for challenges of the new marketplace.

Guth and Ginsberg stress that the field of corporate entrepreneurship encompasses both new venture creation within existing organisations and the transformation of organisations through **strategic renewal**.[13] Zahra observes that 'corporate entrepreneurship may be formal or informal activities aimed at creating new businesses in established companies through product and process innovations and market developments. These activities may take place at the top level, at the division level and at the project level, with the unifying objective of improving a company's competitive position and financial performance.'[14]

Covin and Miles describe four kinds of corporate entrepreneurship. Each seems to rejuvenate or redefine the organisation or to bring about new innovations.

- *Sustained regeneration* is the most frequent form of corporate entrepreneurship. The object here is to create a stream of new products and innovations in existing products.
- *Organisation rejuvenation* focuses on a firm's internal processes and procedures. Here the goal is to increase the value derived from the production chain.

- *Strategic renewal* finds the firm seeking to change how it competes. The firm seeks to align itself better with the external environment (for example, customers) and to position itself more competitively, or even to monopolise, a given market segment.
- *Domain redefinition* means staking out new markets that the competitors have not recognised or have under-served by creating first-move advantage.[15]

PHILIPPINE INTRAPRENEURS

ENTREPRENEURIAL
EDGE

RUEL ROSOPA

Ruel Rosopa, business manager and human resources manager of the La Corona Group, epitomizes the essence of intrapreneurship. As an enterprising and optimistic high school graduate in 1983, he joined the La Corona Group, a fund house whose main business was motel operations. In January 1986, as the historic People Power Revolution ousted President Ferdinand Marcos, Rosario Investment disintegrated. The group was divided between the motel patriarch's two sons. Rosopa found himself allied with the management one side, known as Victoria Court.

Capitalizing on his typing and stenography skills, which he learned during his night-time classes at the Polytechnic University of the Philippines, Roposa started as a personnel clerk for the group. From there, Mr Rosopa advanced to the ranks of compensation and benefits assistant, personnel officer and, later, personnel manager. For 22 years, Mr Rosopa has held various positions, all in the same company, showing that his life is indeed intertwined with the Group. His positions have given him the distinct advantage of reconciling opposing views that often slow down a company's growth. The secret? 'Hands-on and focused' management of the company's operations. 'I always walk around, inspecting the environment and talking to employees and guests. I also visit our employees in their houses every month', said Mr Rosopa, who also attributes his success to his continuing studies.

FRANCIS GOMEZ

Francis Gomez, MD is the president of Altermed Corp., a Filipino company that manufactures natural products. Being a true advocate of traditional medicine, the opportunity to develop and promote herbal medicines was something Gomez could not resist. Gomez first and foremost oversees the administrative and finance aspects of the company. In sales, he sees to it that the sales people are up to a certain standard of competence. His principal marketing role is to develop the overall strategic plan. It is on the technical aspect of the business that the doctor in Dr Gomez is best seen. Here, all materials and products that pertain to herbal medicines or natural products are ascertained to meet a certain level of science. But Dr Gomez does not stop there. 'An intrapreneur also asks questions that some businessmen or managers may not be asking. I always look for the patterns of harmony or disharmony', he said. 'For me, whether it's the patient or the business, I look for a certain pattern of disharmony and that helps diagnose the problem.' In the pharmaceutical industry, Dr Gomez looks for things that occur out of the usual, because these are where the opportunities are. They could be in the form of problems like bad sales, a company closing, or companies making a real killing in selling.

In search for opportunities, corporate entrepreneurs analyze the logic behind things – be it the logic of an industry that one is playing in or that one intends to penetrate, or looking at the logic of a business, or the logic of one's competitors, or the logic of why ampalaya [herbal remedy for diabetes] is being assassinated [discredited].

LEO FERRERIA

In the fast paced automobile industry, innovation and evolution is the name of the game. This is Leo J. Ferreria's strong suit. As president of four out of the 24 Toyota dealerships in the country, with the aid of technology, Ferreria is able to do the job even if he is not physically at the specific location. Some may think that being a corporate entrepreneur is much easier since the money spent in the undertaking does not come from one's own pocket. On the contrary, Ferreria feels more pressure since it is not his own money he's spending. 'You are liable to someone's pocket if something goes wrong', he explains. 'Being a professional entrepreneur, you have to really be careful with your moves.'

The greatest challenge is how to beat the performance of the previous years. 'If we stop challenging ourselves to outdo what we have done previously, that is the start of one's downfall', Ferreria said.

Like anybody else, Ferreria aspires to have his own business one day and be his own boss. He admits he is not in a rush to plunge into entrepreneurship on his own just yet. He said it is a matter of right timing and good business idea and if it does not come, then he is perfectly happy and content being a corporate entrepreneur.

Source: Roulee Jane F. Calayag, 'BW Entrepreneurs', *BusinessWorld* (Philippines), 14 April 2005.

Summing up all the research, we can define intrapreneurship as a process whereby an individual or a group of individuals initiates renewal or innovation within an existing organisation. The organisation need not be only a company; it can be profit-making, non-profit, public, non-governmental, or even a government bureaucracy. In this chapter, we focus especially on corporations but we will also mention other large institutions as sites for intrapreneurial activity.

Corporate entrepreneurship and innovation in the Asia–Pacific

Governments and companies in the Asia–Pacific today are only just beginning to realise the need for corporate intrapreneuring.[16] Generally our firms are way behind the rest of the world. Fitzsimmons et al., after surveying 70 firms, are adamant that 'Australian firms may need to be more proactive and in particular, should increase their new business venturing activities to a much higher level'.[17]

Yet throughout the world, intrapreneurship has been a driving force in business for more than 20 years. Tom Peters has devoted a considerable portion of his writing to innovation in the corporation.[18] This need has arisen in response to several pressing problems. These problems include rapid growth in the number of new and sophisticated competitors; a sense of distrust in the traditional methods of corporate management; an exodus of some of the best and brightest people from corporations to become small-business entrepreneurs; international competition; downsizing of major corporations; and an overall desire to improve efficiency and productivity.[19]

The first of these issues, the problem of competition, has always plagued businesses. However, today's high-tech economy is supporting a far greater number of competitors than ever before. The Internet has become the great leveller of companies. Small firms actually can and do compete online with large firms. Changes, innovations and improvements now pervade the marketplace. Large companies must innovate or they will obsolesce.

Another problem is losing bright people to becoming entrepreneurs. People are leaving the corporate world because being an entrepreneur increasingly carries status and publicity. This enhancement in an entrepreneur's status has made the choice more appealing to both young and seasoned employees. Venture capital, angel networks and other sources are now funding more new ventures than ever before. This development is encouraging people with innovative ideas to leave large corporations and strike out on their own. They would rather follow their dreams to avoid 'the mind-numbing, soul-eating' corporate lifestyle.[20]

The modern corporation must seek ways for developing in-house intrapreneuring. To do otherwise is to wait for stagnation, loss of personnel and decline. This new 'corporate revolution' represents an appreciation for and a desire to develop intrapreneurs within the corporate structure.

Obstacles to corporate entrepreneurship

The obstacles to **corporate venturing** usually reflect the ineffectiveness of traditional management techniques as applied to new-venture development. Although it is unintentional, the adverse impact of a particular traditional management technique can be so destructive that the individuals within an enterprise will tend to avoid corporate entrepreneurial behaviour. Table 3.2 provides a list of traditional management techniques, their adverse effects (when the technique is rigidly enforced) and the recommended actions to change or adjust the practice.

Understanding these obstacles is critical to fostering corporate intrapreneuring because they are the foundation points for all other motivational efforts. To gain support and foster excitement

TABLE 3.2: SOURCES OF AND SOLUTIONS TO OBSTACLES IN CORPORATE VENTURING

OBSTACLES TO CORPORATE VENTURING	ADVERSE EFFECTS	RECOMMENDED ACTIONS
Enforce standard procedures to avoid mistakes	Innovative solutions blocked, funds misspent	Make ground rules specific to each situation
Manage resources for efficiency and ROI	Competitive lead lost, low market penetration	Focus effort on critical issues (e.g. market share)
Control against plan	Facts ignored that should replace assumptions	Change plan to reflect new learning
Plan for the long term	Non-viable goals locked in, high failure costs	Envision a goal, then set interim milestones, reassess after each
Manage functionally	Entrepreneur failure and/or venture failure	Support entrepreneur with managerial and multidiscipline skills
Avoid moves that risk the base business	Missed opportunities	Take small steps, build out from strengths
Protect the base business at all costs	Venturing dumped when base business is threatened	Make venturing mainstream, take affordable risks
Judge new steps from prior experience	Wrong decisions about competition and markets	Use learning strategies, test assumptions
Compensate uniformly	Low motivation and inefficient operations	Balance risk and reward, employ special compensation
Promote compatible individuals	Loss of innovators	Accommodate ‘boat rockers’ and ‘doers’

Source: Reprinted by permission of the publisher from Hollister B. Sykes and Zenas Block, ‘Corporate venturing obstacles: Sources and solutions’, *Journal of Business Venturing* (Winter 1989): 161. Copyright © 1989 by Elsevier Science Publishing Co., Inc.

for new-venture development, managers must remove the perceived obstacles and seek alternative management actions.[21]

After recognising the obstacles, managers need to adapt to the principles of successful innovative companies. James Brian Quinn, an expert in the innovation field, found the following common factors in large corporations that are successful innovators:

- **Atmosphere and vision:** Innovative companies have a clear-cut vision of, and the recognised support for, an innovative atmosphere.
- **Orientation to the market:** Innovative companies tie their visions to the realities of the marketplace.
- **Small, flat organisations:** Most innovative companies keep the total organisation flat and project teams small.
- **Multiple approaches:** Innovative managers encourage several projects to proceed in parallel development.
- **Interactive learning:** Within an innovative environment, learning and investigation of ideas cut across traditional functional lines in the organisation.
- **Gumboot factory[22] or skunkworks:** Every highly innovative enterprise uses groups that function outside traditional lines of authority. This eliminates bureaucracy, permits rapid turnaround and instils a high level of group identity and loyalty.[23]

NOT JUST FOR CORPORATIONS …

Peter Drucker once suggested that one of the great social innovations required to realign the modern economy was to abandon ‘outworn social policies and obsolete public service institutions’. Entrepreneurship, he believed, was as much a public sector imperative as a private sector one.[24]

Citizens and politicians around the world regularly lament the absence of entrepreneurial behaviour in the public sector. Much of the research on entrepreneurship in the public sector focuses on the torpor of academic institutions,[25] or on the inertia of local and regional government organisations.[26] There has been a great deal of debate on whether the public sector (government bureaucracy in particular) can ever act entrepreneurially, given its historical legacy of entrenched bureaucracies and risk-averse functionaries.[27] Some researchers even suggest that public sector entrepreneurship differs fundamentally from entrepreneurship within private sector firms because it is more civic or social in nature and focuses on social betterment.[28] Boyett observes that indeed a 'new strain of leadership – the public sector entrepreneur – is emerging, to display many of the characteristics of their business counterparts', such as strong persuasive powers, risk-taking ability, creativity and the need for achievement. She even argues that successful public sector entrepreneurs have other forms of profit, namely the guilt level in others and self-satisfaction in oneself.[29]

One thing is clear. It has become a political platform for politicians to call for the public sector to be more entrepreneurial.[30]

Differences between private and public sector entrepreneurs

Only recently has attention focused on the differences between public and private sector entrepreneurship.[31] Australian Robert Sadler describes the similarities and differences between **private** and **public sector entrepreneurs**. Both types operate in turbulent environments that hasten the need for entrepreneurial behaviour. Both types use teams for participative decision making. Both in their own ways are more insulated from any organisational authority. However, there are significant differences between public and private:

- there are far fewer entrepreneurs in public sector organisations
- the public sector is structured hierarchically with relatively rigid pay scales and limited opportunity to use motivating mechanisms to foster innovation
- public sector entrepreneurs work in a rigid environment typified by 'red-tape' and regulation
- public sector organisations, unlike their private sector counterparts, have inconsistent and unclear objectives
- public sector entrepreneurs have less access to resources
- public sector entrepreneurial organisations have more **risk aversion** tendencies
- political intrusion is a significant barrier to public sector entrepreneurship.[32]

INTRAPRENEURIAL MYTHS DISPELLED

A great similarity exists between entrepreneurs and intrapreneurs. Consequently, some of the myths about entrepreneurs have carried over as myths about intrapreneurs. These myths sometimes affect the impressions peers and supervisors have of intrapreneurs. They follow, along with a discussion of each:

- **Myth 1:** The primary motivation of intrapreneurs is a desire for wealth and to climb the corporate ladder.
- **Myth 2:** Intrapreneurs are high risk-takers – they are gamblers who play for high stakes.
- **Myth 3:** Because intrapreneurs lack analytical skills, they 'shoot from the hip'. This has led to a philosophy of 'luck is all you need'.

TABLE 3.3: WHO IS THE INTRAPRENEUR?

CHARACTERISTIC	TRADITIONAL MANAGER	ENTREPRENEUR	INTRAPRENEUR
Primary motives	Wants promotion and other traditional corporate rewards; power motivated	Wants freedom; goal oriented, self-reliant and self-motivated	Wants freedom and access to corporate resources; goal oriented and self-motivated, but also responds to corporate rewards and recognition
Tendency to action	Delegates action; supervising and reporting take most energy	Gets hands dirty; may upset employees by suddenly doing their work	Gets hands dirty; may know how to delegate but, when necessary, does what needs to be done
Attitude towards courage and destiny	Sees others being in charge of their destiny; can be forceful and ambitious but may be fearful of others' ability to do them in	Self-confident, optimistic and courageous	Self-confident and courageous; many are cynical about the system but optimistic about their ability to outwit it
Focus of attention	Primarily on events inside corporation	Primarily on technology and marketplace	Both inside and outside; sells insiders on needs of venture and marketplace but also focuses on customers
Attitude towards risk	Cautious	Likes moderate risk; invests heavily but expects to succeed	Likes moderate risk; generally not afraid of being fired, so sees little personal risk

- **Myth 4:** Intrapreneurs lack morals or ethics due to their strong desire to succeed. They do not care how they succeed, just as long as they do succeed.
- **Myth 5:** Intrapreneurs have a power-hungry attitude and are most interested in building an empire. They want the venture to grow as big and as fast as it can.

Table 3.3 compares the characteristics and skills of the intrapreneur with those of the traditional manager and entrepreneur.[33]

RE-ENGINEERING THE THINKING OF LARGE INSTITUTIONS

To establish an intrapreneurial attitude (whether in the commercial world or in government bureaucracies), the institution needs to provide the freedom and encouragement that intrapreneurs require to develop their ideas.[34] This is often a problem because many top managers do not believe entrepreneurial ideas can be nurtured and developed in their environment. They also find it difficult to implement policies that encourage freedom and unstructured activity.

Thirty years ago in an article called 'The coming entrepreneurial revolution' in *The Economist*, journalist Norman Macrae prophesied that 'methods of operation in business are going to change radically in the next few decades'. He said that job growth would come either from small firms or from those bigger firms that managed to split themselves into smaller and smaller profit centres, which would need to become more and more entrepreneurial. This was totally against the common corporate wisdom, which was smitten at the time by Galbraith's *New Industrial State*. Firms, Galbraith claimed, were natural oligopolies vying for market share (not profit maximisation), which had wrested power away from entrepreneurs, shareholders, regulators and consumers, vertical integration and bureaucratisation.[35]

When Macrae saw the future for corporate entrepreneurship, he was actually popularising the growing work of Gifford Pinchot, whose 1985 book *Intrapreneuring* went on to become a classic in the field. Pinchot famously said that intrapreneurs are 'dreamers who do'. His strategy sounds remarkably contemporary:

- *Does your company encourage self-appointed intrapreneurs?* Intrapreneurs appoint themselves to their role and receive the corporation's blessing for their self-appointed task. Despite this, some corporations foolishly try to appoint outsiders to carry out an innovation.
- *Does your company provide ways for intrapreneurs to stay with their enterprises?* When the innovation process involves switching the people working on an idea – that is, handing off a developing business or product from a committed intrapreneur to whomever is next in line – that person is often not as committed as the originator of a project.
- *Are people in your company permitted to do the job in their own way, or are they constantly stopping to explain their actions and ask for permission?* Some organisations push decisions up through a multilevel approval process so that the doers and the deciders never even meet.
- *Has your company evolved quick and informal ways to access the resources to try new ideas?* Intrapreneurs need discretionary resources to explore and develop new ideas. Some companies give employees the freedom to use a percentage of their time on projects of their own choosing and set aside funds to explore new ideas when they occur. Others control resources so tightly that nothing is available for the new and unexpected. The result is nothing new.
- *Has your company developed ways to manage many small and experimental products and businesses?* Today's corporate cultures favour a few well-studied, well-planned attempts to hit a home run. In fact, nobody scores under the posts throughout the game and it is better to try more often with less careful and less expensive preparation than to succeed every time.
- *Is your system set up to encourage risk-taking and to tolerate mistakes?* Innovation cannot be achieved without risk and mistakes. Even successful innovation generally begins with blunders and false starts.
- *Can your company decide to try something and stick with the experiment long enough to see if it will work, even when that may take years and several false starts?* Innovation takes time, even decades, but the rhythm of corporations is annual planning.
- *Are people in your company more concerned with new ideas or with defending their turf?* Because new ideas almost always cross the boundaries of existing patterns of organisation, a jealous tendency to 'turfiness' blocks innovation.
- *How easy is it to form functionally complete, autonomous teams in your corporate environment?* Small teams with full responsibility for developing an 'intraprise' solve many of the basic innovation problems. But some companies resist their formation.
- *Do intrapreneurs in your company face monopolies, or are they free to use the resources of other divisions and outside vendors if they choose?* Entrepreneurs live in a multi-option universe. If one venture capitalist or supplier cannot or will not meet their needs, they have many more from which to choose. Intrapreneurs, however, often face single-option situations that may be called internal monopolies. They must have their product made by a certain factory or sold by a specific sales force. Too often these groups lack motivation or are simply wrong for the job and a good idea dies an unnecessary death.[36]

If these questions can be answered positively, they create an environment conducive to, and supportive of, potential corporate entrepreneurs. The result is a philosophy that supports intrapreneurial behaviour.

What can a corporation do to re-engineer its thinking? The organisation needs to examine and revise its management philosophy. Many enterprises have obsolete ideas about cooperative cultures, management techniques and the values of managers and employees. Unfortunately, doing old tasks more efficiently is not the answer to new challenges; a new culture with new values has to be developed. Bureaucrats and controllers must learn to coexist with or give way to the designer and intrapreneur.

Unfortunately, this is easier said than done. Nonetheless, organisations can take some steps to help restructure corporate thinking and encourage an intrapreneurial environment: (1) early identification of potential intrapreneurs; (2) top management sponsorship of intrapreneurial projects; (3) creation of both diversity and order in strategic activities; (4) promotion of intrapreneurship through experimentation; and (5) development of collaboration between intrapreneurial participants and the organisation at large.[37]

Developing an intrapreneurial philosophy provides many advantages. One is that this type of atmosphere often leads to the development of new products and services and helps the organisation

INNOVATION INSIDE FISHER & PAYKEL

ENTREPRENEURIAL EDGE

Fisher & Paykel Appliances of Dunedin faced a big challenge. Theirs was a highly successful brand name at home, but on the global stage, its iconic New Zealand reputation stood for little. The company needed a reason – a clear point of difference – for American or Japanese families to head straight for Fisher & Paykel Appliances on the showroom floor. To compete, Fisher & Paykel Appliances needed to change the rules of the game.

Against the backdrop of these commercial threats, the company saw an opportunity. It was an opportunity to change their emphasis and put design on the agenda. Their goal was to make design a key point of difference. But more than skin deep, they wanted them to look different as a result of their products being very different, from the inside out.

Fisher & Paykel Appliances said the dishwasher needn't be a dishwasher; it could be a drawer that washes dishes. In developing the DishDrawer, Fisher & Paykel Appliances did more than redesign the dishwasher; they redefined the way people saw the washing of dishes.

Running the dishwasher was once an 'event' – something that happened only when you had enough dishes to fill the rather large space. As such, the dishwasher was still dictating terms, despite it having been invented to give humans more control.

The Fisher & Paykel Appliances design team envisaged an appliance that was considerably more in tune with human needs and with the way that humans were living their lives. Smaller families, fewer dwellers per household and the demise of three-square-meals-per-day are just some of the changes with which traditional washers had lost touch.

The DishDrawer was designed to make the dishwasher, an extension of the storage systems in the kitchen – a drawer that keeps your dishes clean.

The DishDrawer has done four remarkable things for Fisher & Paykel Appliances.

It has been a platform for entering the UK, European and the Middle Eastern markets. Previously, Fisher & Paykel Appliances exported solely to Australia, Asia, the Pacific and the US. It has helped position Fisher & Paykel Appliances as innovative across its broader range of products and has helped maintain market share in its home market which was under considerable pressure from imported goods.

The DishDrawer is heavily patent protected in 27 countries which gives the company considerable protection against imitation.

The company's revenue from appliances increased from $500 million in the 1997–98 financial year to $853 million for 2003–04 and 150 additional staff have been added for DishDrawer development and production alone.

Perhaps most markedly, the operating profit before interest and tax for appliances has leapt from $11.5 million in the 1997–98 financial year to $102 million for 2003–04.

This bottom line increase is significantly greater than the increase in the total number of units produced, due in large part to the price premium products such as the DishDrawer command.

With 19 patents in 27 countries, the DishDrawer's uniqueness continues to be a strong competitive advantage. This, however, is not a reason for Fisher & Paykel Appliances to limit their innovation – the DishDrawer is undergoing constant re-evaluation as they strive to improve the product further.

Source: See [www.fisherandpaykel.co.nz]. This case is abridged from *Better by Design*, funded by New Zealand Trade & Enterprise [www.betterbydesign.org.nz/stories/fisherandpaykel/step2.php].

expand and grow. A second is it creates a workforce that can help the enterprise maintain its competitive posture. A third is it promotes a climate conducive to high achievers and helps the enterprise motivate and keep its best people.

SPECIFIC ELEMENTS OF A CORPORATE INTRAPRENEURIAL STRATEGY

Corporations that create an intrapreneurial strategy find that the ethos of the original enterprise often changes dramatically.[38] Traditions are set aside in favour of new processes and procedures. Some people, unaccustomed to operating in this environment, will leave; others will discover a new motivational system that encourages creativity, ingenuity, risk-taking, teamwork and informal networking, all designed to increase productivity and make the organisation more viable. Some people thrive in an intrapreneurial environment; others dislike it intensely.

Enough data have been collected that we can now say which corporate venturing strategies are typically successful and which are not. Before we describe five models of corporate venturing, let us see what they all have in common. The development of a shared vision is critical to the success of any corporate venture, whether entrepreneurial or not. A corporate model that can indicate readiness for the company-wide absorption of a shared vision is shown in figure 3.1. There are four commonly accepted cultural indicators: belonging, relationships, structure and commitment.

Developing the vision

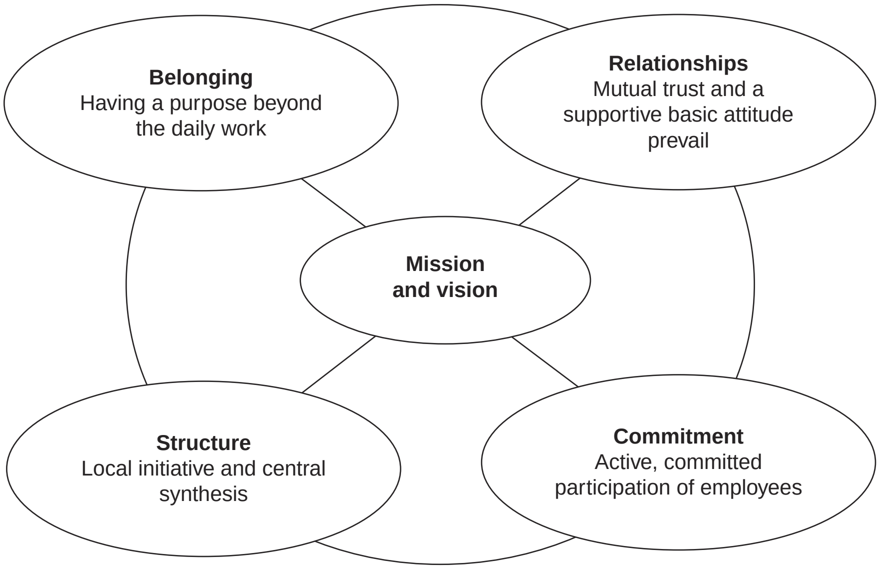
The first step in planning an intrapreneurial strategy for the enterprise is sharing the vision of innovation that the corporate leaders wish to achieve.[39] Since corporate intrapreneuring results from the creative talents of people within the organisation, employees need to know about and understand this vision. Shared vision is a critical element for a strategy that seeks high achievement (see figure 3.1). This shared vision requires identification of specific objectives for corporate intrapreneuring strategies and of the programs needed to achieve those objectives.

Encouraging innovation

Innovation is the specific tool of the entrepreneur (see also chapter 5). Therefore, corporations must understand and develop innovation as the key element in their strategy.[40] Some authors have described innovation as chaotic and unplanned,[41] while other researchers insist it is a systematic discipline.[42] Yet both can be right, depending on the nature of the innovation. One way to understand this concept is to focus on two different types of innovation: radical and incremental.[43]

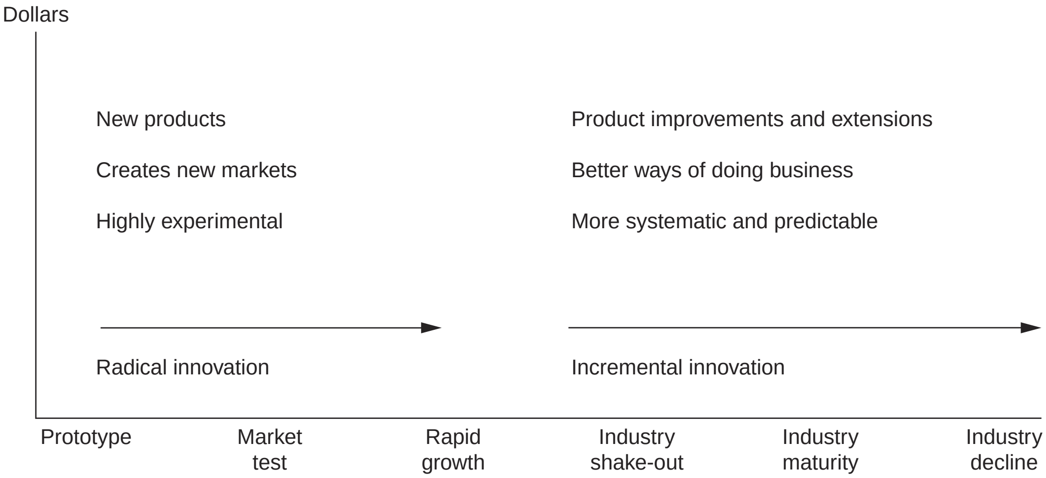
- **Radical innovation** is the launching of major breakthroughs that radically transform an industry, such as wireless Internet, iPods, videophones, Post-it notes, disposable nappies, optical fibres, CT scanners, mobile phones, NutraSweet, even overnight mail delivery. They were all radical innovations at the early stages of their diffusion and adoption. They took experimentation and determined vision. They could be ‘managed’ only with difficulty, but they had to be recognised, nurtured and guided.
- **Incremental innovation** refers to the systematic transformation of an existing product or service into newer or larger markets. These are all products at advanced stages of their product life cycles. Examples include microwave popcorn, packaging beads (to replace Styrofoam), frozen yoghurt and so forth. Sometimes an incremental innovation will actually take over after a radical innovation introduces a breakthrough (see figure 3.2). Think of how many incremental versions of Microsoft Windows there have been! The structure, marketing, financing and formal systems of a corporation can help implement incremental

FIGURE 3.1 SHARED VISION



Source: Jon Arild Johannessen, 'A systematic approach to the problem of rooting a vision in the basic components of an organization', *Entrepreneurship, Innovation and Change* (March 1994): 47. Reprinted with permission from Plenum Publishing Corporation.

FIGURE 3.2 RADICAL VERSUS INCREMENTAL INNOVATION



Source: Harry S. Dent, Jr, 'Reinventing corporate innovation', *Small Business Reports* (June 1990): 33.

innovation. As Sir Richard Branson has said, 'business opportunities are like buses, there's always another one coming'; Virgin Airlines is like that. It is the airline famous for service innovation. Nothing radical, just incrementally better than the others – constantly.

Amazingly, the history of technology development is littered with good ideas which were not taken up by their creators, like the computer mouse or GUI computer interface. Large corporations failed to commercialise these ideas because they fell 'outside of our core competencies'. Other organisations took the ideas and created wealth with them. Recent research shows that large firms fail at developing radical innovations in their core markets because they fear that the new innovations will compete with existing products and services.[44]

Structuring an intrapreneurial climate

When re-establishing the drive to innovate in today's corporations, possibly the most critical step is to invest heavily in *entrepreneurial activities* that allow new ideas to flourish in an

ENTREPRENEURIAL EDGE

INTRAPRENEURING AND VISIONARY LEADERSHIP: THE EXAMPLE OF 3M

Both types of innovation require vision and support. This support takes different steps for effective development. In addition, they both need a **champion** – the person with a vision and the ability to share it.[45] Both types of innovation require an effort by the top management of the corporation to develop and educate employees concerning innovation and intrapreneurship.[46]

Encouraging innovation requires a willingness not only to tolerate failure but also to learn from it. For example, one of the founders of 3M, Francis G. Oakie, had an idea to replace razor blades with sandpaper. He believed men could rub sandpaper on their face rather than use a sharp razor. He was wrong and the idea failed, but his ideas evolved until he developed waterproof sandpaper for the auto industry, a blockbuster success! Thus, 3M's philosophy was born.

3M Company (formerly Minnesota Mining and Manufacturing Company until 2002) is an American corporation with a worldwide presence that produces over 55 000 products, including adhesives, abrasives and laminates, electronic circuits and displays and pharmaceuticals. The company's early innovations included waterproof sandpaper (early 1920s) and masking tape (1925), as well as cellophane tape and sound deadening materials for metal-frame cars in the years that followed. 3M's contributions to modern life include magnetic sound and video recording tape, offset printing plates, Scotchguard Fabric Protector, as well as photographic and health care products.

Today 3M follows a set of innovative rules that encourage employees to foster ideas. The key rules include the following:

- >> **Don't kill a project:** If an idea can't find a home in one of 3M's divisions, an employee can devote 15 per cent of their time to prove it is workable. For those who need seed money, as many as 90 Genesis grants of $50 000 are awarded each year.
- >> **Tolerate failure:** Encouraging plenty of experimentation and risk-taking allows more chances for a new product hit. The goal: Divisions must derive 25 per cent of sales from products introduced in the past five years. The target may be boosted to 30 per cent in some cases.
- >> **Keep divisions small:** Division managers must know each employee's first name. When a division gets too big, perhaps reaching $250 million to $300 million in sales, it is split up.
- >> **Motivate the champions:** When a 3M employee has a product idea, they recruit an action team to develop it. Salaries and promotions are tied to the product's progress. The champion has a chance to some day run their own product group or division.
- >> **Stay close to the customer:** Researchers, marketers and managers visit customers and routinely invite them to help brainstorm product ideas.
- >> **Share the wealth:** Technology, wherever it is developed, belongs to everyone.[47]

intrapreneurial climate. This concept, when coupled with the other elements of an innovation strategy, can enhance the potential for employees to become venture developers. To develop employees as a source of innovations for corporations, companies need to provide more nurturing and information-sharing activities.[48] In addition to establishing entrepreneurial ways and nurturing intrapreneurs, they need to develop a climate that will help innovative-minded people reach their full potential. Employee perception of an innovative climate is critical for stressing the importance of management's commitment not only to the organisation's people but also to the innovative projects.

There are four methods in which corporations can develop key environmental factors for intrapreneurial activity and to increase successful innovation.

- Developing an **Intrapreneurship Training Program (ITP)** taps the entrepreneurial potential of the corporate business environment for growth and retention of developed human capital. The process challenges and stimulates corporate entrepreneurs to think and act like new venture focused entrepreneurs. The corporate entrepreneurs are encouraged to examine the characteristics of an enterprise culture and relate their leadership skills, planning processes and strategic thinking capabilities to capturing new venture opportunities in their corporate business culture.[49]
- Encourage – not mandate – intrapreneurial activity, using financial rewards and strong company recognition rather than rules or strict procedures to encourage corporate entrepreneurship.
- Develop human resource policies that will encourage managers to remain in positions for a period long enough to allow them to learn an industry and a particular division.
- Create the right conditions for management to sustain a commitment to intrapreneurial projects long enough for momentum to occur. Failures will inevitably occur and learning must be the key aftermath of those failures. Thus, sustained commitment is an important element in managing corporate entrepreneurship.[50]

There is still a great deal of discussion about which kind of rewards actually encourage corporate entrepreneurs.[51] Some believe allowing the inventor to take charge of the new venture is the best reward. Others say it is allowing the corporate entrepreneur more discretionary time to work on future projects. Still others insist that special capital, called **intracapital**, should be set aside for the corporate entrepreneur to use whenever investment money is needed for further research ideas.

In light of these climate elements, it is clear that change in the corporate structure is inevitable if intrapreneurial activity is going to exist and prosper. The change process consists of a series of emerging constructions of people, corporate goals and existing needs. In short, the organisation can encourage innovation by relinquishing controls and changing the traditional bureaucratic structure.[52]

Developing venture teams

The final element common to all intrapreneurship models is the **venture teams** themselves. Companies that have committed to a venture team approach often label the change they have undergone a 'transformation' or a 'revolution'. This new breed of work team is self-directing, self-managing, or high-performing.[53]

Reich believed that intrapreneurship was not the sole province of a single individual. It can and should be diffused throughout the company. He called it **collective entrepreneurship**:

> In collective entrepreneurship, individual skills are integrated into a group; this collective capacity to innovate becomes something greater than the sum of its parts.

> Over time, as group members work through various problems and approaches, they learn about each other's abilities. They learn how they can help one another perform better, what each can contribute to a particular project, how they can best take advantage of one another's experience. Each participant is constantly on the lookout for small adjustments that will speed and smooth the evolution of the whole. The net result of many such small-scale adaptations, effected throughout the organisation, is to propel the enterprise forward.[54]

In keeping with Reich's focus on collective entrepreneurship, venture teams offer corporations the opportunity to use the talents of individuals but with a sense of teamwork.

A venture team is composed of two or more people who formally create and share the ownership of a new organisation.[55] The unit is semi-autonomous in the sense it has a budget plus a leader who has the freedom to make decisions within broad guidelines. Sometimes the leader is called a 'product champion' or an 'intrapreneur'. The unit is often separated from other parts of the firm – in particular, from parts involved with daily activities. This prevents the unit from engaging in procedures that can stifle innovative activities. If the venture proves successful, however, it eventually is treated the same as other outputs the organisation produces. It is then integrated into the larger organisation.[56] In many ways, a venture team is a small business operating within a large business and its strength is its focus on design (that is, structure and process) issues for innovative activities.

In this section we have examined the specific elements of a corporate intrapreneurship strategy, namely developing the vision, encouraging innovation, structuring an intrapreneurial climate and developing venture teams. All models of corporate venturing have these elements in common. But the latest research shows that some models are more successful than others.

SUCCESSFUL AND UNSUCCESSFUL MODELS OF CORPORATE VENTURING

We would have to say that corporate venturing has been quite in vogue over the last decade. Specific intrapreneurship strategies have varied from firm to firm, as have their success rates. Campbell et al. suggest that investment levels in intrapreneurship have fallen considerably as some failings of the approach were noticed.[57] They examined more than 100 'venturing units' in the top OECD countries. They categorised these venturing units into five models, four of which were reasonably successful and one of which was not. They are:

- **Ecosystem venturing**: An ecosystem is a complex community and environment that forms a functional whole. The intrapreneurial ecosystem consists of suppliers, distributors, franchisees, out-sourced services and so forth. In this model, a company funds the entrepreneurial support activities of its ecosystem. A good example is all the companies that surround Intel Corporation.
- **Innovation venturing**: This model copies the methods of the venture capital industry. A separate funding unit competitively evaluates research and development projects within the firm and rewards people and divisions that create value. Xerox New Enterprises sought out ideas from employees, funded them and provided an incubator-like environment for their growth.
- **Harvest venturing**: Here the corporation harvests its existing intellectual assets by selling or licensing technology, brands, skills and other assets. Lucent New Ventures Group captured intellectual property out of Bell Labs to take to the marketplace.
- **New leg venturing**: An outgrowth of harvest venturing, this is the least successful of the bunch. It involves taking the harvested assets and spinning them out as 'new legs' for the company.

TABLE 3.4: SUCCESSFUL CORPORATE VENTURING BUSINESS MODELS

	ECOSYSTEM VENTURING	INNOVATION VENTURING	HARVEST VENTURING	PRIVATE EQUITY VENTURING
Focus	Take minority stakes in suppliers, customers and/or complementors to improve prospects of existing businesses Generate value through commercial links with firms invested in	Use venturing techniques as a more effective means of performing (part of) an existing functional activity Often, but not exclusively, this applies to R&D	Generate cash from harvesting spare resources	Take advantage of a unique deal flow and relevant, non-tradeable assets to participate directly in the venture capital/private equity industry
Main pitfall	The loss of focus pitfall – investing too widely and seeking too much autonomy	The culture change pitfall – aiming for a broad impact on culture change rather than focusing on improving part of a function	The new legs pitfall – seeking to develop new growth platforms in addition to harvesting	The anyone can do this pitfall – believing that it is easy because others are having success
Examples	Intel investing in its community – good example is creation of the WiFi standard	Xerox New Enterprises identified ideas from within the firm and provided financing	Lucent New Ventures Group (LNVG) commercialised IP coming out of Bell Labs BT Brightstar did the same for British Telecom	GE Equity, a spin-off of General Electric Nokia Venture Partners (NVP)
Performance measures and incentives	Significant cash bonus scheme based on impact on existing businesses and portfolio performance; no carried interest	Performance benchmarked against rest of function; financial interest given to entrepreneurs, not to nurturers	Cash performance against allocated assets; large bonuses paid against performance targets; no carried interest	Bonus and share carry incentives in line with venture capital industry norms

Source: Adapted from Andrew Campbell, Julian Birkinshaw, Andy Morrison and Robert van Basten Batenburg, 'The future of corporate venturing', *MIT Sloan Management Review* 45(1) (2003): 30-37.

- **Private equity venturing**: Essentially a pure venture capital model, the corporation sets up a private equity unit that invests in projects regardless of whether they add to the parent company's bottom line. General Electric launched GE Equity as a classic venture capital firm.

THE INTERACTIVE PROCESS OF INTRAPRENEURSHIP

Who are intrapreneurs?

Intrapreneurs are not necessarily the inventors of new products or services, but they are the people who can turn ideas or prototypes into profitable realities. They are the people behind a product or service. They are team builders with a commitment and a strong drive to see their ideas become a reality. Perhaps most surprising, they are typically of average or slightly above-average intelligence – they are not geniuses.

Most intrapreneurs begin their 'intraprise' with an idea. This idea typically starts as a vision, often referred to as the 'daydreaming phase', Here the intrapreneur mentally goes through the process of taking the idea to fruition. Different pathways are thought through and potential obstacles and barriers are mentally examined. The intrapreneur of the Pontiac Fiero, Hulki Aldikacti, provides an example of this process. When Aldikacti first came up with the idea for the Fiero, he was unsure what the car would look like. So he built a wooden mock-up of the passenger compartment. He then sat in the model and imagined what it would feel like to drive the finished car. This helped him develop and perfect the final product.

Initially, the intrapreneur is the general manager of a new business that does not yet exist. In the beginning, the individual may specialise in one area, such as marketing or research and development, but once the intraprise is started, the intrapreneur quickly begins to learn all the project's facets, soon becoming a generalist with many skills.

Intrapreneurs are sometimes captured by the description of 'a dreamer who does'. They tend to be action oriented. They can move quickly to get things done. They are goal oriented, willing to do whatever it takes to achieve their objectives. They are also a combination of thinker, doer, planner and worker. They combine vision and action. Dedication to the new idea is paramount. As a result, intrapreneurs often expect the impossible from themselves and consider no setback too great to make their venture successful. They are self-determined goal setters who go beyond the call of duty in achieving their goals.[58] (See figure 3.3 for the intrapreneur's 10 commandments.)

When faced with failure or setback, intrapreneurs employ an optimistic approach. First, they do not admit they are beaten; they view failure as a temporary setback to be learned from and dealt with. It is not seen as a reason to quit. Second, they view themselves as proprietors of their own destiny. They do not blame their failure on others but instead focus on learning how they might have done better. By objectively dealing with their own mistakes and failures, intrapreneurs learn to avoid making the same mistakes again and this, in turn, is part of what helps make them successful.

FIGURE 3.3 **THE INTRAPRENEUR'S 10 COMMANDMENTS**

- Build your team; intrapreneuring is not a solo activity
- Share credit widely
- Ask for advice before you ask for resources
- Under-promise and over-deliver – publicity triggers the corporate immune system
- Do any job needed to make your dream work, regardless of your job description
- Remember it is easier to ask for forgiveness than for permission
- Keep the best interests of the company and its customers in mind, especially when you have to bend the rules or circumvent the bureaucracy
- Come to work each day willing to be fired
- Be true to your goals, but be realistic about how to achieve them
- Honour and educate your sponsors

Source: [www.intrapreneur.com/MainPages/History/TenCommandments.html].

SUMMARY

Around the world, more and more entrepreneurs are starting up businesses for their employers. Intrapreneurship is the process of profitably creating innovation within (sometimes very large) organisational settings. Most companies are realising the need for intrapreneurship. This need has arisen as a response to (a) the rapidly growing number of new, sophisticated competitors, (b) a sense of distrust in the traditional methods of corporate management and (c) an exodus of some of the best and brightest people from corporations to become small-business entrepreneurs.

Intrapreneurship can lead to innovation, new product development, greater wealth creation and economic development for companies that want to compete effectively in international markets. The term intrapreneurship means both new venture creation within existing organisations (be they profit-making, non-profit, public, or non-governmental) and their transformation through strategic renewal.

When creating the climate for in-house entrepreneurial ways, companies must develop four climate characteristics: (1) explicit goals, (2) a system of feedback and positive reinforcement, (3) an emphasis on individual responsibility and (4) rewards based on results. Organisations create corporate intrapreneuring in a variety of ways. The first step is to understand the obstacles to corporate venturing. These are usually based on the adverse impact of traditional management techniques. The next step is to adopt innovative principles that include atmosphere and vision, multiple approaches, interactive learning and skunkworks.

Intrapreneurship is not just for corporations; it is also for government bureaucracies and other large institutions. While public and private sector entrepreneurs have a lot in common, there are some significant differences. Public sector organisations have fewer entrepreneurs, are hierarchically structured and are rigid environments. They often have unclear objectives, less resources available for change, significant risk aversion and often political intrusion.

Gifford Pinchot's use of the term intrapreneurship contrasted with the large corporate industrial policies of the time. He and others prophesied that job growth would increasingly come from small firms and entrepreneurial corporations.

Specific strategies for corporate entrepreneurship entail the development of a vision as well as the development of innovation. Two types of innovation exist: radical and incremental. To facilitate the development of innovation, corporations need to focus on the key factors of top management support, time, resources and rewards. Thus, commitment to and support of intrapreneurial activity are critical.

Venture teams are the semi-autonomous units that have the collective capacity to develop new ideas. Sometimes referred to as self-managing or high-performance teams, venture teams are emerging as the new breed of work teams formed to strengthen innovative developments.

Intrapreneurs and entrepreneurs share similar characteristics and traits. Among these traits are a generalist point of view, an action orientation, an optimistic approach, self-determination, ambitious goal setting, dedication to new ideas and a willingness to accept mistakes and learn from them. Inventors sometimes acquire intrapreneurial skills, but often the inventors must team up with intrapreneurs to take the invention successfully into the marketplace.

Recent research has shown that there are several models of corporate entrepreneurship that work and at least one that does not. The successful models include ecosystem venturing, innovation venturing, harvest venturing and private equity venturing. It seems that 'new leg' venturing, where a company spins out assets, does not work as well.

KEY TERMS AND CONCEPTS

champion
collective entrepreneurship
corporate entrepreneurship
corporate revolution
corporate venturing
ecosystem venturing
gumboot factory or skunkworks
harvest venturing
incremental innovation
innovation venturing
interactive learning
intracapital
intrapreneurial climate
intrapreneurship
Intrapreneurship Training Program (ITP)
'new leg' venturing
private equity venturing
private sector entrepreneurs
public sector entrepreneurs
radical innovation
risk aversion
strategic renewal
venture team

REVIEW AND DISCUSSION QUESTIONS

1 In your own words, what is an intrapreneur?
2 What are two reasons that such a strong desire to develop intrapreneurs has arisen in recent years?
3 What are some of the corporate obstacles that must be overcome to establish an intrapreneurial environment?
4 What are some of the innovative principles identified by James Brian Quinn that companies need to establish?
5 Corporations today are working to re-engineer corporate thinking and encourage an intrapreneurial environment. What types of steps would you recommend? Offer at least three and explain each.
6 What are five useful rules for innovation?
7 What are three advantages of developing an intrapreneurial philosophy?
8 Identify the four key elements on which managers should concentrate to develop an intrapreneurial strategy.
9 Explain the differences between radical and incremental innovation.
10 Identify the five specific entrepreneurial climate factors that organisations need to address in structuring their environment.
11 Why are venture teams emerging as part of a new strategy for many corporations?
12 Of the key intrapreneurial considerations set forth in figure 3.3, which three are of most value to practising managers? Why?
13 How does an entrepreneur differ from an intrapreneur? Compare and contrast the two.
14 Why is it useful to understand some of the myths that have sprung up about intrapreneurs? Explain, using two of these myths as examples.

CASE 3.1:
IT'S ALL ABOUT GROWING ENTREPRENEURS IN-HOUSE

Sir C.K. Chow is now domiciled in Sydney as the chief executive of the new Brambles after its A$17 billion merger with British engineering giant GKN late last year. Brambles is an Australian-based global provider of support services, operating in almost 50 countries across six continents and employing approximately 28 000 people.

Chow brings an entrepreneurial style of corporate leadership to the local marketplace. It is a style that made GKN a frontrunner in Britain and won him a knighthood before his fiftieth birthday.

Chow was headhunted to become chief executive of GKN in 1996. He set himself and the company the ambitious task of boosting revenue growth by 40 per cent over five years. In a sector such as automotive components, GKN's main business, this seemed a tough call. The British pound, GKN's reporting currency, was so strong that it was threatening to sink other icons of British manufacturing such as Rover and BTR.

That Chow and GKN managed to achieve, even exceed, the goal are now on public record. At GKN, the company managed to achieve Chow's target not only through strategic moves in helicopter and armoured car manufacturing, but also through his championing of corporate entrepreneurship within the organisation in a program called 'The Way Forward'.

'There was a good reason to promote entrepreneurship at GKN', says Chow. 'It is a very structured and disciplined company and most of its executives are engineers with very high work ethics. In order to encourage growth, we needed to support this strength and combine it with entrepreneurship.'

The cornerstone of the Way Forward program was the formation of what Chow calls 'real working teams' starting from the executive committee of the company through to every business unit. 'They work together on real business issues, often recharting their strategies and redefining their culture.'

Along with the practice of seconding people from their home plants to other parts of the company for long periods, the Way Forward program helped break down competition and suspicion between the plants and created an open atmosphere that encouraged people to feel they were at a disadvantage if they did not share their ideas. Previously impeded by cross-cultural rivalries, this was a major breakthrough in organisational behaviour for GKN that took five years to achieve.

'No successful entrepreneur achieves his success by merely copying what others do; they do something new, different and better', says Chow. 'They are resourceful and often leverage other people's resources to succeed. They also do not take risks blindly. They understand risks very well and take actions to mitigate them as they understand that their survival depends on it.

'Two things that I emphasise in the new Brambles, is firstly that we are a business-to-business solutions provider for outsourcing support services and secondly the key to doing that successfully is through the development of people and promoting an enterprising spirit', Chow says.

'An enterprising spirit is about innovation, overcoming barriers and it is about resourcefulness. And that's what we would encourage our people to do.'

Innovation in support services is best to come from interfacing with your customers, says Chow. 'It is about ideas that start with somebody saying, "Hey let me do this for you" and then it begins; it may start in a relatively small way, but it can grow very quickly.'

Source: Adapted from Lachlan Colquhoun, 'It's all about growing entrepreneurs in-house', *AGSM Magazine* (Sydney: Australian School of Management), (30 March 2002): 11–12.

QUESTIONS

1. How did GKN achieve Sir C.K. Chow's target of 40 per cent revenue increase over five years?
2. What is the importance of having the executive committee spearhead an intrapreneurial initiative? What are the potential problems with that approach?
3. How would you characterise the enterprising spirit at GKN?

RECOMMENDED CASES FROM HARVARD BUSINESS SCHOOL ONLINE

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Business Teams at Rubbermaid, Inc.

Publication date: 10 March 1997
Author(s): Teresa M. Amabile, Dean Whitney
Product number: 897165

Rubbermaid, a consumer-products company widely praised for its innovation, has instituted a company-wide experiment to stimulate innovation even further. The experiment consists of creating small cross-functional business teams within each division, with each team being responsible for the creation, management and profitability of a particular product line.

Lucent Technologies: The Future of the New Ventures Group

Publication date: 5 June 2001
Author(s): Henry W. Chesbrough, Anthony Massaro
Product number: 601102

Lucent Technologies' New Ventures Group has created innovative ways to commercialise Bell Labs research. The success of this approach now forces the group to evaluate whether to stay inside Bell Labs or become an external venture capitalist group.

Corporate Entrepreneurship for Dummies

Publication date: 1 January 2001
Author(s): Neal Thornberry and Sam Perkins
Product number: BAB114

As the new millennium dawned, many old economy companies faced the challenge of transitioning into the Internet era, making 'Go web or go dead' the common mandate. For John Kilcullen, CEO and publisher of IDG Books, the Internet offered an opportunity to fashion a new business model based on recurring revenues rather than one-time transactions. Chronicles the evolution of the 'Dummies' series of books within the structure of the huge IDG organisation, offering insights and discussion on what it takes to foster a successful corporate entrepreneurial climate.

E-GOVERNMENT ENTREPRENEURIAL MINDSET TOOL: A SELF-ASSESSMENT FOR E-GOVERNMENT LEADERS

Publication date: 1 March 2002
Author(s): Lynda M. Applegate and Susan Saltrick
Product number: 9-802-176

Enables students to assess their personal (or organisation's) propensity to think and act like an entrepreneur.

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part 1

ENTREPRENEURIAL CASE ANALYSIS

COASTAL STREET SWEEPING PTY

Dr Stephane Tywoniak, Queensland University of Technology and Simon Best, PhD, MBA, JP Qual, Managing Director, Access Business Consultants Pty Ltd

INTRODUCTION Coastal Street Sweeping was created four years ago in a mid-sized seaside town in northern Queensland, by John and his partner Kathy. At the time, John was employed as a street cleaner by the local authority. The street sweeping equipment used by the council was ageing and needed replacement. When evaluating replacement machines, the local council quickly realised that the increased efficiency of the new machine meant it would not be used full-time, and they were concerned about getting value for money. Where other people would see a threat to their job, John saw an entrepreneurial opportunity: he realised he could turn his job into a business by acquiring himself the new machine and becoming a contractor to the local authority – and possibly other customers.

Until recent times, the local economy had been reliant on cane growing and the sugar industry, but the low prices for Australian sugar had driven many farmers to diversify into the production of fruit and vegetables. The local authority was concerned about the economic growth of the town and had targeted five areas for future development and investment:

- tourism
- lifestyle
- agriculture
- business and employment
- community.

The local authority and the state government had started a substantial program of infrastructure works, including the installation and upgrade of sewerage works and roads, the development of two industrial parks, and road building and maintenance. Private developers had also started to invest in residential development linked to tourism.

John had sensed that the growth of tourism and local businesses provided opportunities for a sweeping business in addition to street cleaning for the local council. Specifically, he had identified the following opportunities:

- cleaning up of construction sites before building inspections – the investment in tourism implied increased construction activity in the years to come, both for residential and commercial development
- cleaning of parking areas in commercial and industrial developments – the local shopping centre and two planned business parks were perceived to be prime targets
- after storm cleaning – tropical storms occur regularly during summer and this results in dirt and waste blocking gutters and drains, providing an opportunity for seasonal work.

Finally, John knew he would be the only contractor with this kind of equipment in a 50 kilometre radius and felt that there would be opportunities to find additional work in the surrounding towns and localities.

GETTING STARTED Businesses such as Coastal Street Sweeping are moderately capital intensive, using relatively expensive equipment. John knew he needed advice to raise funding for his venture. He was aware of his lack of experience in writing business plans and negotiating with banks so he hired the local branch of one the big accountancy firms to help him. The consultants wrote a financially-oriented business plan for him designed to negotiate a loan from the local bank. In parallel, John negotiated with the council to outsource his street cleaning job – having a stable source of income was essential in securing any funding.

After a few weeks of work, the negotiations were successfully completed. John had negotiated a contract with the local council that provided for adequate returns, and had secured adequate finance on that basis. Coastal Street Sweeping was formed, with John and Kathy as equal part-owners of the business. It was agreed that in the beginning John would work full time on the new venture, while Kathy would keep her job with the state government four days a week. Kathy had experience in office administration

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and book-keeping and would spend one day a week managing the administrative tasks of the business.

Coastal Street Sweeping's first asset was the council's old sweeper. This was acquired at a relatively low price – the purchase was opportunistically perceived to provide a basis to start work quickly. However, the age of the equipment was starting to show – not only did the productivity of the equipment remain low due to frequent breakdowns, but substantial repair bills were incurred during the first year of the venture, resulting in an operating loss for the business (see table A). A new low-power sweeper was acquired after a few months' of operations, with the old machine being kept for spare parts. During the second year of operation, Coastal Street Sweeping covered its costs, and generated a small profit, though this did not provide for a satisfactory remuneration for the owners. John knew he had to do more to expand the business.

TABLE A: COASTAL STREET SWEEPING FINANCIAL TARGETS AND PERFORMANCE ($'000)

YEAR	1	2	3	4
Revenue target	70	77	85	95
Profit before tax and owner's remuneration target	20	17	20	23
Revenue actual	24	56	83	110
Profit before tax and owner's remuneration actual	(16)	5	14	35

EXPANSION

During the third year of operation, Coastal Street Sweeping acquired a tip truck and a bobcat (four-wheel-drive utility vehicle which can be used with a variety of attachments: sweeping, road excavations and building sites). The original idea was to provide sweeping and cleaning services in places where the large sweeper did not have easy access, for example, small construction sites, underground car parks. The bobcat and tip truck work as a combination – the truck is used to transport the bobcat to the site, and any rubbish collected during the cleaning can be collected in the truck before disposal. Some small contracts had been obtained for this service, but John felt that there was more potential to be exploited from this equipment.

At that time, the main contract for street cleaning with the local council was going well, and an opportunity for referral business arose: the council of a nearby town up the coast was looking for cleaning services. This was a smaller town, with a lower budget, but John was able to obtain a cleaning contract amounting to six weeks of work every 12 weeks. This required the acquisition of a second low-power sweeping machine. The operation was financially viable – even though the contract provided for only one-third capacity utilisation, this was more than enough to cover leasing costs and the salary of a casual operator. John could drive the sweeper up the coast using the truck, thus minimising transport costs. During this third year, the expansion of the business required the hiring of some casual labour to operate the sweepers as there was regularly more work than John could handle. In year four, the business continued to expand as the second sweeping contract ran for a full year. The profitability of the business had also started to improve. Although Coastal Street Sweeping was still not providing adequate returns, John and Kathy felt that the company was now firmly established. They felt that if the customer base could be expanded, then they could improve the capacity utilisation of the business and generate satisfactory profits. John and Kathy decided to hire Mary, a small business consultant, to help them review their options.

OPTIONS FOR GROWTH

John exhibits some character traits typical of many entrepreneurs: he is constantly on the look out for new opportunities, trying to leverage his network of customers and business relations. During his contacts with customers, and also just driving around, he has thought up more than 30 ideas. Although some are clearly not viable business opportunities, John believes that the following have genuine potential:

- **Labour hire:** Some of the casual workers John employs are good workers. Over the past two years, he has had consistent positive feedback from his customers, in particular regarding three of his regular operators. He thinks that this good team could form the foundation for a labour hire business – he has the business contacts and opportunities, and he believes that he can easily overcome his lack of experience in employing people and lack of knowledge of the labour market and regulations by subcontracting the administrative work to a third party.
- **Poison spraying:** During one of John's meetings with the council, the need to spray weeds and stagnant water for mosquitoes was mentioned. John thinks he can start a new activity around this – he has the right connections with the council. He says that all he needs is to find a licensed operator who would do the job for him once the work has been secured.
- **Building and excavation work:** The tip truck and bobcat were currently under utilised for cleaning jobs. By fitting the bobcat with excavation attachments, John felt that building and construction jobs could be found. The current program of infrastructure investment provided opportunities in sewerage works and road upgrades. This would be a way to increase the capacity utilisation of the equipment. However, this was a market where John had few contacts – his network was among cleaning and maintenance people, not construction. He wondered how he could enter into this new market.

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- **Super suction:** John believed there was a market for a high-powered sweeping and suction machine (suction 10 times more powerful than the low-power equipment). This super suction machine is used in construction sites to lay foundations in sandy soil: steel tubes are planted in the ground where the foundation piles are to be set, and the super suction machine sucks out the sandy soil, making way to pour the concrete which will form the foundation pile. Another possible use of the super suction machine is related to cleaning – gutters and drains are often blocked after major storms. The super suction machine provides a faster and more efficient service than the standard sweeper in these circumstances. Finally, it is also possible to use the super suction machine on low power setting and operate it for standard sweeping and cleaning jobs. At the moment there is no super suction machine in town. John believes that having one would allow him to pick up business currently handed to out of town operators who cannot provide the best service because of the lead times and extra logistical costs.

Although John and Kathy had discussed some of these options, they had not investigated any in detail. None of these were part of the original business plan, which has not been updated since written. Indeed, John and Kathy had never looked again at the business plan – for them it was only a document to obtain their first loan from the bank.

BUSINESS ISSUES Before she could finalise her advice to John and Kathy, Mary felt that she needed a more detailed understanding of how the business was run. She asked John to provide a breakdown of his usage of time over the past few weeks. Although John does not keep precise records, he worked out the following approximate breakdown:

- operating sweeping machine for local council contract: 3 days/week
- driving second sweeper to second council and back: 1/3 day/week
- bobcat and tip truck hire: 1-1/2 days/week
- customer relations, marketing, acquiring new business: rest of the time.

In addition, John employed casual labour for about three days a week on average (including the second council sweeper contract) but there were some jobs he thought he had to do himself because he did not trust that the casual workers could do them, and he did not have the time to provide any training. Reflecting on his own usage of time, John felt that he should spend more time developing the business, but he did not really know how to proceed.

Kathy's work in the back-office was also organised informally. Because the business still involved a limited number of regular customers (the contracts for the two councils account for about 80 per cent of revenues) Kathy felt she could properly handle the administration without having to set up formal procedures beyond what was required for invoicing and book-keeping. As a result, she was the only person who could make sense of the administration of the business, and when John needed information on the days she was working for the government, he often had to either call her, or wait until the evening to get the information.

As she sat down to prepare her report to John and Kathy, Mary felt that Coastal Street Sweepers had a bright future ahead, provided the appropriate opportunities were developed, and crucially, if John and Mary could structure and organise the business properly.

Source: The case is based on a real business, but names and locations have been disguised to preserve the confidentiality of the entrepreneurs.

PART TWO:
THE ENTREPRENEURIAL PERSPECTIVE

CHAPTER

4

UNDERSTANDING THE ENTREPRENEURIAL EDGE IN INDIVIDUALS

> Would-be entrepreneurs live in a sea of dreams. Their destinations are private islands – places to build, create and transform their particular dreams into reality. Being an entrepreneur entails envisioning your island and even more important, it means getting in the boat and rowing to your island. Some leave the shore and drift aimlessly in the shallow waters close to shore, while others paddle furiously and get nowhere, because they don't know how to paddle or steer. Worst of all are those who remain on the shore of the mainland, afraid to get in the boat. Yet, all those dreamers may one day be entrepreneurs if they can marshal the resources – external and internal – needed to transform their dreams into reality.
>
> Everyone has dreams. We all dream while asleep, even if we don't remember dreaming. Entrepreneurs' dreams are different. Their dreams are not limited to dreams about fantasy islands or fast cars. Theirs are about business.
>
> Lloyd E. Shefsky, *Entrepreneurs Are Made Not Born*[1]

CHAPTER OBJECTIVES

1. To describe how entrepreneurs see the world
2. To present the major sources of information useful in profiling the entrepreneurial edge
3. To identify and discuss the most commonly cited characteristics found in successful entrepreneurs
4. To discuss the 'dark side' of entrepreneurship
5. To identify and describe the different types of risk entrepreneurs face
6. To identify the major causes of stress for these individuals and the ways they can handle stress
7. To examine entrepreneurial motivation

THE ENTREPRENEURIAL EDGE

Most entrepreneurs have a strong desire to be independent, which frequently leads to a decision to leave the present employer. They may see limited opportunities for advance or they may become bored with the same work every day. Ultimately they want to be their own bosses, what we call sole proprietors of their own destiny. The second most important reason to become an entrepreneur is to make more money. Wealth creation is an essential motivation for many. Entrepreneurs believe it is better to invest in themselves than to park their earnings in a low-interest savings account. For job satisfaction, achievement, opportunity and money – these are the primary motivations for people to launch their own venture.

Oftentimes the decision to start one's own business comes from a disruption. One person in a two-person family is transferred and the other becomes the 'trailing spouse'. A job is made redundant. Needs are not being met. Around the world, economic dislocation and even civil war contribute to this 'creative disruption'.

One characteristic that we frequently observe is that the entrepreneur is the oldest child in the family or the only child. Perhaps this contributes to self-confidence and self-esteem. Another attribute is that entrepreneurs more frequently know another entrepreneur than the general population.[2] Parental and acquaintance influences have an impact on one's choice to become self-employed.

The highest rate of entrepreneurship is in one's thirties and forties. Yet there are millions of younger people around the world who are currently starting businesses. Table 4.1 shows the statistics for selected countries. Countries in the Asia–Pacific have some of the world's highest rates of youth entrepreneurship. New Zealand has the highest rate in the developed world at 39 per cent of its entrepreneurs being between 18 and 34 years old. In Singapore, Australia and New Zealand combined, there are more than 750 000 young people starting businesses.

Combining all age groups, there are literally hundreds of millions of people starting a business. As a proportion of the total population, 21 per cent of the entire Thai population are doing so. About 17.5 per cent of New Zealanders and 11 per cent of Australians are entrepreneurially active. Among the more active countries are Norway, Canada, Argentina, Ireland, Iceland, Chile, Brazil and the United States.

As we can see, entrepreneurship is not just a first-world phenomenon. The poor in the developing countries can and do get richer through enterprise. UN Secretary-General Kofi Annan has said 'entrepreneurs have the power to create the greatest change for their own countries'.[3] With their peers around the world, these young people are now one of the most entrepreneurial generations since the Industrial Revolution.[4]

TABLE 4.1: YOUTH ENTREPRENEURS IN SELECTED COUNTRIES, 2005

COUNTRY	TOTAL NUMBER OF ENTREPRENEURS 18–64 YEARS OLD	TOTAL NUMBER OF ENTREPRENEURS BETWEEN 18–34 YEARS OLD	% OF ENTREPRENEURS WHO ARE 18–34
China	1 983 000	907 000	45.8
Thailand	8 680 000	3 830 000	44.1
Singapore	232 000	94 000	40.7
New Zealand	444 000	173 000	39.0
Australia	1 378 000	487 000	35.3
United Kingdom	2 351 000	772 000	32.8
United States	23 071 000	7 172 000	31.1

Source: *Global Entrepreneurship Monitor,* 2005.

Some believe that every person has the potential and free choice to pursue a career as an entrepreneur. However, exactly what motivates individuals to make a choice for entrepreneurship has not been identified as one single event, characteristic, or trait. Researchers are continually striving to learn more about the entire entrepreneurial process to better understand the driving forces within entrepreneurs.[5] Here we describe the most common characteristics associated with successful entrepreneurs as well as the elements associated with the 'dark side' of entrepreneurship. In this manner we can become more acquainted with the complete perspective involved with **entrepreneurial behaviour**.

How do entrepreneurs view the world? We call this the **entrepreneurial edge**. Although certainly not an exact science, this perspective provides an interesting look at the entrepreneurial potential within every individual.[6] For we believe that every individual can become the sole proprietor of their destiny at some point in their lives.

Who are entrepreneurs?

Frank Carney, the founder of Pizza Hut, once described entrepreneurs as the cornerstone of the enterprise system, the self-renewing agents for the economic environment. Normally defined as risk-takers in new-venture creations, entrepreneurs are optimistic, hard-driving, committed individuals who derive great satisfaction from being independent. Starting a new business requires more than just an idea; it requires a special person who uses sound judgement and planning along with managed risk-taking to ensure the success of their own business.

Bolton and Thompson define an entrepreneur as 'a person who habitually creates and innovates to build something of recognised value around perceived opportunities'. A *person* can be also a group of people as it is possible to describe teams and even organisations as entrepreneurial. The word 'person' emphasises that a personality rather than a system is involved. *Habitually* is an important characteristic of entrepreneurs that distinguishes them from business owner–managers or people who build a business simply to achieve a comfortable lifestyle. True entrepreneurs just cannot stop being entrepreneurs.[7]

Entrepreneurs are driven by an intense commitment and determined perseverance and they work very hard. They are optimists who see the cup as half full rather than half empty. They strive for integrity. They burn with the competitive desire to excel. They use failure as a tool for learning. They have enough confidence in themselves to believe they personally can make a major difference in the final outcome of their ventures.[8]

The substantial failure rate of new ventures attests to the challenge of entrepreneurship. Inexperience and incompetent management are the main reasons for failure. But what are the factors for success? Do they apply to all components of entrepreneurship? These are some of the issues we shall explore in this chapter.

Common characteristics associated with entrepreneurs

A review of the literature related to entrepreneurial characteristics reveals the existence of a large number of factors that can be consolidated into a much smaller set of profile dimensions. For example, if the work of Kao[9] is considered, 11 common characteristics can be identified:

- total commitment, determination and perseverance
- **drive to achieve** and grow
- **opportunity orientation** and goal orientation
- taking initiative and personal responsibility
- persistent problem solving

- realism and a sense of humour
- seeking and using feedback
- internal locus of control
- **calculated risk-taking** and risk seeking
- low need for status and power
- integrity and reliability.

Hornaday examined various research sources and formulated a list of 42 characteristics often attributed to entrepreneurs (see table 4.2).

As we study this fascinating creature called the entrepreneur, it is clear that these characteristics will become an ever-growing list. But based upon our present knowledge, what are the most often cited entrepreneurial qualities?

Commitment, determination and perseverance

More than any other factor, total dedication to success and focus on advantage can overcome obstacles and setbacks. Sheer determination and an unwavering commitment to succeed often win out against odds that many people would consider insurmountable. They also can compensate for personal shortcomings. Often, entrepreneurs with a high-potential venture and a plan that includes venture capital financing can expect investors to measure their commitment in several ways. Examples include a willingness to mortgage their house, take a cut in pay, sacrifice family time and reduce their standard of living.

TABLE 4.2: **CHARACTERISTICS OFTEN ATTRIBUTED TO ENTREPRENEURS**

1	Confidence
2	Perseverance, determination
3	Energy, diligence
4	Resourcefulness
5	Ability to take calculated risks
6	Dynamism, leadership
7	Optimism
8	Need to achieve
9	Versatility; knowledge of product, market, machinery, technology
10	Creativity
11	Ability to influence others
12	Ability to get along well with people
13	Initiative
14	Flexibility
15	Intelligence
16	Orientation to clear goals
17	Positive response to challenges
18	Independence
19	Responsiveness to suggestions and criticism
20	Time competence, efficiency
21	Ability to make decisions quickly
22	Responsibility
23	Foresight
24	Accuracy, thoroughness
25	Cooperativeness
26	Profit orientation
27	Ability to learn from mistakes
28	Sense of power
29	Pleasant personality
30	Egotism
31	Courage
32	Imagination
33	Perceptiveness
34	Toleration for ambiguity
35	Aggressiveness
36	Capacity for enjoyment
37	Efficacy
38	Commitment
39	Ability to trust workers
40	Sensitivity to others
41	Honesty, integrity
42	Maturity, balance

Source: John A. Hornaday, 'Research about living entrepreneurs', in C. Kent, D.L. Sexton and K.H. Vesper (eds), *Encyclopedia of Entrepreneurship*, Prentice-Hall, Englewood Cliffs, NJ, 1982, 26–7. © Adapted by permission.

Drive to achieve

Entrepreneurs are self-starters who appear to others to be internally driven by a strong desire to compete, to excel against self-imposed standards and to pursue and attain challenging goals. This **need to achieve** has been well documented in the entrepreneurial literature beginning with David McClelland's pioneering work on motivation in the 1950s and 1960s.[10] McClelland suggested that the key to entrepreneurial behaviour lies in the drive to excel, to achieve a goal in relation to a set of standards. High achievers take calculated risks. They examine a situation, determine how to increase the odds of winning and then push ahead. A high-risk decision for the average businessperson is often perceived as a moderate risk decision for the well-prepared high achiever.

Opportunity orientation

One clear pattern among successful, growth-minded entrepreneurs is their focus on opportunity. They start with the opportunity, marshal their resources, structure and strategy, and then let their understanding guide them. They are goal oriented in their pursuit of opportunities. Setting high but attainable goals enables them to focus their energies, selectively to sort out opportunities and to know when to say 'no'. Their goal orientation also helps them to define priorities and provides them with measures of how well they are performing.

Initiative and responsibility

Entrepreneurs are independent and highly self-reliant. Most researchers agree that effective entrepreneurs actively seek and take the initiative. They willingly put themselves in situations where they are personally responsible for the success or failure of the operation. They like to take the initiative in solving a problem or in filling a vacuum where no leadership exists. They also like situations where their personal impact on problems can be measured. This is the action-oriented nature of the entrepreneur expressing itself.

Persistent problem solving

Entrepreneurs are not intimidated by difficult situations. In fact, their self-confidence and general optimism seem to translate into a view that the impossible just takes a little longer. Yet they are neither aimless nor foolhardy in their relentless attack on a problem or an obstacle that is impeding business operations. If the task is extremely easy or perceived to be unsolvable, entrepreneurs often will give up sooner than others. Simple problems bore them; unsolvable ones do not warrant their time. Moreover, although entrepreneurs are extremely persistent, they are realistic in recognising what they can and cannot do and where they can get help in solving difficult but unavoidable tasks.

Seeking feedback

Effective entrepreneurs often are described as quick learners. Unlike many people, however, they also have a strong desire to know how well they are doing and how they might improve their performance. In attempting to make these determinations, they actively seek out mentors and use their feedback. Feedback is also central to their learning from their mistakes and setbacks.

Internal locus of control

Successful entrepreneurs believe in themselves. They do not believe the success or failure of their venture will be governed by fate, luck, or similar forces. They believe their accomplishments and setbacks are within their own control and influence and they can affect the outcome of their actions. This attribute is consistent with a high-achievement motivational drive, the desire to take personal responsibility and self-confidence. They believe that they can control the environment through their own actions.

Tolerance for ambiguity

Start-up entrepreneurs face uncertainty multiplied by constant change. This introduces ambiguity and stress into every aspect of the enterprise. Setbacks and surprises are inevitable; lack of organisation, structure and order is a way of life. Yet successful entrepreneurs thrive on the fluidity and excitement of such an ambiguous existence and generally have a high **tolerance for ambiguity**. Job security and retirement generally are of no concern to them.

Calculated risk-taking

Successful entrepreneurs are not gamblers. When they decide to participate in a venture, they do so in a very calculated, carefully thought-out manner. They do everything possible to get the odds in their favour and they often avoid taking unnecessary risks. These strategies include getting others to share inherent financial and business risks with them – for example, by persuading partners and investors to put up money, creditors to offer special terms and suppliers to advance merchandise.

Integrity and reliability

Integrity and reliability are the glue and fibre that bind successful personal and business relationships and make them endure. Investors, partners, customers and creditors alike value these attributes highly. Integrity and reliability help build and sustain trust and confidence. Small-business entrepreneurs, in particular, find these two characteristics crucial to success.

Tolerance for failure

Entrepreneurs use failure as a learning experience and generally have a high **tolerance for failure**. The iterative, trial-and-error nature of becoming a successful entrepreneur makes serious setbacks and disappointments an integral part of the learning process. The most effective entrepreneurs are realistic enough to expect such difficulties. Furthermore, they do not become disappointed, discouraged, or depressed by a setback or failure. In adverse and difficult times, they look for opportunity. Many of them believe they learn more from their early failures than from their early successes. Entrepreneurs differentiate between noble failure and stupid failure. Charles Schwab has a set of criteria for defining noble failure. Noble failures occur when:

- you have a good plan and know what you're doing, you've thought everything through carefully and have implemented with sufficient management discipline, that if you look back in review, you'd conclude it was thoughtfully done
- you have a reasonable contingency plan to deal with any initial failure and the contingency plan must have been implemented
- you need to debrief yourself and ask what you can learn from the experience that will lead your company to be smarter next time.[11]

High energy level

The extraordinary workloads and the stressful demands faced by entrepreneurs place a premium on energy. Many entrepreneurs fine-tune their energy levels by carefully monitoring what they eat and drink, establishing exercise routines and knowing when to get away for relaxation.

Creativity and innovativeness

Contrary to popular thought, creativity isn't necessarily more prevalent in the arts. Nor is it an exclusively inherited trait. An expanding school of thought believes creativity can be learned. It is a process marked by 'fluency, flexibility and ability to make unusual associations'.[12] New ventures often have a collective creativity that emerges from the joint efforts of the founders and personnel and produces unique goods and services. The bad news is that the uncreative are at a significant disadvantage in the new economy. The good news is, it turns out that exercise creativity can be learned. Chapter 5 provides a comprehensive examination of this critical characteristic.

Vision

Entrepreneurs know where they want to go. They have a **vision** or concept of what their firm can be. For example, Steve Jobs, one of the two founders of Apple Computer, wanted his firm to provide microcomputers that could be used by everyone from schoolchildren to businesspeople. The computer would be more than a machine. It would be an integral part of the person's life in terms of learning and communicating. This vision helped make Apple a major competitor in the microcomputer industry. Not all entrepreneurs have predetermined visions for their firm. In many cases this vision develops over time as the individual begins to realise what the firm is and what it can become.

Independence

The desire for independence is a driving force behind contemporary entrepreneurs. Their frustration with rigid bureaucratic systems, coupled with a sincere commitment to 'make a difference', adds up to an independent personality trying to accomplish tasks their own way. This is not to say entrepreneurs must make all the decisions; however, they do want the authority to make the important ones.

Self-confidence and optimism

Although entrepreneurs often face major obstacles, their belief in their ability seldom wavers. During these down periods they maintain their confidence and let those around them know it. This helps the others sustain their own optimism and creates the level of self-confidence necessary for efficient group effort. Many entrepreneurs are ego-centric. They want to be 'recognised' (see Bolton and Thompson's definition).

Team-building

The desire for recognition and autonomy does not preclude the entrepreneur's desire to build a strong entrepreneurial team. Successful entrepreneurs need to have highly qualified, well-motivated teams that help handle the venture's growth and development. In fact, although the entrepreneur may have the clearest vision of where the firm is (or should be) headed, the personnel are often more qualified to handle the day-to-day implementation challenges.[13]

THE DARK SIDE OF BEING AN ENTREPRENEUR

Do entrepreneurs suffer more from mental disorders? After all, it takes a little bit of madness to start a business and, just as surely, a business can drive one a little bit mad. A great deal of literature is devoted to extolling the rewards, successes and achievements of entrepreneurs. However, there is also a **dark side of entrepreneurship**. In examining this dual-edged approach to the entrepreneurial personality, Kets de Vries has acknowledged the existence of certain negative factors that may envelop entrepreneurs and dominate their behaviour.[14] Among entrepreneurs there are those who have failed and were exposed as well as those who have destroyed something that was important to others. For some it was an error of judgement – we called them 'failed entrepreneurs'. But some entrepreneurs exhibit criminal behaviour. It is no accident that many people associate the word

ENTREPRENEURSHIP IN PRACTICE

CHILDHOOD SHAPES THE FUTURE WHIZ-KIDS

They are hugely optimistic, full of energy and extremely exciting to be around. But they are also stubborn, single-minded and selfish. And they absolutely hate holidays.

Welcome to the fascinating world inside the mind of the entrepreneur, where risk is irrelevant, speed is vital – and failure is not an option.

In a bid to find out what makes them tick, a team of psychologists and business experts spent a day putting a group of entrepreneurs through a series of psychological tests for a new BBC2 series, called *Mind of a Millionaire*. What they found was rather surprising.

Adrian Atkinson, business psychologist with the consultancy Human Factor International and one of the program's experts, says: 'Entrepreneurs are different from the rest of us. They don't behave rationally in the way other people do. They're willing to risk everything to start a business. They pursue opportunities without regard for resources, preferring to create the opportunity and then find the money later.

'They believe that everything that happens, whether good or bad, is due to their actions.'

The result, he says, is great for the economy, which thrives on constant innovation and change, but not so good for dinner-party conversation.

'You wouldn't want to get stuck in a lift with an entrepreneur because most of them are not tremendously enjoyable companions', he says. 'They have this amazing focus and single-mindedness and they don't need relationships with other people. They just talk about business all the time.'

Atkinson says entrepreneurs can be divided into three distinct types: (1) Social entrepreneurs, such as Paul Harrod, whose company provides employment for the homeless. These entrepreneurs are driven by the desire to improve society; (2) Theme entrepreneurs, such as Anita Roddick, who start businesses within a particular defined area; and (3) Serial entrepreneurs, such as Richard Branson, who look for opportunities to create wealth anywhere and will often set up one company after another in quick succession.

All three types are, however, motivated by one of three factors – revenge, status or power. And the roots of that stem overwhelmingly from their childhood experiences.

Atkinson explains: 'Revenge entrepreneurs are driven to put right a social injustice to their family or to themselves, which they experienced as a child.

'Status entrepreneurs are driven to create a situation where they are highly respected by the people they think matter. Something in their childhood has made them feel excluded and they are determined to show the world that they fit in.

'Power entrepreneurs are driven by the desire to show people they can do whatever they want to do. What drives all of them is the desire to create wealth to appease their feelings of insecurity. It is not about money, it is about providing security from slipping back into their previous existence'.

René Carayul, a business adviser and another member of the program's team of experts, says one of the most fascinating characteristics of entrepreneurs is their absolute refusal to acknowledge failure.

He says: 'They don't do failure, they redefine it. Failure for them is a learning experience that will enable them to be even better. If they fall over, they just come straight back up again. I have never met such a bunch of optimistic people. Everything is an opportunity, the glass isn't half full, it's spilling over'.

Carayul says there are several things traditional business people can learn from the way entrepreneurs work. He says: 'Number one, making mistakes is okay. It's a necessary part of learning. Number two, speed is the key competitive advantage when you're in business now – it's not who does it better, it's who gets there first. Time used to be the enemy. It's now an assassin. And number three, play to your strengths'.

Sadly, for the rest of us, however, Carayul thinks that ultimately entrepreneurs are born, not made. He says: 'If you don't have that drive, that energy, that focus, then you can't make a chicken salad out of chicken s**t, no matter how you try'.

Source: Rachel Bridge, *sunday times*, nd, from [www.lesblind.is/dislexic1/index.cfm?ccs=149&cs=316]

'entrepreneur' with rogues and wheeler-dealers. Bolton and Thompson even have an entire chapter entitled 'Entrepreneurs in the shadows'. They examine:

- opportunist entrepreneurs who either adopt a flawed strategy or fail to deliver
- inventors who become failed entrepreneurs as they lack key project championing capabilities

- empire-builders who grow too quickly and lose control – sometimes involving a creative cover-up strategy
- entrepreneurs who make mistakes, or whose business fails, but who determinedly make a comeback
- entrepreneurs who attract controversy
- dishonest entrepreneurs.[15]

It is important to understand some of the potential harmful characteristics that entrepreneurs face.

The entrepreneur's confrontation with risk

Starting or buying a new business involves **risk**. The higher the rewards, the greater the risk entrepreneurs usually face. This is why entrepreneurs tend to evaluate risk very carefully.[16]

In an attempt to describe the risk-taking activity of entrepreneurs, Monroy and Folger developed a typology of entrepreneurial styles.[17] Figure 4.1 illustrates the classifications in terms of the **financial risk** endured when undertaking a new venture. In this model, the financial risk is measured against the level of profit motive (defined as the desire for monetary gain or return from the venture), with the characteristic or risk coupled with the type of activity. Profit-seeking activity is associated with the strong desire to maximise profit and activity seeking refers to other activities associated with entrepreneurship, such as independence or the work of the venture itself. The thrust of this theory argues that entrepreneurs vary in relation to their attitude toward risk and

FIGURE 4.1 TYPOLOGY OF ENTREPRENEURIAL RISK STYLES

Level of personal financial risk

		Low	**High**
Level of profit motive	**Low**	Risk avoiding Activity seeking	Risk accepting Activity seeking
	High	Risk avoiding Profit seeking	Risk accepting Profit seeking

Source: Thomas Monroy and Robert Folger, 'A typology of entrepreneurial styles: Beyond economic rationality', *Journal of Private Enterprise* IX(2) (1993): 64–79.

financial return. This typology highlights the need to explore in economic theory the styles or **entrepreneurial motivations** that deviate from the styles most characterising the rational person.

Not all entrepreneurs are driven solely by monetary gain and the level of financial risk cannot be completely explained by profit opportunity. Entrepreneurial risk is a far more complex issue than a simple economic risk-versus-return analysis. It should be noted that ‘People who successfully innovate and start businesses come in all shapes and sizes. But they do have a few things others do not. In the deepest sense, they are willing to accept risk for what they believe in’.[18]

Entrepreneurs face different types of risk. These can be grouped into four basic areas.[19]

Financial risk

In most new ventures the individual puts a significant portion of their savings or other resources at stake. This money or these resources will, in all likelihood, be lost if the venture fails. The entrepreneur also may be required to sign personally on company obligations that far exceed their personal net worth. The entrepreneur is thus exposed to personal bankruptcy. Many people are unwilling to risk their savings, house, property and salary to start a new business.

Career risk

A question frequently raised by would-be entrepreneurs is whether they will be able to find a job or go back to their old job if their venture should fail. **Career risk** is a major concern to managers who have a secure organisational job with a high salary and a good benefit package.

Family and social risk

Starting a new venture uses much of the entrepreneur’s energy and time. Consequently, their other commitments may suffer and there is increased **family and social risk**. Entrepreneurs who are married, and especially those with children, expose their families to the risks of an incomplete family experience and the possibility of permanent emotional scars. In addition, old friends may vanish slowly because of missed get-togethers.

Psychic risk

The greatest risk may be to the well-being of the entrepreneur. Money can be replaced; a new house can be built; spouse, children and friends can usually adapt. But some entrepreneurs who have suffered financial catastrophes have been unable to bounce back, at least not immediately. The **psychic risk** has proved to be too severe for them.

Stress and the entrepreneur

Some of the most common entrepreneurial goals are independence, wealth and work satisfaction. Research studies of entrepreneurs show that those who achieve these goals often pay a high price.[20] A majority of entrepreneurs surveyed had back problems, indigestion, insomnia, or headaches. To achieve their goals, however, these entrepreneurs were willing to tolerate these effects of stress. The rewards justified the costs.

What is entrepreneurial stress?

Entrepreneurs may be the masters of their own success, but they have so many variables to track and they often don’t have a safety net. In general, **stress** can be viewed as a function of:

- discrepancies between a person’s expectations and ability to meet demands
- discrepancies between the individual’s expectations and personality.

If a person is unable to fulfil role demands, then stress occurs. To the extent entrepreneurs' work demands and expectations exceed their abilities to perform as venture initiators, they are likely to experience stress.

One researcher has pointed out how entrepreneurial roles and operating environments can lead to stress. Initiating and managing a business require taking significant risk. As previously mentioned, these risks may be described as financial, career, family, social, or psychic. Also, entrepreneurs must engage in constant communication activities, interacting with relevant external constituencies including customers, suppliers, regulators, lawyers and accountants, which is stressful.

Lacking the depth of resources, entrepreneurs must bear the cost of their mistakes while playing a multitude of roles, such as salesperson, recruiter, spokesperson and negotiator. These simultaneous demands can lead to role overload. Owning and operating a business require a large commitment of time and energy, often at the expense of family and social activities. Finally, entrepreneurs are often working alone or with a small number of employees and therefore lack the support from colleagues that may be available to managers in a large corporation.[21]

In addition to the roles and environment that entrepreneurs experience, stress can result from a basic personality structure. Referred to as 'Type A' behaviour, this personality structure describes people who are impatient, demanding and overstrung. These individuals gravitate towards heavy workloads and find themselves completely immersed in their business demands. Some of the distinguishing characteristics associated with Type A personalities include:

- chronic and severe sense of time urgency – for instance, Type A people become particularly frustrated in traffic jams
- constant involvement in multiple projects subject to deadlines; somehow Type A people take delight in the feeling of being swamped with work
- neglect of all aspects of life except work – workaholics live to work rather than work to live
- a tendency to take on excessive responsibility, combined with the feeling that 'Only I am capable of taking care of this matter'
- explosiveness of speech and a tendency to speak faster than most people – Type A people are thus prone to ranting and swearing when upset.

A widespread belief in the stress literature is that Type A behaviour is related to coronary heart disease and that stress is a contributor to heart disease.[22]

Thus, to better understand stress, entrepreneurs need to be aware of their particular personality as well as the roles and operating environments that differentiate their business pursuits.[23]

Sources of stress

Boyd and Gumpert have identified four causes of entrepreneurial stress.[24]

- **Loneliness:** Although entrepreneurs are usually surrounded by others – employees, customers, accountants and lawyers – they are isolated from persons in whom they can confide. Long hours at work prevent them from seeking the comfort and counsel of friends and family members. Moreover, they tend not to participate in social activities unless they provide a business benefit.
- **Immersion in business:** One of the ironies of entrepreneurship is that successful entrepreneurs make enough money to partake of a variety of leisure activities, but they cannot take that exotic cruise, fishing trip, or skiing vacation because their business will not allow their absence. Most entrepreneurs are married to their business. They work long hours, leaving little time for civic organisations, recreation, or further education.

- **People problems:** Entrepreneurs must depend on and work with partners, employees, customers, bankers and professionals. Most experience frustration, disappointment and aggravation in their experiences with these people. Successful entrepreneurs are to some extent perfectionists and know how they want things done; often they spend a great deal of time trying to get lackadaisical employees to meet their performance standards. And, frequently, because of irreconcilable conflict, many partnerships are dissolved.
- **Need to achieve:** Achievement brings satisfaction. During the Boyd and Gumpert study, however, it became clear that a fine line exists between attempting to achieve too much and failing to achieve enough. More often than not, the entrepreneur was trying to accomplish too much. Many are never satisfied with their work no matter how well it was done. They seem to recognise the dangers (for example, to their health) of unbridled ambition, but they have a difficult time tempering their achievement need. They seem to believe that if they stop or slow down, some competitor is going to come from behind and everything they have built will fall apart.

Dealing with stress

It is important to point out that not all stress is bad. Certainly, if stress becomes overbearing and unrelenting in a person's life, it wears down the body's physical abilities. However, if stress can be kept within constructive bounds, then it could increase a person's efficiency and improve performance.[25]

Boyd and Gumpert made a significant contribution to defining the causes of entrepreneurial stress, but what makes their study particularly noteworthy is the presentation of stress reduction techniques – ways entrepreneurs can improve the quality of their business and personal lives.[26] Although classical stress reduction techniques, such as transcendental meditation, biofeedback, muscle relaxation and regular exercise, help reduce stress, Boyd and Gumpert suggest that another important step entrepreneurs can take is to clarify the causes of their stress. Having identified these causes, entrepreneurs then can combat excessive stress by:

- acknowledging its existence
- developing coping mechanisms
- probing unacknowledged personal needs.

Presented here are seven specific ways entrepreneurs can cope with stress.

- **Networking:** One way to relieve the loneliness of running a business is to share experiences by networking with other business owners. The objectivity gained from hearing about the triumphs and errors of others is itself therapeutic.
- **Getting away from it all:** The best antidote to immersion in business, report many entrepreneurs, is a holiday. If leave days or weeks are limited by valid business constraints, short breaks still may be possible. Such interludes allow a measure of self-renewal.
- **Communicating with employees:** Entrepreneurs are in close contact with employees and can readily assess the concerns of their staff. The personal touches often unavailable in large corporations, such as company-wide outings, flexible hours and small loans to tide workers over until payday, are possible. In such settings employees often are more productive than their counterparts in large organisations.
- **Finding satisfaction outside the company:** Countering the obsessive need to achieve can be difficult because the entrepreneur's personality is inextricably bound in the company fabric. Entrepreneurs need to get away from the business occasionally and become more passionate about life itself; they need to gain some new perspectives.
- **Delegating:** Implementation of coping mechanisms requires implementation time. To gain this time, the entrepreneur has to delegate tasks. Entrepreneurs find delegation difficult, because they think they have to be at the business all of the time and be involved in every

aspect of the operation. But if time is to be gained for alleviation of stress, then appropriate delegatees must be found and trained.

- **Mental-health check-up:** If others remark about the entrepreneur's unhappiness, then they should consider a mental-health check-up. It is just as important to know where they are mentally and psychologically as it is to have a regular physical exam.
- **Knowing self and business/life partners:** Entrepreneurs should use psychometric tests to identify key talent preferences, natural work styles, as well as those for whom they work.

The entrepreneurial ego

In addition to the challenges of risk and stress, the entrepreneur also may experience the negative effects of having an ego, especially in countries that value modesty and circumspection. In other words, certain characteristics that usually propel entrepreneurs into success also can be exhibited to their extreme. We examine four of these characteristics that may hold destructive implications for entrepreneurs.[27]

An overbearing need for control

Entrepreneurs are driven by a strong **need for control** – both their venture and their destiny. This internal focus of control spills over into a preoccupation with controlling everything. An obsession for autonomy and control may cause entrepreneurs to work in structured situations only when they have created the structure on their terms. This, of course, has serious implications for networking in an entrepreneurial team, since entrepreneurs can visualise the external control by others as a threat of subjection or infringement on their will. Thus, the same characteristic that entrepreneurs need for successful venture creation also contains within it the seeds of their own destruction.

Sense of distrust

To remain alert to competition, customers and government regulations, entrepreneurs are continually scanning the environment. They try to anticipate and act on developments that others might recognise too late. This distrustful state can result in their focusing on trivial things, causing them to lose sight of reality, to distort reasoning and logic, and to take destructive actions. Again, distrust is a dual-edged characteristic.

Overriding desire for success

The entrepreneur's ego is involved in the desire for success. Although many of today's entrepreneurs believe they are living on the edge of existence, constantly stirring within them is a strong desire to succeed in spite of the odds. Thus the entrepreneur rises up as a defiant person who creatively acts to deny any feelings of insignificance. The individual is driven to succeed and takes pride in demonstrating that success. Therein lie the seeds of possible destructiveness. If the entrepreneur seeks to demonstrate achievement through the erection of a monument – such as a huge office building, an imposing factory, or a plush office – then the danger exists that the individual will become more important than the venture itself. Losing perspective like this can, of course, be the destructive side of the desire to succeed.

Unrealistic optimism

The ceaseless optimism that emanates from entrepreneurs (even through the bleak times) is a key factor in the drive towards success. Entrepreneurs maintain a high enthusiasm level that becomes an **external optimism** which allows others to believe in them during rough periods. However, when taken to its extreme, this optimistic attitude can lead to a fantasy approach to the business. A self-deceptive state may arise in which entrepreneurs ignore trends, facts and reports and delude themselves into thinking everything will turn out fine. This type of behaviour can lead to an inability to handle the reality of the business world.

These examples do not imply that all entrepreneurs fall prey to these scenarios nor that each of the characteristics presented always gives way to the ‘destructive’ side. Nevertheless, all potential entrepreneurs need to know that the dark side of entrepreneurship exists.

ENTREPRENEURIAL MOTIVATION

Examining why people start businesses and how they differ from those who do not (or those who start unsuccessful businesses) may help explain how the motivation that entrepreneurs exhibit during start-up is linked to the sustaining behaviour exhibited later. Lanny Herron and Harry J. Sapienza have stated, ‘Because motivation plays an important part in the creation of new organisations, theories of organisation creation that fail to address this notion are incomplete’.[28]

Researcher Bradley Johnson, in his review of achievement motivation and the entrepreneur, stated, ‘It remains worthwhile to carefully study the role of the individual, including his or her psychological profile. Individuals are, after all, the energisers of the entrepreneurial process’.[29]

MELTDOWN: ARE YOU LOSING IT?

ENTREPRENEURIAL EDGE

Scott Corlett, founder of Internet retailer NexGift, was 22 years old when he launched the first of his three start-ups. In spite of his youth, the stress of running a new business with 50 employees and a stop-and-go cash flow got to him. Twice, the San Diego gift manufacturer landed in the hospital with severe chest pains. They turned out to be anxiety attacks caused by the triple whammy of long hours, little sleep and the unrelenting pressures of running the company. Corlett says he can’t put his finger on any specific trigger. The pressure just built up. In his first four years in business he had six of these episodes, one so severe that paramedics had to cart him out of his office on a stretcher. Each time, the diagnosis was the same: stress. ‘I love the start-up period when you are running a company and doing the undoable, but my body couldn’t handle the stress back then’, he recalls. ‘I’m now 36 with three children, so I’ve settled down. I’m still an entrepreneur and I still drive myself and my company hard. Now, though, I have people that I communicate with to relieve a lot of that stress’.

Even more normal type A personalities can find the top of a business a lonely, frightening place if they’ve neglected relationships along the way. Entrepreneurs do best when they have strong and supportive networks. A network, in fact, is what saved Carol Frank, the owner of Avian Adventures, from emotional and business collapse. In 1999, a competitor stole her company’s sole supplier of the ornate birdcages she sells. It was a devastating loss. She had no product and the rival put her out of business for months until she could find another one. Frank says she became so stressed that she sank into an isolated funk and didn’t date for an entire year. ‘I just felt like I had nothing to give anybody’, she recalls. Fortunately, she didn’t shun her fellow members of Group One, a confidential forum within the Dallas chapter of the Young Entrepreneurs Organization. ‘When you run a business, you don’t want to admit to your employees – or to anyone – that things aren’t going well, so being able to bounce things off other entrepreneurs who have gone through the same things is invaluable’, she says. ‘With the help of friends in YEO, I eventually found another manufacturer, too’.

Source: Wes Smith, ‘Meltdown: Are you losing it?’, *Business Week*, 23 April 2001.

ENTREPRENEURIAL EDGE

ENTREPRENEURIAL FEAR 101

The fear an entrepreneur experiences has its own taste, its own smell and its own gut wrenching pain. And it does not go away as long as the person remains an entrepreneur. It becomes an education that entrepreneurs experience – Entrepreneurial Fear 101. Although the course is very exclusive, admission is automatic; permission is neither needed nor sought, and tenure is indefinite. The fear entrepreneurs experience cannot be expected, cannot be escaped and cannot be prepared against. Because most entrepreneurs do not admit they have experienced this entrepreneurial fear, it remains a deep, dark secret. And because it is not talked about, most entrepreneurs feel they are the only ones who have ever experienced it.

According to Wilson Harrell, an entrepreneur from Jacksonville, Florida, USA this entrepreneurial fear is much different from simple fear. Fear is usually accidental, unexpected and short lived, such as the sudden rush of adrenaline experienced when you almost get hit by a bus, he explains. On the other hand, entrepreneurial fear is self-inflicted. It is a private world where no sleep occurs and wide-awakening nightmares filled with monsters constantly try to destroy every morsel of the entrepreneur's being.

What causes this fear? Well, it is not the money, for any entrepreneur will explain that money is just a bonus of the accomplishment and losing money is one of the risks taken. Fear of failure has a lot to do with it. Entrepreneurs do not want to become just another businessperson and pass into oblivion without leaving their mark. What induces this complex fear has yet to be determined.

For Harrell, the fear came while starting his own food brokerage business to sell products on military bases in Europe. Harrell was appointed a representative of Kraft Food Company and did so well increasing its sales that he sold himself out of a job. Because he had made his job look so easy, it was suggested to Kraft's management team that its own salespeople could do the work better and cheaper. So what did Harrell do? Because losing the Kraft account would put him out of business, he put everything on the line and proposed that if Kraft kept brokering through his company and took over the brokering in Germany, then Harrell would help it take over the food industry everywhere. After Harrell experienced 30 days of immeasurable terror, Kraft made the decision to trust Harrell and continue brokering through his company. Although he later sold his business, 30 years later the company still represents Kraft, Inc., not only in Europe but also in the Far East and many other countries. The company has grown into the largest military-representative organisation in the field and was sold in 1985 for more than $40 million.

What is the secret to entrepreneurship, given such fear? Its reward. No matter what pain is experienced through the fear, the elation felt from success subsides it. That high, along with fear, is an emotion reserved for entrepreneurs and becomes food for spirit. Addicting? It is more like a roller-coaster ride. In the beginning, imagine pulling yourself up the incline very slowly, making any tough decisions with a growing sense of excitement and foreboding. Then when you hit the top, for a brief moment it is frightening and the anticipation accelerates before you feel no more feelings of control. As you go screaming into the unknown, fear takes over. At first, all you feel is fear; then, suddenly, the ride is over, the fear is gone, but the exhilaration remains. What is next for the entrepreneur? He or she buys another ticket.

So what is the key ingredient for entrepreneurial success? According to Wilson Harrell, it is the ability to handle fear. For he believes it is the lonely entrepreneur living with his or her personal fear who breathes life and excitement into an otherwise dull and mundane world.

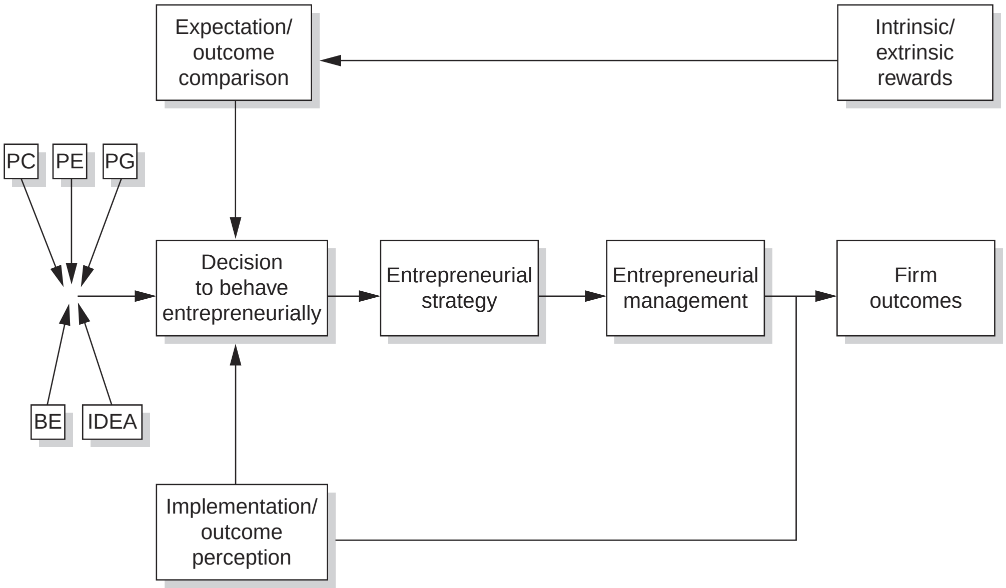
Source: Wilson Harrell, 'Entrepreneurial terror', *Inc.* (February 1987): 74–6.

Thus, although research on the psychological characteristics of entrepreneurs has not provided an agreed-on 'profile' of an entrepreneur, it is still important to recognise the contribution of psychological factors to the entrepreneurial process.[30] In fact, the quest for new-venture creation as well as the willingness to sustain that venture is directly related to an entrepreneur's motivation. One research study examined the importance of satisfaction to an entrepreneur's willingness to remain with the venture. Particular goals, attitudes and backgrounds were all important determinants of an entrepreneur's eventual satisfaction.[31] In that vein, one research approach examines the motivational process an entrepreneur experiences.[32] Figure 4.2 illustrates the key elements of this approach.

The decision to behave entrepreneurially is the result of the interaction of several factors. One set of factors includes the individual's personal characteristics (PC), the individual's personal environment (PE), the relevant business environment (BE), the individual's personal goal set (PG) and the existence of a viable business idea.[33] In addition, the individual compares their perception of the probable outcomes with the personal expectations they have in mind. Next, an individual looks at the relationship between the entrepreneurial behaviour they would implement and the expected outcomes.

According to the model, the entrepreneur's expectations are finally compared with the actual or perceived firm outcomes. Future entrepreneurial behaviour is based on the results of all of these comparisons. When outcomes meet or exceed expectations, the entrepreneurial behaviour is positively reinforced and the individual is motivated to continue to behave entrepreneurially, either within the current venture or possibly through the initiation of additional ventures, depending on the existing entrepreneurial goal. When outcomes fail to meet expectations, the

FIGURE 4.2 **A MODEL OF ENTREPRENEURIAL MOTIVATION**



PC = personal characteristics
PE = personal environment
PG = personal goals
BE = business environment

Source: Douglas W. Naffziger, Jeffrey S. Hornsby and Donald F. Kuratko, 'A proposed research model of entrepreneurial motivation', *Entrepreneurship Theory and Practice* (Spring 1994): 33.

entrepreneur's motivation will be lower and will have a corresponding impact on the decision to continue to act entrepreneurially. These perceptions also affect succeeding strategies, strategy implementation and management of the firm.[34]

SOURCES OF RESEARCH ON ENTREPRENEURS

The best source of information about the entrepreneurial edge is direct observation of practising entrepreneurs. Through the use of interviews, surveys and case studies, the experiences of individual entrepreneurs can be related. Analysis of these experiences can provide insights into the traits, characteristics and personalities of individual entrepreneurs and leads to the discovery of commonalities that help explain the perspective. At the end of this chapter you'll find an exciting experiential exercise called 'The interview of an entrepreneur'.

Another big source is publications, research-based as well as popular.[35] The following are among the more important of these publications:

- **Technical and professional journals:** These are refereed journals that contain articles dealing with research – methodology, results and application of results – that are well designed and tightly structured (see below).
- **Textbooks on entrepreneurship:** These texts typically address the operation of small firms and non-profit organisations. Sections or chapters are frequently devoted to research on entrepreneurs.[36]
- **Books about entrepreneurship:** Most of these books are written as practitioners' 'how-to' guides. Some deal with the problems facing the individual who starts a business; others deal with a specific aspect of the subject. Examples include *The Big Jump into Entrepreneurship*, *Entrepreneur's Blueprint: Strategies and Lessons for Success*, *Small Business Start-up Guide*, *Building a Lemonade Stand is Not Just for Kids Anymore* and *Entrepreneurship for Dummies.*[37]
- **Biographies or autobiographies of successful, failed and dishonest entrepreneurs:** Examples include *Business at the Speed of Thought* and *Radicals and Visionaries*.[38]
- **Magazines:** Many newspapers and news periodicals run stories on entrepreneurs either regularly or periodically. Examples include *Fast Company* (USA), 'Entrepreneur' special supplement to the *Australian* (Australia), *BRW* (Australia), *Unlimited* (New Zealand), *Ideolog* (New Zealand), *Entrepreneur* (USA), *Economist* (UK).
- **Newsletters:** Several newsletters are devoted exclusively to entrepreneurship such as those from the National Dialogue on Entrepreneurship and the Kauffman Foundation.
- **Proceedings of conferences:** Publications relating to annual or periodic conferences deal at least in part with entrepreneurship. Examples include *Proceedings of the Academy of Management*, *Proceedings of the International Council for Small Business*, *Proceedings of the US Association for Small Business and Entrepreneurship, Frontiers in Entrepreneurship Research* (proceedings of the Babson College Annual Entrepreneurship Conference), *Regional Frontiers of Entrepreneurship Research (proceedings of the annual Australian Graduate School of Entrepreneurship Conference).*
- **Government publications:** The best publications come from the Small Business Administration (USA) and the Organisation for Economic Cooperation and Development (France).

The final source of entrepreneurial information is speeches and presentations (including seminars) by practising entrepreneurs. This source may not go as far in-depth as the others do, but it does provide an opportunity to learn about the entrepreneurial edge. Entrepreneur-in-residence programs at various universities illustrate the added value oral presentations may have in educating people about entrepreneurship.

TABLE 4.3: REFEREED ACADEMIC JOURNALS IN THE FIELD OF ENTREPRENEURSHIP

- *Academy of Entrepreneurship Journal*
- *Asian Journal of Business and Entrepreneurship*
- *Creativity and Innovation Management*
- *Economic Analysis: A Journal of Enterprise and Participation*
- *Entrepreneurial Executive*
- *Entrepreneurship Development Review*
- *Entrepreneurship, Innovation and Change*
- *Entrepreneurship and Regional Development*
- *Entrepreneurship: Theory and Practice*
- *Enterprise and Innovation Management Studies*
- *Family Business Review*
- *International Journal of Entrepreneurial Behaviour and Research*
- *International Journal of Entrepreneurship*
- *International Journal of Entrepreneurship and Innovation*
- *International Journal of Entrepreneurship and Innovation Management*
- *International Journal of Entrepreneurship and Small Business*
- *International Journal of Technological Innovation and Entrepreneurship*
- *International Small Business Journal*
- *Journal of Applied Management and Entrepreneurship*
- *Journal of Business and Entrepreneurship*
- *Journal of Business Strategies*
- *Journal of Business Venturing*
- *Journal of Creative Behavior*
- *Journal of Developmental Entrepreneurship*
- *Journal of Enterprising Culture*
- *Journal of Entrepreneurship*
- *Journal of Entrepreneurship Education*
- *Journal of Extension*
- *Journal of International Business and Entrepreneurship*
- *Journal of Microfinance*
- *Journal of Private Enterprise*
- *Journal of Private Equity*
- *Journal of Small Business and Enterprise Development*
- *Journal of Small Business and Entrepreneurship*
- *Journal of Small Business Management*
- *Journal of Small Business Strategy*
- *Journal of Technology Transfer*
- *New England Journal of Entrepreneurship*
- *Small Business Economics*
- *Small Business and Enterprise Development*
- *Small Enterprise Development: An International Journal*
- *Southern Africa Journal for Entrepreneurship and Small Business*
- *Small Enterprise Research: The Journal of SEAANZ*
- *Venture Capital Journal*

Refereed journals in entrepreneurship and small business

The academic literature in the fields of enterprise and entrepreneurship is vast and deep with at least 45 dedicated refereed academic journals (see Table 4.3).[39] Assuming four issues per year of eight articles, that means that there are about 1400 new articles coming out annually. This does not include the mainstream management journals that are devoting more issues (some special issues) to entrepreneurship. Nor does it count the thousands of conference papers presented each year. The literature has long reached the point where it would be impossible for any individual to read all refereed journal articles. Use the electronic library databases to access these invaluable resources.

SUMMARY

In attempting to explain the 'entrepreneurial edge' within individuals, this chapter presented the most common characteristics exhibited by successful entrepreneurs. Then a review of the 'dark side' of entrepreneurship revealed certain negative factors that can arise when entrepreneurs overextend their characteristics. Finally, a motivational model of entrepreneurship was discussed.

Several studies have been conducted to determine the personal qualities and traits of successful entrepreneurs. Some of these were examined in the chapter: commitment, determination

and perseverance; drive to achieve; opportunity orientation; initiative and responsibility; persistent problem solving; seeking feedback; internal locus of control; tolerance for ambiguity; calculated risk-taking; integrity and reliability; tolerance for failure; high energy level; creativity and innovativeness; vision; independence; self-confidence and optimism; and team building.

The next part of the chapter focused on the dark side of entrepreneurship, including the confrontation with risk, the problems of stress and the particular traits that may permeate the entrepreneurial ego. We also examined failure as a basic human trait.

Next, the chapter introduced a model of entrepreneurial motivation. Recognising the contribution of psychological factors to the process of entrepreneurship, this model demonstrated the importance of entrepreneurs' perceived expectations and actual outcomes in their motivation to start and sustain a venture.

Finally, it is important to recognise that many sources of information relating to the entrepreneurial edge exist. Three major ones are direct observation, presentations by or case studies of practising entrepreneurs and publications.

KEY TERMS AND CONCEPTS

calculated risk-taking
career risk
dark side of entrepreneurship
delegating
drive to achieve
entrepreneurial behaviour
entrepreneurial edge
entrepreneurial motivation
external optimism
family and social risk
financial risk
immersion in business
loneliness
need for control
need to achieve
networking
opportunity orientation
psychic risk
risk
stress
tolerance for ambiguity
tolerance for failure
vision

REVIEW AND DISCUSSION QUESTIONS

1. What do we mean when we say societies have had differing attitudes towards entrepreneurs? Can you describe your own society's attitudes?
2. How do the following traits relate to entrepreneurs: desire to achieve, opportunity orientation, initiative and responsibility?
3. Some of the characteristics attributed to entrepreneurs include persistent problem solving, continuous seeking of feedback and internal locus of control. What does this mean?
4. Entrepreneurs have a tolerance for ambiguity, are calculated risk-takers and have a high regard for integrity and reliability. What does this mean?
5. Is it true that most successful entrepreneurs have failed at some point in their business careers? Explain.
6. In what way is 'vision' important to an entrepreneur? Self-confidence? Independence?
7. Entrepreneurship has a 'dark side'. What is meant by this statement?
8. What are the four specific areas of risk that entrepreneurs face? Describe each.
9. What are four causes of stress among entrepreneurs? How can an entrepreneur deal with each of them?
10. Describe the factors associated with the entrepreneurial ego.
11. What is the concept of entrepreneurial motivation?
12. How does the model depicted in the chapter illustrate an entrepreneur's motivation?
13. Identify and describe the three major sources of information that supply data related to the entrepreneurial edge.
14. Describe as best you can who you think of as entrepreneurs in your company or organisation.
15. Describe the roles you take which contribute to the entrepreneurial process in your organisation.
16. To what extent do you experience 'going with the flow' and/or stress in your work? How could you increase the incidence of flow and mitigate the effects of stress?

EXPERIENTIAL EXERCISE
ENTREPRENEURIAL SELF-ASSESSMENT

Are you the entrepreneurial type? Go to [www.bdc.ca/en/home.htm] and follow the links to Business tools/Entrepreneurial Self-Assessment and complete the questionnaire. Your overall score describes your profile compared to other entrepreneurs.

EXPERIENTIAL EXERCISE
THE INTERVIEWING OF AN ENTREPRENEUR

TIPS ON HOW TO CONDUCT THE INTERVIEW

You will conduct a formal interview with an entrepreneur. Find someone who is currently (in the past three years) starting a business, who owns at least 51% of the business and has paid wages to someone other than him/herself. Be sure to get the person to commit to at least 45 minutes. Record the date, place of interview, person's name. What is this person's position, your relationship to him/her? The final section of the write up should address how the findings of the interview apply or are meaningful to you. What did you learn or discover that has meaning for your own plans, for your own future?

The interview must be approached rigorously, not casually. You should be prepared with the questions in advance. Rehearse them with a friend in a mock interview. Develop an efficient means of taking notes or capturing the key points of the entrepreneur. Establish a personal rapport (take the entrepreneur out to lunch!). Do not just deal with the superficial questions and answers. The key is to probe, to ask why, to delve beneath the surface. Try to cut through the propaganda. Be sure to examine the effect of the venture on the person's total life. Here are some guides for questions.

THE ENTREPRENEUR BEFORE STARTING THE VENTURE

- What is your education background?
- What is your previous work experience (before starting the venture)?
- Did you have any role models when growing up?
- Did you do entrepreneurial things as a youth?
- When did you know you wanted to be an entrepreneur?
- Did you have parents who were entrepreneurial?

THE ENTREPRENEUR AT THE TIME HE/SHE STARTED THE VENTURE

- What was your primary motivation for starting a business? What were the factors that led you to start the venture?
- What were your goals at the time you started the venture?
- What sort of beliefs did you have (e.g. about employees, partners, debt, etc.)?
- Did you seek to establish a 'lifestyle' business, a 'rapid growth' business, or what? Did your growth orientation change over time?
- What sort of resources (not just financial) did you have when you started the venture? What sort of network did you have? Were there any especially creative things you did to come up with the needed resources?
- How concerned were you with control when starting the venture? Explore the entrepreneur's need for control (of the venture, of people, of decision making).
- What was your risk orientation when you started the venture?
- Did you write a business plan?
- Did you feel prepared to start the venture at the time you started it?
- How long was a typical work day and work week when you first started your venture?

THE ENTREPRENEUR AS SHE/HE GREW THE VENTURE

- How have your goals and values changed since starting the venture?
- Did your risk orientation change as the venture grew?
- Did your need for control change as the venture grew?
- Did the typical work week change as the venture grew (in terms of how much time the venture required and in terms of how you allocated your time?
- Did you make assumptions when you first started out that subsequently proved to be wrong? What sorts of insights were gained?

- What key mistakes did you make along the way? What were some of the key lessons learned? (their greatest moment and their worst moment)
- Were there some critical points in the development of the venture when the venture almost failed, or when you found yourself at a critical crossroads in terms of some vital decision or issue that had to be addressed in a certain way or the venture would have failed?

THE ENTREPRENEUR TODAY AND TOMORROW

- What would you do differently if you had it all to do over again?
- What key personal characteristics do you see in yourself that were especially critical for achieving success with this particular venture?
- What are your plans for the future in terms of the venture?
- What is your 'exit strategy' or do you not have one?
- What advice, based on your own experience, do you have for a student interested in starting a venture today?

Source: Michael Morris, 'The business model, marketing inventions, the entrepreneurial audit and the interview of an entrepreneur as learning vehicles', presentation at 'Experiential classroom: Lifelong learning for entrepreneurship education professions' (Syracuse University: September 2004). For further information on this yearly program, see [sominfo.syr.edu/eee/Falcone/classroom].

EXPERIENTIAL EXERCISE

RECOGNISE YOURSELF?

Which of these categories do you fit into? *Business Week* once segmented entrepreneurs into various groups. What does psychographic research say about you?

You know you're perfectly sane. But that doesn't mean you can't be pigeonholed by your attitudes, foibles and neuroses. It's a science known as psychographics and people who study small biz say it brings a sense of order to a diverse group. One problem: Psychographic definitions can get pretty diverse, too, depending on the focus. Some samples:

SELF IMAGE (WARRILLOW & CO.)

- Mountain Climbers (10% of entrepreneurs): Insatiable appetite for achievement. Live for fast growth. Win awards and media coverage. Demand excellence.
- Freedom Fighters (30% of entrepreneurs): Value independence above all. Started own company to 'call the shots'. Want to build a successful business and still have a life.
- Craftspeople (60% of entrepreneurs): Don't think of themselves as small-biz owners. Defined by profession (jeweller, plumber, caterer) and value mastery of craft.

WORK HABIT (PITNEY BOWES/YANKELOVICH)

- Idealists (24% of entrepreneurs): Passionate about an idea they want to bring to life, but dislike details of running a business and finance. Seek work–life balance.
- Optimisers (21% of entrepreneurs): Enjoy their work. Seek efficiency. Savvy on finance and tech. Focus on profits, not size. Confident, happy with work–life balance.
- Hard Workers (20% of entrepreneurs): Growth, growth, growth – whatever it takes. Want a bigger company with growth in revenue, staff. They sweat all the details.
- Jugglers (20% of entrepreneurs): Worriers and control freaks. Pressed for time. Proud of ability to juggle. Want to grow to 'promised land' where worries are over.
- Sustainers (15% of entrepreneurs): Just trying to make a living. Want comfort, stability and to keep things the way they are. Good work–home balance. Not into technology.

BY OBJECTIVE (WUNERMAN/CATO/JOHNSON)

- Success (20% of entrepreneurs): Optimists who want to win. They value quick growth, money and material possessions. They want control and status.
- Big Idea (16% of entrepreneurs): Risk taking mavericks who seek social validation and creative fulfilment. Informal, intuitive, value self-satisfaction.
- People (23% of entrepreneurs): Want to create a good place to work and do business. Integrate work, home, community. Value emotional support, loyalty, respect.

- Security (10% of entrepreneurs): The Goal: Less stress, more leisure time. Value integrity. Cautious but optimistic.
- Survival (31% of entrepreneurs): Pessimists. Feel put upon; just want to stay in business.

Source: 'Recognize Yourself? See what psychographics says about you', *Business Week*, 23 April 2001.

RECOMMENDED CASES FROM HARVARD BUSINESS SCHOOL ONLINE

HARVARD BUSINESS
SCHOOL PUBLISHING

www.hbsp.harvard.edu

Leadership in Crisis: Ernest Shackleton and the Epic Voyage of the *Endurance*

Publication date: 3 April 2003
Revision date: 16 June 2003
Author(s): Nancy F. Koehn, Erica Helms, Phillip Mead
Product number: 9-803-127

Provides an opportunity to examine leadership and entrepreneurship in the context of Ernest Shackleton's 1914 Antarctic expedition, a compelling story of crisis, survival and triumph.

Candy Land: The Utopian Vision of Milton Hershey

Publication date: 5 April 2005
Author(s): Nancy F. Koehn, Erica Helms
Product number: 805066

Explores the life, work and achievements of Milton S. Hershey. Analyses his entrepreneurial achievements, including the creation of the Hershey bar, the founding of the business and the development of the mass market for chocolate. Also investigates the broader contributions that Milton Hershey made to a sustainable, mutually beneficial social contract between business and community.

Jack on Jack: The HBR Interview

Publication date: 1 February 2002
Author(s): Jack F. Welch Jr., Harris Collingwood, Diane L. Coutu
Product number: R0202G

There was a time when CEOs weren't celebrities, but that was before Jack Welch. Over the past 20 years, Welch, more than any other business leader, has changed the way people view the role of the CEO. In this frank and wide-ranging interview with HBR senior editors Harris Collingwood and Diane Coutu, Welch replies to his critics and offers a detailed look at his theory and practice of business.

When Everything Isn't Half Enough

Publication date: 1 March 2000
Author(s): Suzy Wetlaufer, Edward M. Hallowell, Scott Neely, Jean Hollands, Manfred F.R. Kets de Vries
Product number: R00211

Norman Spencer, who grew up poor, worked for two decades to make his investment firm successful and his family wealthy. The company he founded, Arrowhead, is now known on Wall Street as a top-notch boutique firm with $25 billion in assets under management. But at the pinnacle of his career, Norman feels as though he's drowning. Norman's success only makes him feel numb and his home life is a disaster. What is wrong with Norman and how can he fix it? … commentators Edward M. Hallowell, Scott Neely, Jean Hollands and F.R. Manfred Kets de Vries offer advice on this fictional case study.

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Online reading

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UNDERSTANDING INNOVATION AND DEVELOPING CREATIVITY

5

You see things as they are and ask, 'Why?' I dream of things that never were and ask 'Why not?'

George Bernard Shaw

CHAPTER OBJECTIVES

1. To introduce the four major types of innovation: invention, extension, duplication and synthesis
2. To define and illustrate the sources of innovation for entrepreneurs
3. To review some of the major myths associated with innovation and to define the 10 principles of innovation
4. To describe financial support for innovation, both governmental and venture capital, in the Asia–Pacific
5. To examine the role of creativity and to review the major components of the creative process: knowledge accumulation, incubation process, idea evaluation and implementation
6. To present ways of developing personal creativity: recognise relationships, develop a functional perspective, use your 'brains' and eliminate muddling mind-sets

INNOVATION AND THE ENTREPRENEUR

Innovation is a key function in the entrepreneurial process. Josef Schumpeter, the father of modern entrepreneurship theory, defined economic innovation in 1934:

> 1) The introduction of a new good – that is one with which consumers are not yet familiar – or of a new quality of a good. 2) The introduction of a new method of production, which need by no means be founded upon a discovery scientifically new and can also exist in a new way of handling a commodity commercially. 3) The opening of a new market, that is, a market into which the particular branch of manufacture of the country in question has not previously entered, whether or not this market has existed before. 4) The conquest of a new source of supply of raw materials or half-manufactured goods, again irrespective of whether this source already exists or whether it has first to be created. 5) The carrying out of the new organisation of any industry, like the creation of a monopoly position … or the breaking up of a monopoly position.[1]

And most authors agree with Drucker about the concept of innovation: 'Innovation is the specific function of entrepreneurship … It is the means by which the entrepreneur either creates new wealth-producing resources or endows existing resources with enhanced potential for creating wealth'.[2]

In essence, innovation is the process by which entrepreneurs convert opportunities into marketable ideas. It is the conversion of new knowledge into new products and services. It is the means by which ideas become catalysts for change.

More than just a bright idea

The innovation process is more than just a good idea. The origin of an idea is important and the role of creative thinking may be vital to that development.[3] However, a major difference exists between an idea arising from mere speculation and one that is the product of extended thinking, research, experience and work. More important, a prospective entrepreneur must have the desire to bring a good idea through the development stages. Thus, innovation is a combination of the vision to create a good idea and the perseverance and dedication to remain with the concept through implementation.

Entrepreneurs blend imaginative and creative thinking with systematic, logical process ability. This combination is a key to success. In addition, potential entrepreneurs are always looking for unique opportunities to fill needs or wants. They sense economic potential in business problems by continually asking 'If only they …', 'What if …?' or 'Why not …?' They develop an ability to see, recognise and create opportunity where others find only problems. It has been said that the first rule for developing entrepreneurial vision is to recognise that problems are to solutions what demand is to supply. Applying this rule means an entrepreneur will analyse a problem from every possible angle: What is the problem? Whom does it affect? How does it affect them? What costs are involved? Can it be solved? Would the marketplace pay for a solution? This is the type of analysis that blends creative thinking with systematic analysis.[4]

In order to give a better perspective of this entrepreneurial vision, this chapter is devoted to examining the role of **creativity** and the innovation process. These two major topics are keys to understanding opportunity and its development for entrepreneurs.

ENTREPRENEURSHIP IN PRACTICE

TOP INVENTIONS IN OUR REGION

- **Lawn-mower:** Australian Mervyn Victor Richardson developed the Victa rotary lawn-mower in August 1952. It was not the first rotary lawn-mower ever developed, but it was cheaper, lighter and easier to use than the mowers that came before.
- **Incat Catamarans:** During the 1990s, large catamaran ferries made of aluminium started operating on ferry routes around the world. These ferries, first made by Incat in Hobart, Tasmania, operated at twice the speed of conventional ferries and had very short 'turnaround' times, allowing operators to provide twice as many trips as before and dramatically reduce travel times for their passengers.
- **Australian tea tree oil:** The Aboriginal Bunjulung people of the NSW north coast use it to take the sting out of cuts and insect bites and to successfully treat bacterial, viral and fungal infections. The tea tree industry has developed dramatically from one relying on harvesting of naturally occurring plants to one characterised by highly mechanised intensive plantations. Australia leads the world in the supply of high quality tea tree oil and associated products.
- **Hills Hoist:** The Australian Hills Hoist is a rotary clothes line fitted with a hoist operated by a crown and pinion winding mechanism which allows the frame to be raised and lowered. It was developed and marketed by Lance Hill in 1945 after he returned from World War II.
- **Cochlear – the bionic ear:** The Australian bionic ear is the result of pioneering research commenced by Professor Graeme Clark in the late 1960s at the University of Melbourne Department of Otolaryngology. The device analyses the complex speech signal and presents it as electrical stimulation to the hearing nerve so that speech could be understood.
- **Stump jump plough:** The South Australian stump jump plough was designed to allow the farmers to jump their equipment over stumps in their way thereby protecting their machinery and avoiding the cost of having to remove each stump.
- **Plastic banknotes:** Australia was the first country to have all polymer banknotes, but the rest of the world is starting to follow our lead. Note Printing Australia has produced banknotes for Thailand, Indonesia, Papua New Guinea, Kuwait, Western Samoa, Singapore, Brunei, Sri Lanka and New Zealand.
- **Woomera:** Hunters all over the world have used spears but the 'woomera', a type of spear thrower, is a unique Aboriginal invention. A woomera is a simple lever that acts to increase the speed at which a spear is thrown and thus increase the distance it travels.
- **Bungy jumping:** A.J. Hackett spent two years working with the University of Auckland developing a special cord made up entirely of individual rubber strands which, when attached to the ankles, could be used to bungy jump from a fixed platform. They originally got the idea from watching native tribes in Papua New Guinea who used forest vines to leap from manmade towers, an initiation rite often with tragic consequences.
- **Seismic isolators:** No one else in the world had thought of it before New Zealand engineer Bill Robinson. Today many prominent buildings around the world are made safe from earthquakes by earthquake bearings that can move sideways as well as up and down.
- **Flight:** It was actually New Zealand's Richard Pearse, not the Wright Brothers, who was first to fly. The quintessential 'mad scientist' inventor, he didn't realise the historic importance of the event and so didn't bother to have any photographs taken of his machine flying, although there is extensive evidence from witnesses describing his flights eight months before the Wright Brothers. What distinguished the Wright Brothers was sustained controlled flight and their focus on building a business out of this invention.
- **Driverless metro train:** The newest addition to Singapore's impressive transport system is the world's first heavy driverless metro train.
- **Metal-fuel engine:** InventQjaya has developed a metal-fuel engine, which is 100 per cent Malaysian made, that is powered by zinc-air fuel cells. The engine could generate and store energy, is rechargeable and refuellable, has a short refuelling time, is equipped with a rechargeable exhaust fuel and is environmentally friendly.
- **X-ray crystallography:** Father and son, Sir William Henry Bragg and Sir William Lawrence Bragg of Adelaide shared the 1915 Nobel Prize for their studies of X-ray spectra crystal structure. This tool allowed many different types of crystals to be analysed.

- **Black box flight recorder:** The black box was invented in 1953 by Australian David Warren. The box is now standard equipment in large aircraft all over the world.
- **Refrigeration:** Making ice was invented in 1851 by James Harrison in Geelong, Victoria. It was invented because cooling was needed to stop food becoming spoilt while it was being transported within Australia and to other countries.
- **Penicillin:** Australian scientist Howard Florey transformed penicillin, first observed by Scotsman Alexander Fleming, from an interesting observation into a life saving antibiotic medicine.
- **Microsurgery:** Earl Owen graduated as a surgeon from Sydney University. He convinced Zeiss Optics to develop a range of equipment that made surgery possible on a tiny scale.

Sources: For Australia: The Science and Technology Centre, Canberra, Australia; the Powerhouse Museum in Sydney; Paul Holper & Simon Torok, *Australian Inventions* (ABC Books for the Australian Broadcasting Corporation); and William D. Ferris, 'Australia chooses: Venture capital and a future Australia', *Australian Journal of Management* (26) (2001): 45. For New Zealand: New Zealand Inventors Trust [www.inventors.co.nz]. For Singapore: 'Riding the "ghost train" across Singapore'.

THE ROLE OF CREATIVITY

Research on creativity in business has increased rapidly in the last decade. Not only is creativity of interest to scientific researchers, it has become a compelling topic in the popular media. Richard Florida is an academic whose field is regional economic development. He says: 'Human creativity [is] the key factor in our economy and society … we now have an economy powered by human creativity. Creativity … is now the *decisive* source of competitive advantage'.[5]

He believes that there is a profound shift taking place comparable to the Industrial Revolution in its impact. We are living in the creative age and work is now defined by the needs of a creative economy that, in turn, has given rise to a creative class. Members include entrepreneurs, scientists, engineers, architects, educators, writers, artists and entertainers. These are people whose economic function is to create new ideas, new technology and new creative content. Florida defines creativity as 'the ability to create meaningful new forms'.[6]

Two important aspects of creativity exist: process and people. The process is goal-oriented; it is designed to attain a solution to a problem. The people are the resources that determine the solution. The process remains the same, but the approach that the people use will vary. For example, sometimes they will adapt a solution and at other times they will innovate a solution.[7] Table 5.1 compares these two approaches.

One study examined the validity of these two approaches for distinguishing innovative entrepreneurs from adaptive entrepreneurs and found their application very effective.[8] Thus,

TABLE 5.1: TWO APPROACHES TO CREATIVE PROBLEM SOLVING

ADAPTOR	INNOVATOR
Employs a disciplined, precise, methodical approach	Approaches tasks from unusual angles
Is concerned with solving, rather than finding, problems	Discovers problems and avenues of solutions
Attempts to refine current practices	Questions basic assumptions related to current practices
Tends to be means oriented	Has little regard for means; is more interested in ends
Is capable of extended detail work	Has little tolerance for routine work
Is sensitive to group cohesion and cooperation	Has little or no need for consensus; often is insensitive to others

Source: Michael Kirton, 'Adaptors and innovators: A description and measure', *Journal of Applied Psychology* (October 1976): 623. Copyright 1976 by The American Psychological Association.

understanding the problem-solving orientation of individuals helps develop their creative abilities.

The nature of the creative process

One's creative potential is something that can be developed and improved.[9] Everyone is creative to some degree. However, as is the case with many abilities and talents (for example, athletic, artistic), some individuals have a greater aptitude for creativity than others. Also, some people have been raised and educated in an environment that encouraged them to develop their creativity. They have been taught to think and act creatively. For others the process is more difficult because they have not been positively reinforced and, if they are to be creative, they must learn how to implement formal the **creative process**.[10]

Many people incorrectly believe that only a genius can be creative.[11] Most people also assume some people are born creative and others are not, or only the gifted or highly intelligent person is capable of generating creative ideas and insights. Yet, the real barriers to creative thinking are sometimes the inadvertent 'killer phrases' we use in our communications. Table 5.2 lists 15 'idea stoppers' that we use. People may not intentionally stop a creative idea, but these simple negative phrases prohibit people from thinking any further.[12]

Creativity is not some mysterious and rare talent reserved for a select few. It is a distinct way of looking at the world that is oftentimes illogical. The creative process involves seeing relationships among things others have not seen before.[13]

The creative process has four commonly agreed-on phases or steps. Most experts agree on the general nature and relationships among these phases, although they refer to them by a variety of names.[14] Experts also agree that these phases do not always occur in the same order for every creative activity. For creativity to occur, chaos is necessary but a structured and focused chaos. We shall examine this four-step process using the most typical structural development.

TABLE 5.2: **THE MOST COMMON IDEA STOPPERS**

1	*'Naah.'*
2	*'Can't' (said with a shake of the head and an air of finality).*
3	*'That's the dumbest thing I've ever heard.'*
4	*'Yeah, but if you did that …' (poses an extreme or unlikely disaster case).*
5	*'We already tried that – years ago.'*
6	*'We've done all right so far; why do we need that?'*
7	*'I don't see anything wrong with the way we're doing it now.'*
8	*'That doesn't sound too practical.'*
9	*'We've never done anything like that before.'*
10	*'Let's get back to reality.'*
11	*'We've got deadlines to meet – we don't have time to consider that.'*
12	*'It's not in the budget.'*
13	*'Are you kidding?'*
14	*'Let's not go off on a tangent.'*
15	*'Where do you get these weird ideas?'*

Source: Adapted from Angela M. Biondi (ed.), *The Creative Process* (The Creative Education Foundation, 1986).

Phase 1: Background or knowledge accumulation

Successful creations are generally preceded by investigation and information gathering. This usually involves extensive reading, conversations with others working in the field, attendance at professional meetings and workshops and a general absorption of information relative to the problem or issue under study. Additional investigation in both related and unrelated fields is sometimes involved. This exploration provides the individual with a variety of perspectives on the problem and it is particularly important to the entrepreneur, who needs a basic understanding of all aspects of the development of a new product, service, or business venture.

People practise the creative search for background knowledge in several ways. Some of the most helpful follow:

- read in a variety of fields
- join professional groups and associations
- attend professional meetings and seminars
- travel to new places
- talk to anyone and everyone about your subject
- scan magazines, newspapers and journals for articles related to the subject
- develop a subject library for future reference
- carry a small notebook and record useful information
- devote time to pursue natural curiosities.[15]

Phase 2: The mind incubation process

Creative individuals allow their subconscious to mull over the tremendous amounts of information they gather during the preparation phase. This incubation process often occurs while they are engaged in activities totally unrelated to the subject or problem. It happens even when they are sleeping. This accounts for the advice frequently given to a person who is frustrated by what appears to be an unsolvable problem: 'Why don't you sleep on it?'[16] Getting away from a problem and letting the subconscious mind work on it allows creativity to spring forth. Some of the most helpful steps to induce incubation follow:

- engage in routine, 'mindless' activities (cutting the grass, painting the house)
- exercise regularly
- play (sports, board games, puzzles)
- think about the project or problem before falling asleep
- meditate or practise self-hypnosis
- sit back and relax on a regular basis.[17]

Phase 3: The idea experience

This phase of the creative process is often the most exciting. It is when the idea or solution the individual is seeking is discovered. Sometimes referred to as the **eureka factor**, this phase is also the one the average person incorrectly perceives as the only component of creativity.[18]

As with the incubation process, new and innovative ideas often emerge while the person is busy doing something unrelated to the enterprise, venture, or investigation (for example, taking a shower, driving on an interstate highway, leafing through a newspaper).[19] Sometimes the idea appears as a bolt out of the blue. In most cases, however, the answer comes to the individual incrementally. Slowly but surely, the person begins to formulate the solution. Because it is often difficult to determine when the incubation process ends and the idea experience phase begins, many people are unaware of moving from phase 2 to phase 3.

In any event, here are ways to speed up the idea experience

- daydream and fantasise about your project
- practise your hobbies
- work in a leisurely environment (for example, at home instead of the office)
- put the problem on the back burner
- keep a notebook at your bedside to record late-night or early-morning ideas
- take breaks while working.[20]

Phase 4: Evaluation and implementation

This is the most difficult step of a creative endeavour and requires a great deal of courage, self-discipline and perseverance. Successful entrepreneurs can identify ideas that are workable and that they have the skills to implement. More important, they do not give up when they run into temporary obstacles.[21] Often they will fail several times before they successfully develop their best ideas. In some cases entrepreneurs will take the idea in an entirely different direction or will discover a new and more workable idea while struggling to implement the original idea. Another important part of this phase is the reworking of ideas to put them into final form. Because frequently an idea emerges from phase 3 in rough form, it needs to be modified or tested to put it in final shape. Some of the most useful suggestions for carrying out this phase follow:

- increase your energy level with proper exercise, diet and rest
- educate yourself in the business planning process and all facets of business
- test your ideas with knowledgeable people
- take notice of your intuitive hunches and feelings
- educate yourself in the selling process
- learn about organisational policies and practices
- seek advice from others (for example, friends, experts)
- view the problems you encounter while implementing your ideas as challenges to be overcome.[22]

Figure 5.1 illustrates the four phases of a creative thinking process. If a person encounters a major problem while moving through the process, it is sometimes helpful to go back to a previous phase and try again. For example, if an individual is unable to formulate an idea or solution (phase 3), a return to phase 1 often helps. By immersing themselves in the data, entrepreneurs allow the unconscious mind to begin anew processing the data, establishing cause/effect relationships and formulating potential solutions.

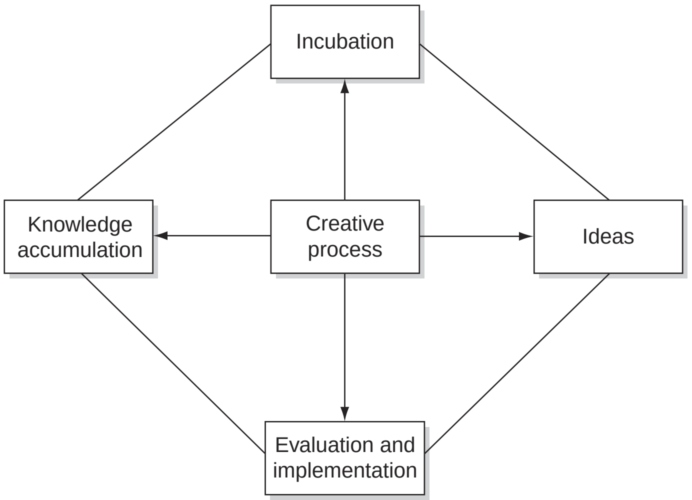
Developing your creativity

You can do a several things to improve your own creative talents. Becoming aware of some of the habits and mental blocks that stifle creativity is one of the most helpful.[23] Of course, as with most processes, your development will be more effective if you regularly practise exercises designed to increase your creative abilities. The following section is designed to improve your awareness of some of the thought habits that limit your creativity and to assist you in developing a personalised creativity improvement program.

Lateral thinking

One of the difficulties in using the four-step creative process is the reliance on bright ideas emerging from phase 2, The mind incubation process. In recent years, creativity researchers have devised specific techniques to forcibly generate novel ideas. Among the best-known approaches are the

FIGURE 5.1 A CREATIVE THINKING PROCESS



'lateral thinking' approaches devised by de Bono. Lateral thinking is concerned with generation of new ideas. It is also concerned with 'breaking out of the concept prisons of old ideas'.[24] Lateral thinking is not a substitute for vertical thinking. Both are required – they are complementary: lateral thinking is generative, vertical thinking is selective. For instance, during brainstorming meetings, you encourage lateral thinking throughout the first session to generate as many creative solutions as possible and vertical thinking during the second session to select the feasible ideas.

In traditional vertical thinking (logic or mathematics), you move forward by sequential steps, each of which must be justified. You select out only what is relevant. You must be right at each stage in order to achieve a correct solution.

In lateral thinking, you may deliberately seek out irrelevant information – you use information not for its own sake but for its effect. You may have to be wrong at some stage in order to achieve an innovative and correct solution.

Thinking outside the box

Thinking outside the box is never easy, nor is it merely a reflection of mental brightness. To leave your psychological comfort zone and explore:

> solutions in the unknown world on the outside requires large measures of mental agility, boldness and creativity – and/or a leader who makes life in the old box so

TABLE 5.3: LATERAL THINKING VERSUS VERTICAL THINKING

VERTICAL THINKING	LATERAL THINKING
Chooses	Changes
Looks for what is right	Looks for what is different
One thing must follow directly from another	Makes deliberate jumps
Concentrates on relevance	Welcomes chance intrusions
Moves in the most likely directions	Explores the least likely directions

ENTREPRENEURIAL EDGE

SINGAPOREAN ENTREPRENEUR 'ABDUCTED BY ALIENS'

Examining the evidence, it is possible to conclude that Sim Wong Hoo was at one time abducted by aliens. The Singaporean exudes an otherworldly openness of mind seemingly at odds with buttoned-down Singapore. He taught himself to program a computer. His personal net worth exceeds $400 million, yet he plays musical instruments favoured by down-and-out street buskers – the accordion and the harmonica (as well as the piano). He responds to unsolicited faxes from students who want his opinion on their science projects. He once wrote an elegant algorithm for piano software that automatically chords left-hand accompaniment to tunes plunked out with the right hand. Then he called it the 'Keytar'.

'Being creative' was Sim Wong Hoo's hobby. The hobby turned him into a taker of risks and maker of contrarian moves. His exceptional qualities led to his being described as the 'quintessential entrepreneur of Singapore'. In 1981, after 'a moment of self-revelation under a starry night sky on an offshore rig', Sim felt he needed a goal: he wanted to make $1 million in five years. First Sim developed a unique microcomputer. Sound cards came next and this ushered in a whole new industry. In 1981, with an initial capital of $6000 Sim Wong Hoo founded Creative Technology. The founding of the company was one step towards realising Sim's vision of building a personal computer that could talk, sing and play music, besides crunching numbers.

Yet Sim is an atypical offspring of Singapore's regimented educational system. He did not follow a prescribed career trajectory, working instead as a teacher and as an engineer in a Japanese electronics firm, then on an oil drilling rig in the South China Sea. The tenth of 12 children born to a chicken-egg vendor, he grew up in the kampongs (native Malaysian village). With no money for toys, he played with ants and improvised board games to amuse himself – an activity he says helped to form his capacity for innovation, his tendency to colour outside the lines.

Leading Creative Technology – or any business, for that matter – is all about managing chaos, Sim says. 'You have to balance chaos with structure. Because of chaos, you can create mutation. Because of mutation we survive, we evolve as a species. If you are very structured, you can't move. If you are all chaos, you crash. This balance is important. It allows variety'.

He believed that, 'Chaos is the nature of all things … [and] provides the environment for Creativity'. Therefore, 'Chaos is the Mother of Creativity'. Chaotic environments generate many new ideas (like brainstorming sessions) but need to reign in the 'Chaos to convert ideas into actions', Sim explained. In stressing the importance of 'creativity', Sim mentioned that 'creativity' is needed for survival when meeting the next evolution or disruptive change. However, 'creativity' must be controlled and 'put into boxes' because too much chaos can collapse a system.

He also introduced his own 'creative oxymoron' which is 'teaching-creativity'. 'We should make rules to teach our people to be creative and entrepreneurial', said Sim in relation to today's obedient Singaporeans. 'We spend enormous energy and money to teach our kids not to be creative', he says joking about the lack of creativity among Singaporeans.

His recently published book, *Chaotic Thoughts from the Last Millennium*, contains a chapter entitled 'Uses for Saliva' (use no. 7: to ease fungi-related body itches). 'If I had the time', Sim muses, 'I'd like to concentrate on being an inventor'. If he had lots of time, Sim would probably spend it trying to produce a warp drive, a time machine, or Flubber.

Source: Adapted from: Alexandra A. Seno, 'Creative's genius' *Asiaweek*, 29 September 2000; V. Bala Kiran and N.N. Rajshekar, 'Sim Wong Hoo: The nimble entrepreneur' (Hyderabad: ICFAI Business School Case Development Centre, 2004); Andrea Lau, Eunice Tan and Wai XiaoWen, 'Forum on creativity in the arts, science and technology in Singapore 2002' [www.fineartforum.org]

uncomfortable that getting out is the only option. The future rests in those willing and able to do so.[25]

Here are some tips for challenging assumptions:

- understand the problem – recognise that you and everyone else have ingrained assumptions about every situation
- play a child – ask plenty of basic 'why?' and 'why not?' questions in order to discover and challenge those assumptions

- play an external observer – pretend you are a complete outsider and ask questions such as: 'Why do you do it this way at all?'
- disassemble the problem – reduce a situation to its simplest components in order to take it out of your environment
- reframe – consider an issue from many different angles; restate a problem in different terms
- imagine the opposite – consider what the experts and professionals advise and then consider doing the opposite.[26]

Recognising relationships

Many inventions and innovations are a result of the inventor's seeing new and different relationships among objects, processes, materials, technologies and people.[27] Examples range widely and include:

- biodegradable packaging materials made out of starch
- combining combustion engine technology with the wheel to create the automobile
- using a winged keel on an Australian yacht to break the 'longest winning streak in modern sports' and wrest the America's Cup away from the Americans for the first time in 132 years.

If you wish to improve your creativity, it helps to look for different or unorthodox relationships among the elements and people around you. This activity involves *perceiving in a relational mode*. You can develop this talent by viewing things and people as existing in a complementary or **appositional relationship** with other things and people. Simply stated, things and people exist in the world in relation to other things and people. Creative people seem to be intuitively aware of this phenomenon and have developed a talent for recognising new and different relationships. These relationships often lead to visions that result in new ideas, products and services.[28] In order to develop the ability to recognise new relationships, you must practise perceiving in a relational mode. The following exercise helps with this development.

A creative exercise

Analyse and elaborate on how the following pairs relate to each other in a complementary way: nut and bolt, husband and wife, chocolate cake and vanilla ice cream, grass clippings and tomato plants, athlete and coach, humanity and water, winning and losing, television and overhead projectors, and managers and production workers.

Developing a functional perspective

If expanded, the principle of perceiving in a relational mode helps develop a **functional perspective** towards things and people. A creative person tends to view things and people in terms of how they can satisfy their needs and help complete a project. For example, the homemaker who cannot find a screwdriver often will use a butter knife to tighten a loose screw. Or the cereal manufacturer will add fruit to its product to create a new product line that appeals to a health-conscious market.

If you wish to become more innovative and creative, you need to visualise yourself in complementary relationships to the things and people of the world. You must learn to look at them in terms of how they complement you in your attempts to satisfy your own needs and to complete your projects. You must begin to look at things and people in non-conventional ways and from different perspectives.[29] The following exercise is designed to help you develop a functional perspective.

A creative exercise

Think of and write down all the functions you can imagine for the following items:

- An egotistical staff member
- A large pebble
- A fallen tree branch
- A chair
- A computer 'whiz kid'
- An obsessively organised employee
- The office 'gossip'
- An old hubcap
- A new secretary
- An empty roll of masking tape
- A yardstick
- An old coat hanger
- The tight-fisted co-worker
- This exercise

Going with the flow

Mihaly Csikszentmihalyi[30] is best known for his bestselling 1990 book, *Flow = The Psychology of Optimal Experience*. He defined and explored the concept of 'flow' – as in 'getting in the flow' – as our experience of optimal fulfilment and engagement. Flow, whether in creative arts, athletic competition, engaging work, or spiritual practice, is a deep and uniquely human motivation to excel, exceed and triumph over limitation. The flow experience is when a person is completely involved in what they are doing, when the concentration is very high, when the person knows moment by moment what the next steps should be (if you are playing tennis, you know where you want the ball to go, if you are playing a musical instrument you know what notes you want to play, every millisecond, almost). He describes flow as:

> being completely involved in an activity for its own sake. The ego falls away. Time flies. Every action, movement and thought follows inevitably from the previous one, like playing jazz. Your whole being is involved and you're using your skills to the utmost.[31]

Csikszentmihalyi described six components of 'flow':

- you know at any time without thinking what you must do
- even under highly demanding circumstances you still feel in control
- you glide from one event to another as if by some inner logic
- you concentrate like you breathe – without effort or thought; you filter out distractions
- you forget about time – hours fly by like minutes
- your self melts into your activity and you lose self-consciousness.

Using your brains

Ever since split-brain studies were conducted in the 1950s and 1960s, experts on creativity, innovation and self-development have emphasised the importance of developing the skills associated with both hemispheres of the brain.[32]

The **right brain** hemisphere helps an individual understand analogies, imagine things and synthesise information. The **left brain** hemisphere helps the person analyse, verbalise and use rational approaches to problem solving. Although the two brain hemispheres (right and left) process

TABLE 5.4: PROCESSES ASSOCIATED WITH THE TWO BRAIN HEMISPHERES

LEFT HEMISPHERE	RIGHT HEMISPHERE
Verbal	Non-verbal
Analytical	Synthesising
Abstract	Seeing analogies
Rational	Non-rational
Logical	Spatial
Linear	Intuitive
	Imaginative

Source: Betty Edwards, *Drawing on the Right Side of the Brain* (Los Angeles: Tarcher, 1979).

information differently and are responsible for different brain activities and skills (see table 5.4), they are integrated through a group of connecting nerve fibres called the *corpus callosum*. Because of this connection and the nature of the relationship between the activities of each hemisphere, each hemisphere should be viewed as existing and functioning in a complementary relationship with the other hemisphere.[33]

The creative process involves logical and analytical thinking in the knowledge accumulation, evaluation and implementation stages. In addition, it calls for imagination, intuition, analogy conceptualisation and synthesising in the incubation and idea creation stages. So to become more creative, it is necessary to practise and develop both right- and left-hemisphere skills. The following problem-solving exercise is designed to demonstrate the effectiveness of combining the skills of both hemispheres when solving problems.

A creative exercise

Assume you have an idea that will save your organisation time and money on processing customer complaints. Your supervisor has been extremely busy and has been unwilling to stop and listen to your idea.

1. Write down all the left-hemisphere-type solutions to this problem you can think of in five minutes.
2. Write down all the right-hemisphere-type solutions to this problem you can think of in five minutes.
3. Compare these lists and combine two or more solutions from each list that will result in a unique and innovative way to solve this problem.
4. Repeat numbers 1, 2 and 3 using a current problem you are facing at work or at home.

Our society and its educational institutions reward individuals who have been successful at developing their logical, analytical and rational left-brain skills. Little emphasis, however, has been placed on practising and using right-brain skills. Table 5.5 represents some ways you can practise developing both left- and right-hemisphere skills.[34]

Eliminating muddling mind-sets

Mental habits block or impede creative thinking and it is important to eliminate **muddling mind-sets**. It has been estimated that adults use only 2 to 10 per cent of their creative potential.[35] For example, many individuals tend to make quick judgements about new things, people and ideas. Another inclination is to point out the negative components of a new or different idea because of the psychological discomfort associated with change. Some common mental habits that inhibit

ENTREPRENEURSHIP IN PRACTICE

DEVELOPING CREATIVITY

What colour is the sky when you dream? Do you consider yourself to be creative? 'Creativity' has been defined as having the quality or power of creating. People are innately creative. Really. Let your creativity out of the playpen! Millions of dollars are made from creative endeavours that are truly simple. You can too if you use some of these methods to boost your creativity.

- **Brainstorm!** This is the old-school way to drum up creative ideas and solve problems, but it is still by far the best. The corporate world was woken up when Alex Osborn introduced this concept in the 1950s. Established rules were easy to follow:
  - shout out or write down every solution that comes to mind
  - off-the-wall ideas are welcome
  - criticise nothing
  - organise later
  - build on every idea – even when it seems foolish or fanciful.
- **Opposites attract:** Here's an interesting concept. Synectics. Similar to the word itself, synectics involves putting two 'nonsensical' things together to see what happens. Examples: 'Imagine a restaurant with no waiters, tables, or silverware.' It's McDonald's. 'Imagine a bookstore with no books – and no store.' Isn't that Amazon.com? U-Haul: 'Moving trucks with no movers.' Don't hesitate to explore that which is strange!
- **THINKubate:** Gerald Haman created the 'THINKubator' – a playground where businesspeople, entrepreneurs and the like can go to escape the humdrum environment of offices and 'can't doers'. The playground houses comfortable seating, toys, fun pictures and overall, offers an environment that favours brain stimulation and idea creation. It must work, because Haman has developed numerous products for Procter & Gamble.
- **Trigger great ideas:** Triggers are everyday items that can be used to stimulate the brain: abstract photos, inspiring quotes, uncompleted ideas, tips and so on. Place trigger items in various places you look or visit often – the refrigerator door, your dashboard, your phone. You never know when a connection will be made.
- **Connect:** 'Every person you meet or place you visit might be an opportunity waiting to happen.' The key is to be prepared for that opportunity when it arises. Creativity consultant Jordan Ayan suggests building up your CORE: curiosity, openness, risk and energy. These traits can be enhanced by reading up on trends, attending trade shows, browsing and trying new things. Spotting open windows isn't necessarily easy, but increasing the number of the windows can be.
- **Always celebrate failure:** Try and try again. What doesn't kill you only makes you stronger. Dare to be great! Get the idea? Don't suffer from insanity! Enjoy every minute of it!
- **Make 'em laugh:** Humour is a great way to relieve stress. Use it in your creative endeavours. Can you imagine Dennis the Menace helping you build your prototype? How about letting the Monty Python writers co-author your business plan? Let Urkel, or even your youngest relative, in on your invention. Humour and laughter certainly encourage creativity.
- **Sweat it:** Yes! Sweat it out! … Exercise gets the creative juices – endorphins – flowing. Let the mind wander while you're jogging, or ride the exercise bike while reading the year-end reports. Just be sure to keep a notepad handy to jot down all of the great ideas!
- **Remember your wildest dreams:** Has anyone ever replied to you with this statement: 'In your dreams!' Well, go figure! Dreams are a great place to start when it comes to unleashing creativity. Elias Howe once had a dream in which cannibals were piercing his flesh with spears. Thus the sewing machine was invented. Don't ignore daydreams or spur of the moment ideas, either. Your subconscious could be trying to tell you something.

Source: Adapted from Nick D. Alto, 'Think big', *Business Start Ups* (January 2000): 61–5.

TABLE 5.5: **WAYS TO DEVELOP LEFT- AND RIGHT-HEMISPHERE SKILLS**

LEFT-HEMISPHERE SKILLS	RIGHT-HEMISPHERE SKILLS
1 *Step-by-step planning of your work and life activities*	1 *Using metaphors and analogies to describe things and people in your conversations and writing*
2 *Reading ancient, medieval and scholastic philosophy, legal cases and books on logic*	2 *Taking off your watch when you are not working*
3 *Establishing timetables for all of your activities*	3 *Suspending your initial judgement of ideas, new acquaintances, movies, TV programs and so on*
4 *Using and working with a computer program*	4 *Recording your hunches, feelings and intuitions and calculating their accuracy*
	5 *Detailed fantasising and visualising things and situations in the future*
	6 *Drawing faces, caricatures and landscapes*

creativity and innovation are ‘either/or’ thinking, security hunting, **stereotyping** and **probability thinking**. These habits tend to muddle creative thought processes and different thought processes must be used to enhance creative thinking.[36]

Either/or thinking

Because of the speed of change in the modern world, personal lives are filled with a great deal of uncertainty and ambiguity. People often get bogged down with striving for an unreasonable amount of certainty in their lives. But the creative person learns to accept a reasonable amount of ambiguity in their work and life. In fact, many exceptionally creative people thrive in an uncertain environment and find it exhilarating.[37]

Security hunting

Many people try to make the right decision or take the correct action every time. In doing so, they rely on averages, stereotypes and probability theory to minimise their risks. Although this strategy often is appropriate, at times a creator or innovator must take some calculated risks.[38] Sometimes these risks result in the innovator being wrong and making mistakes. Yet by recognising this as part of the innovative game, the creative person learns from their mistakes and moves on to create bigger and better things. We all know Thomas Edison failed numerous times when searching for the correct materials to use inside the incandescent light bulb.

Stereotyping

It is ironic that although averages and stereotypes are abstractions that people fabricate, people act and make decisions based on them as if these were data entities existing in the real world. For example, one could hypothesise that the average homemaker is female, 38 years old and 160 cm tall; weighs 55 kg; and has 2 children, a part-time job and 14.5 years of formal education. If one tried to find a person who fits this description, however, the chances of success would be small. In short, the more descriptive the abstraction or stereotype, the less real it becomes. Predicating actions from stereotypes and averages can cause an individual to act on the basis of a distorted picture of reality. More important, relying on these abstractions can limit a person’s perception of the real entities and possibilities in the world. Edward de Bono argues that people must alter their thinking to enhance their creativity. Only new patterns of thinking will lead to new ideas and innovations.[39]

Probability thinking

In their struggle to achieve security, many people also tend to rely on probability theory to make decisions. An over-reliance on this decision-making method, however, can distort reality and prohibit one from taking calculated risks that may lead to creative endeavours.

Some say that the power of probability theory increases in proportion to the number of times an event is repeated. If a person wishes to predict the probability of tossing the number *3* when rolling a die a certain number of times, probability theory is extremely useful. However, if the person wishes to know the likelihood of rolling a *4* with one roll of the die, the predictive ability of probability theory is much less valuable.

In the creative game, often an individual is looking at an opportunity or situation that may occur only once in a lifetime. In a single-event situation, intuition and educated guesses are just as useful, if not more useful, than logic and probability.[40] One way of increasing your creative capacities is to practise looking at some of the situations in your life as a 50/50 game and then begin to take some risks. Additionally, the following problem-solving exercises are designed to help eliminate muddling mind-sets.

Problem-solving exercises

- Practise taking small risks in your personal life and at work, relying on your intuition and hunches. Keep a log of these risks and chart their accuracy and consequences. For example, in your next poker game discard safe but low-risk cards (like pairs) and aim for a straight (five sequential cards of the same suit).
- Go out of your way to talk to people who you think conform to a commonly accepted stereotype.
- Take on complex projects at work and at home that do not lend themselves to guaranteed and predictable results. Allow yourself to live with a manageable amount of ambiguity. Notice how you react to this ambiguity.
- When an idea is presented to you, first think of all the positive aspects of the idea, then of all the negative aspects and, finally, of all the interesting aspects of the idea.
- When listening to people, suspend initial judgement of them, their ideas and their information and simply listen.
- Try making some decisions in the present. That is, do not let your personal history or your estimates about the future dominate your decision-making process.[41]

The creative climate

Creativity is most likely to occur when the business climate is right. No enterprise will have creative owners and managers for long if the right climate is not established and nurtured. Some of the important characteristics of this climate follow:

- a trustful management that does not over-control the personnel
- open channels of communication among all business members
- considerable contact and communication with outsiders
- a large variety of personality types
- a willingness to accept change
- an enjoyment in experimenting with new ideas
- little fear of negative consequences for making a mistake
- the selection and promotion of employees on the basis of merit
- the use of techniques that encourage ideas, including suggestion systems and brainstorming
- sufficient financial, managerial, human and time resources for accomplishing goals.[42]

THE INNOVATION PROCESS

What is the difference between creativity and innovation? Creativity means coming up with bright ideas. Innovation means bringing those ideas to life. Most innovations result from a conscious, purposeful search for new opportunities.[43] This process begins with the analysis of the sources of new opportunities. Drucker has noted that because innovation is both conceptual and perceptual, would-be innovators must go out and look, ask and listen. Successful innovators use both the right and left sides of their brains. They look at figures. They look at people. They analytically work out what the innovation has to be to satisfy the opportunity. Then they go out and look at potential product users to study their expectations, values and needs.[44]

Most successful innovations are simple and focused. They are directed towards a specific, clear and carefully designed application. In the process they create new customers and new markets. Wireless Internet is an example: Why should one be tied down to a desk when computing should be ubiquitous?

Above all, innovation often involves more work than genius. As Thomas Edison once said, 'Genius is 1 per cent inspiration and 99 per cent perspiration'. Moreover, innovators rarely work in more than one area. Edison worked on Portland cement (10 patents), rubber, mechanical phonograph and the cinema camera.

Types of innovation

Four basic types of innovation exist. These extend from the totally new to modifications of existing products or services. In order of originality, these are:

- **invention** – the creation of a new product, service, or process, often one that is novel or untried; such concepts tend to be 'revolutionary' (see table 5.6)
- **extension** – the expansion of a product, service, or process already in existence; such concepts make a different application of a current idea

TABLE 5.6: INNOVATION IN ACTION

TYPE	DESCRIPTION	EXAMPLES
Invention	Totally new product, service, or process	Wright brothers (US) – aeroplane transportation Henry Sutton (AU) – fax machine Thomas Edison (US) – light bulb Sir Ernest Rutherford (NZ) – atom splitting Peter Maire (NZ) – Navman, personal GPS
Extension	New use or different application of an already existing product, service, or process	Mervyn Victor (AU) – lawn mower Sir Edmund Hillary (NZ) – farm tractors for ice exploration Robert Dane (AU) – solar panel yacht sail Ray Kroc (US) – McDonald's Bill Gallagher (NZ) – electric fence
Duplication	Creative replication of an existing concept	Bill Hamilton (NZ) – Hamilton Jet Boat Dean Kamen (US) – Segway Human Transporter Pizza Hut – pizza parlour John Britten – motorcycle (NZ) Team NZ – America's Cup 2000 victory (NZ)
Synthesis	Combination of existing concepts and factors into a new formulation or use	John Neustroski (NZ) – portable fur plucker for possums Ben Lexcen (AU) – America's Cup winning winged keel design Alan Gibb (NZ) – Aquada (car on water) Paul Beckett (NZ) – Blokart (wind sailing on land)

- **duplication** – the replication of an already existing product, service, or process; the duplication effort, however, is not simply copying but adding the entrepreneur's own creative touch to enhance or improve the concept to beat the competition
- **synthesis** – the combination of existing concepts and factors into a new formulation; this involves taking ideas or items already invented and finding a way so together they form a new application.[45]

Sources of innovation

Innovation is a tool by which entrepreneurs typically exploit change rather than create change.[46] Although some inventions have created change, these are rare. It is more common to find innovations that take advantage of change. The internal and external areas that serve as innovation sources are presented next.

- **Unexpected occurrences** (for example, product/service success or failure or outside event). These are successes or failures that, because they were unanticipated or unplanned, often end up proving to be a major innovative surprise to the firm. For example, Alexander Fleming was surprised to note that a contamination of a bacterial plate culture suppressed the growth of his bacteria. He identified the contamination as penicillin mould. Later, Australian scientist Howard Florey drew on Fleming's observation to create industrial-scale manufacture of penicillin.
- **Incongruities** (for example, the gap between what is and what should be). These occur whenever a difference exists between expectations and reality. Innovation is the creation of solutions to incongruities. Solving the problem of how to fly in a vacuum gave us rockets and satellites. Switching electrons through insulators gave us transistors, microchips and then Silicon Valley and the digital age.
- **Process needs** (for example, process gaps or bottlenecks). These exist whenever a demand arises for the entrepreneur to innovate and answer a particular need. Time-saving devices and eco-sustainable 'green' manufacturing are examples.
- **Structural change** (for example, in industries or markets). Continual shifts in the marketplace occur, caused by developments such as consumer attitudes, advancements in technology, industry growth and the like. Industries and markets are always undergoing changes in structure, design, or definition. An example is found in the health care industry, where hospital care has undergone radical change and where home health care and preventive medicine have replaced hospitalisation and surgery as primary focus areas. The entrepreneur needs to be aware of and seize these emerging opportunities.
- **Demographics** (for example, population, education, income changes, age, occupations, geographic locations and similar factors). Demographic shifts are important and often provide new entrepreneurial opportunities. For example, as the average population age in Australia's Gold Coast has increased (due largely to the influx of retirees), land development, recreational and health care industries all have profited.
- **Mood swings** (for example, in what is in or out, acceptable or not). These changes occur in people's interpretation of facts and concepts. They are intangible yet meaningful. Perception can cause major shifts in ideas to take place. The current fitness craze, caused by the perceived need to be healthy and physically fit, has created a demand for both health foods and health facilities throughout the country.
- **New knowledge** (for example, scientific advances). These are the basis for the creation or development of something brand new, tying into our earlier discussion of invention as a type of innovation. Inventions are knowledge-based; they are the product of new

thinking, new methods and new knowledge. Such innovations often require the longest time period between initiation and market implementation because of the need for testing and modification.[47]

Some examples of these innovation sources are presented in table 5.7.

Major innovation myths

Presented next is a list of the commonly accepted innovation myths, along with reasons why these are myths and not facts.[48]

- **Myth 1: Innovation is planned and predictable:** This myth is based on the old concept that innovation should be left to the research and development (R&D) department under a planned format. In truth, innovation is unpredictable and may be introduced by anyone.
- **Myth 2: Technical specifications should be thoroughly prepared:** Thorough preparation often takes too long. Quite often it is more important to use a try/test/revise approach.
- **Myth 3: Creativity relies on dreams and blue-sky ideas:** Accomplished innovators are very practical people and create from the opportunities left by reality – not daydreams.
- **Myth 4: Big projects will develop better innovations than smaller ones:** This myth has been proved false time and time again. Larger firms are now encouraging their people to work in smaller groups, where it often is easier to generate creative ideas.
- **Myth 5: Technology is the driving force of innovation and success:** Technology is certainly one source for innovation, but it is not the only one. Moreover, the customer or market is the driving force behind any innovation. Market-driven or customer-based innovations have the highest probability of success. A good example is found in Polaroid's Polarvision, a television camera that allowed for instant playback of the film. Polaroid hit the market with this technological advance at the same time video cassette recorders arrived. The result: Polaroid's product was rejected and the company lost millions of dollars.

Principles of innovation

Potential entrepreneurs need to realise innovation principles exist. These principles can be learned and, when combined with opportunity, can enable individuals to innovate. The major motivation principles follow:

TABLE 5.7: SOURCES OF INNOVATION

SOURCE	EXAMPLES
Unexpected occurrences	Unexpected success: Viagra, Apple Computer Unexpected failure: Ford's Edsel
Incongruities	Overnight package delivery
Process needs	Sugar-free products Caffeine-free coffee Microwave ovens
Industry and market changes	Health care industry – changing to home health care
Demographic changes	Rest homes or retirement centres for older people
Perceptual changes	Exercise (aerobics) and the growing concern for fitness
Knowledge-based concepts	Video industry; robotics

- **Be action oriented:** Innovators always must be active and searching for new ideas, opportunities, or sources of innovation.
- **Make the product, process, or service simple and understandable:** People must readily understand how the innovation works.
- **Make the product, process, or service customer-based:** Innovators always must keep the customer in mind. The more an innovator has the end-user in mind, the greater the chance the concept will be accepted and used.
- **Start small:** Innovators should not attempt a project or development on a grandiose scale. They should begin small and then build and develop, allowing for planned growth and proper expansion in the right manner and at the right time.
- **Aim high:** Innovators should aim high for success by seeking a niche in the marketplace.
- **Try/test/revise:** Innovators always should follow the rule of try, test and revise. This helps work out any flaws in the product, process, or service.
- **Learn from failures:** Innovation does not guarantee success. More important, failures often give rise to innovations.[49]
- **Follow a milestone schedule:** Every innovator should follow a schedule that indicates milestone accomplishments. Although the project may run ahead or behind schedule, it is still important to have the schedule in order to plan and evaluate the project.
- **Reward heroic activity:** This principle applies more to those involved in seeking and motivating others to innovate. Innovative activity should be rewarded and given the proper amount of respect. This also means tolerating and, to a limited degree, accepting failures as a means of accomplishing innovation. Innovative work must be seen as heroic activity that will reveal new horizons for the enterprise.
- **Work, work, work:** This is a simple but accurate exhortation with which to conclude the innovation principles. It takes work – not genius or mystery – to innovate successfully.[50]

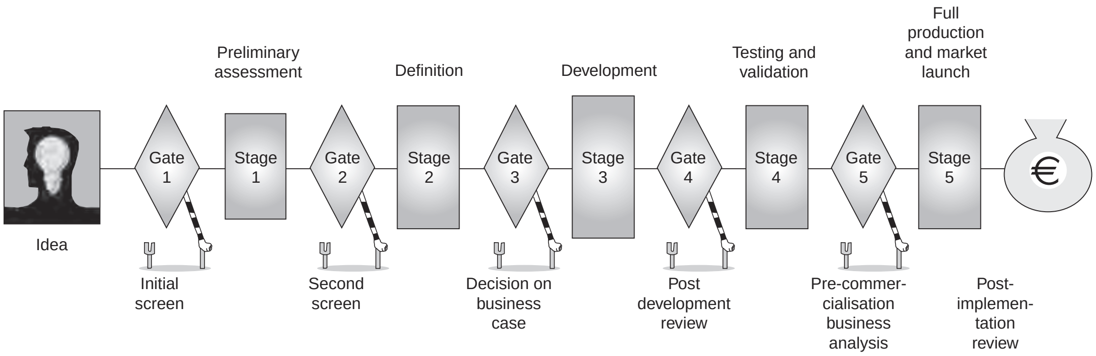
The stage-gate process of innovation

One way to understand innovation is through a metaphor called the **stage-gate** process. It divides the process into distinct time-sequenced stages separated by management decision gates. The innovator must successfully complete a set of related tasks in each stage in order to proceed to the next stage.

Cooper has described the innovation process as stages and gates.[51] Of course it is not a lock-step process and many times the innovator has to go back and repeat steps. Innovation is often an iterative process, meaning a procedure which repeats until some condition is satisfied that permits movement to the next stage.

- **Gate 1: Initial screen:** A 'gentle' screen – a flickering green light – that gives birth to the project, if it meets a handful of key 'must meet' and 'should meet' criteria of strategic alignment, project feasibility, magnitude of the opportunity, differential advantage, synergy with the firm's core business and resources and market attractiveness. A checklist is used for the 'must meet' criteria and a scoring model with weighted rating scales are employed for the 'should meet' criteria.
- **Stage 1: Preliminary assessment:** Quick and simple assessments are made by gathering market and technical information. Market assessment involves a library search, contacts with key users, focus groups and possibly quick concept tests with some potential users to determine market size, market potential and likely market acceptance. Technical assessment is a quick and preliminary in-house appraisal of the proposed product to assess development and manufacturing feasibility and costs and times to execute.

FIGURE 5.2 THE STAGE-GATE PROCESS



- **Gate 2: Second screen:** Based on the new information, the project is subjected to the same 'must meet' and 'should meet' criteria as at gate 1, but with a few additional 'should meet' criteria dealing with the sales force and customer reactions to the proposed product. The financial return is assessed with quick and simple calculations, such as pay back period.
- **Stage 2: Definition:** Final stage before heavy spending involved in development, the project is clearly defined at this stage. Market research studies are carried out to determine customer needs, wants and preferences in order to define the 'winning' product. Concept testing assesses customer acceptance. Competitive analysis is also a vital part of an assessment of the attractiveness of the product and its market. Technical appraisal focuses on the ability to carry through the project successfully. Customer needs and wishes are translated into technically and economically feasible solutions and possibly minor preliminary design or laboratory work. Operations appraisal looks into the product's manufacturability, costs to manufacture and investment required. Legal, patent or copyright issues may need to be examined. Finally, a detailed financial analysis using discounted cash flow and sensitivity analysis is carried out as input to gate 3.
- **Gate 3: Decision on business case:** This is the last chance to kill the project before development – approval at this gate essentially means 'go to heavy spend'. The project is assessed using the complete set of 'must meet' and 'should meet' criteria, a review is undertaken of the activities carried out during stage 2 to check if the quality of execution was sound and the results positive; the financial analysis is scrutinised. The project is defined including target market, product concept, product positioning strategy, delineation of product benefits to be delivered and essential and desired product features, attributes and specifications. Plans are reviewed and approved for development activities as well as preliminary operations and marketing activities.
- **Stage 3: Development:** The product is developed concurrently with detailed tests as well as marketing and operations planning. Financial analysis is updated and legal, patent or copyright issues are resolved.
- **Gate 4: Post-development review:** Project progress and continued attractiveness is reviewed. Development work is checked to ensure that it was completed in a quality fashion. Economic questions are revisited with a financial analysis using the latest and most accurate data. Plans for the next stage of testing and validation are approved and detailed future marketing and operations plans are reviewed.

FIVE TYPES OF INNOVATORS

ENTREPRENEURSHIP IN PRACTICE

There are many kinds of innovators. They are all pioneers in some way. In every field of life endeavour there are people who open up a new line of research or technology or art. Here are some of them.

- **Gatekeepers:** These people collect and channel information about changes in the technical environment. They stay current with events and ideas through personal contacts, professional meetings and the news media. When gatekeepers find relevant information, they send it to the appropriate person or unit for follow-up.
- **Idea generators:** This role involves analysis of information about new technologies, products, or procedures in order to yield a new idea for the company. The fresh idea may be an innovative solution to an existing problem in product or business development or the identification of a new marketplace opportunity.
- **Champions:** Champions advocate and push for the new idea. This role involves obtaining and applying the resources and staff to demonstrate the idea's feasibility. Champions are concerned about results, not risk and do not spend time studying the consequences of failure. Their mission is to remove obstacles.
- **Project managers:** Someone has to draw up schedules and budgets; arrange periodic information sessions and status reports; coordinate labour, equipment and other resources; and monitor progress against the plan. Project managers integrate and administer the tasks, people and physical resources necessary to move an idea into practice.
- **Coaches:** This function addresses the technical and interpersonal aspects of the work in the innovation process. Coaches provide technical training related to new developments and help people work together to turn an idea into a tangible result.

Source: Mark Frohman and Perry Pascarella, 'Achieving purpose-driven innovation', *Industry Week* (March 19, 1990): 20–6.

- **Stage 4: Testing and validation:** Viability of the whole project is tested, including the product, the production process, likely customer acceptance and the economics of the project. In-house product tests check product quality and performance. User or field trials verify that the product functions under actual use conditions and gauge customer reactions. Trial or pilot production tests debug the production process and determine precise production costs. Market pre-tests, tests and trial sells gauge customer reactions, assess launch plan and forecast market share and revenues. Revised financial analysis checks the continued economic viability of the project using more detailed and accurate revenue and cost data.
- **Gate 5: Pre-commercialisation decision:** If the project passes this final gate, the door is opened to full commercialisation. The focus is on the quality and results of validation activities. Positive financial projections are vital to get the final go-ahead. Operations and marketing plans are reviewed and approved progression to stage 5 is commenced.
- **Stage 5: Commercialisation:** The marketing launch plan and operations plan developed during stage 4 are implemented.
- **Post-implementation review:** At some point after commercialisation, the new product project team is disbanded and the product becomes a 'regular product' in the firm's product lines. The project and product performance is reviewed. Latest data on revenues, costs, expenditures, profits and timing are held up against projections. Final post-audit is carried out to assess project strengths and weaknesses and to derive key learnings from the project for future projects.

Innovation and disruptive technology

One controversial yet powerful theory of innovation is disruptive technology, coined by Christensen in his 1997 book *The Innovator's Dilemma*.[52] A disruptive technology is usually a lower performance or less expensive product or process that gains a foothold in the low end, less demanding part of an existing market and then successively moves up-market through performance improvements until finally displacing the market incumbents. Disruptive technologies are usually introduced to the market by small start-up enterprises.

Not all disruptive technologies are of lower performance. There are several examples where the disruptive technology out-performs the existing technology but is not adapted by existing majors in the market. These occur in industries with a high capitalisation sunk into the older technology (for example, vertically integrated steel mills and cargo ships and stevedores).

NATIONAL INNOVATION SYSTEMS

A financial and policy environment that supports innovation is crucial to the continued nurturing of creative activity. Two major sources of financial backing are venture capital as well as the overall 'national innovation system'. Venture capital is treated in chapter 14, particularly how to get it.

In many countries there is a whole infrastructure of support for innovation. Since it is widely accepted that innovation is the key to success for the modern economy, governments have begun stepping in to help the other players in the innovation system. The *national innovation system (NIS)* is the flow of technology and information among people, enterprises and institutions which is key to the innovative process on the national level. According to innovation system theory, innovation and technology development are results of a complex set of relationships among actors in the system, which includes enterprises, universities and government research institutes. The road to establishing a national innovation system has been rocky in many developing countries of the Asia–Pacific, but Australia, New Zealand and Korea particularly have distinguished themselves.[53]

The government is a fundamentally important player in a national innovation system, but it is only one of many participants. Yet government support for innovation encompasses direct provision of funds, such as for public research, as well as provision of funds and preferential tax treatment with regard to venture capital (such as the Pooled Development Fund program in Australia for venture capital).

TABLE 5.8: EXAMPLES OF DISRUPTIVE TECHNOLOGIES

DISRUPTIVE TECHNOLOGY	DISPLACED TECHNOLOGY
Printing press	Manuscripts, scriptoria
Railways	Canals
The automobile	Railways
Digital cameras	Photographic film
Mass-market mobile telephony	Fixed-line telephony
Mini steel mills	Vertically integrated steel mills
Minicomputers	Mainframe computers
Personal computers	Minicomputers
Desktop publishing	Phototypesetting and manual paste-up
Flash drives	Floppy disk drives
Container ships and containerisation	Cargo ships and stevedores

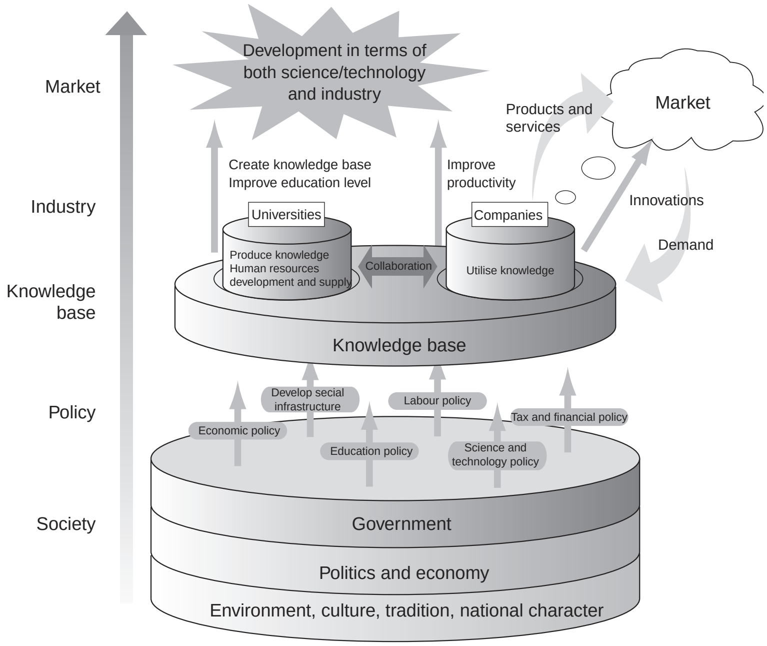
How might one characterise a national innovation system? New Zealand's Minister of Research, Science and Technology has defined his country's innovation system as the 'aggregation of those things that contribute to a nation's ability to create or discover valuable knowledge and to deploy it widely, accurately and quickly'.[54] Fairly typical of other economies, the components of New Zealand's innovation system include:

- research, science and technology
- the education system
- protection of intellectual property – to see it as a new form of capital
- the immigration system
- the ability to form international strategic alliances
- a responsive government led by visionary politicians and state servants
- fluid capital markets
- a robust Internet infrastructure
- creative arts, design and engineering
- linkages between science and society
- basic research and public good research.

Figure 5.3 shows how the Japanese Ministry of Education, Culture, Sports, Science and Technology conceives their national innovation system.

An innovation system exists to drive up the supply of commercialisable innovation, inventions and ideas. It requires an excellent basic infrastructure and responds to stimuli such as grants and incentives. Governments can and should invest in innovation. How do national

FIGURE 5.3 **NATIONAL INNOVATION SYSTEM OF JAPAN**



Source: Ministry of Education, Culture, Sports, Science and Technology, 'Knowledge to create society and economy for a new era' [wwwwp.mext.go.jp/hakusyo/book/hpag200201/hpag200201_2_006.html] innovation systems in Asia–Pacific compare with, for example, the United Kingdom and the United States?

Of course, the GDP amounts vary as do GDP growth rates, with red hot China clocking a 7.3 per cent growth rate. Japan, Singapore and Taiwan lead the pack in patents secured per capita. Japan and Singapore are again leaders in total expenditures on R&D. Australia distinguishes itself in total R&D workers per capita, surpassed only by Japan. In terms of technology transfer between the university and firms, Singapore, Hong Kong and Taiwan are leaders.

TABLE 5.9: ASIA–PACIFIC INNOVATION SYSTEMS IN COMPARISON

	GDP 2005 IN BILLIONS US$, CURRENT PRICES	% REAL GDP GROWTH PER CAPITA, 2005	NO. PATENTS PER 100 000 INHABITANTS, 2001	TOTAL EXPENDITURE ON R&D PER CAPITA 2003, US$	TOTAL R&D WORKERS PER 1000, 2003	TECHNOLOGY TRANSFER BETWEEN UNIVERSITY AND FIRMS: SURVEY, 2005
Australia	692.4	2.6	502.0	313.8†	5†	5.6
China	345.1	7.3	5.1†	14.4	0.8	3.6
Hong Kong	163.4¥	–	242.6	135.5†	1.1†	5.49¥
Japan	4799.0	2.4	860.3†	1006.2†	7.02†	4.8
Korea	655.9¥	–	516.4	290.7†	3.99†	4.04¥
New Zealand	107.6	2.1	–	156.7†	3.82†	4.8
Singapore	116.3	3.5	704.2	469.7	5.6	6.2
Thailand	174.5	3.2	2.6	5.8	0.4	4.2
Taiwan	309.0¥	3.81¥	748.0	288.2†	5.07†	5.98¥
United Kingdom	2295.0	6.1	550.6†	–	–	4.2
United States	12438.8	4.0	487.2	977.8	–	6.5

† 2002 figures
¥ 2004 figures
Source: Global Entrepreneurship Monitor dataset 2005.

ENTREPRENEURSHIP IN PRACTICE

LORD OF THE RINGS INNOVATION

The *Lord of the Rings* film trilogy may have boosted New Zealand's reputation for innovation, but it reinforced what Kiwis – both indigenous **Māori** as well as Pakeha (European New Zealanders) – already knew about themselves as being 'bloody innovative'. Values such as resourcefulness, inventiveness, hard work and respect have always been part of what defines Kiwis – from the cow-cocky (dairy farmer) to the modern Waikato biotechnologist. It is no accident that New Zealanders were the first to climb Mt Everest and to split the atom. Sir Edmund Hillary's 'We knocked the bastard off' and Sir Ernest Rutherford's 'We haven't the money so we must think' are part of Kiwi innovation lore.

European settlers developed a culture of innovation that stemmed from their remoteness from sources of tools and manufactured goods. In the nineteenth century they had only a few of the tools necessary to carry on their trades as farmers and foresters. They had to be innovative or starve. They took up the challenge by modifying and adapting what little equipment could be imported from their remote homelands on an eight-month journey across the globe by sea. The conversion of New Zealand bush into farms created the need for a great many fences. The preferred wire was known as 'Number 8 gauge', but it was also put to so many other uses that the 'Number 8 wire mentality' now represents 'Kiwi ingenuity', a quality that was born out of isolation and lack of infrastructure in New Zealand's early history.

Māori, New Zealand's indigenous Polynesian inhabitants, also have a history of entrepreneurship and enterprise upon which to draw. The **Māori** Land Wars of 1860–66 were fuelled not only by the settlers' hunger for land but also because **Māori** had become such successful entrepreneurs that they controlled a large share of the commerce throughout the country. **Māori** exported to Australia and various other countries and to some degree **Māori** entrepreneurial abilities were the subject of envy by Pakeha. **Māori** were also fervent adopters of technology. Best known is the **Māori** use of the muskets to the great cost of the settler forces. Less well known is the history of **Māori** adaptation of European agriculture and shipping methods as well as their rapid adoption of books and use of publishing.

New Zealand innovation policy has been well informed by developments in the OECD, the European Union and APEC in the fields of research and policy.[55] Important policy initiatives of the present Labour-Progressive coalition government and the previous liberal National government have contributed greatly to today's innovation policy.[56]

The present government, elected in late 1999, saw that a more interventionist attitude was needed to ramp up innovation. This manifested itself in the creation in 2000 of the Science and Innovation Advisory Council to raise public esteem for science; promote a long term strategic direction for research science and technology; build private sector commitment; and coordinate government policies with business and the community. Innovation thus became (with social, environmental and economic policies) one of the four major government goals.

SUMMARY

This chapter examined the importance of creativity and innovation to the entrepreneur. The creativity process was described and ways of developing creativity were presented. Exercises and suggestions were included to help the reader increase the development of their creativity. The nature of the creative climate also was described. Various Asia–Pacific inventions and innovations were described and interesting case studies included.

The innovation process was described in detail. The four basic types of innovation – invention, extension, duplication and synthesis – were explained and the sources of innovation were outlined and examined. The last part of the chapter reviewed the myths commonly associated with innovation, presented the major innovation principles and discussed financial support for innovation. The stage-gate process of innovation was described in detail and the structure and function of several national innovation systems in the Asia–Pacific was depicted.

KEY TERMS AND CONCEPTS

appositional relationship
creative process
creativity
duplication
eureka factor
extension
functional perspective
incongruities
innovation
invention
left brain
muddling mind-sets
probability thinking
right brain
stage-gate
stereotyping
synthesis

REVIEW AND DISCUSSION QUESTIONS

1. In your own words, state what is meant by the term innovation.
2. What is the difference between an adaptor and an innovator?
3. What are four major components in the creative process?
4. What are the four steps involved in developing personal creativity?
5. What are four major types of innovation?
6. What are the major sources of innovation? Explain and give an example of each.
7. Briefly describe each of the five major myths commonly associated with innovation.
8. Identify and describe five of the innovation principles.
9. What is the stage-gate process of innovation and how does it systematise product development?
10. What is the function of national innovation systems?

EXPERIENTIAL EXERCISE

TOP 10 THINGS YOU CAN DO WITH DUCT TAPE

Here's an exercise (inspired by [www.ducttapefashion.com] and the Duct Tape Page [204.255.212.10/~jthorsse/duct.html]) where you can apply some of the things we have been learning about creativity and innovation.

Duct tape is a strong, fabric-based, multi-purpose adhesive tape that can be used for just about anything. It has been said that 'duct tape holds the world together'. Here are the top ten things you can do with it. Your task is to think of as many other uses as you can.

- Patch pipes under the house
- Cover the annoying 'check engine' light that won't go out
- Use as a band-aid
- Tape all the holes in the computer case shut so the fan noise isn't so annoying
- Tape an annoying person's mouth shut
- Repair eyeglass frames
- Patch a broken cigarette
- Hand-cuff the kids as an emergency baby sitter
- Be sure the toilet seat never stays up (duct tape it down)
- Get dried cat puke out of carpeting

EXPERIENTIAL EXERCISE

DEVELOPING YOUR PERSONAL CREATIVITY

This exercise is designed to help you develop your personal creativity. To enhance your creativity, you should make improvements in the following areas:

1. personal development – self-discipline, self-awareness, self-confidence, improvement in energy level and so on
2. problem-solving skills – problem recognition and so on
3. mental fluency – quantity of thoughts/ideas and so on
4. mental flexibility – switching gears/approaches and so on
5. originality – unusual thoughts and ideas and so on.

It is best to start small and work on a few things at a time. Follow the step-by-step approach listed next. Use the accompanying worksheet to help you design a personal creativity program.

1. Choose one of the five areas for improvement listed (for example, mental fluency).
2. Establish a specific objective for this area (for example, to increase your ability to generate logical and intuitive solutions to problems at work).
3. Decide how much time you will give to this program (for example, three hours per week).
4. Decide how long you will work in this area (for example, one month, two months).
5. Decide what actions you will take and what exercises you will perform to improve in this area (for example, sentence-creation exercises, usage ideas, meditation, suspension of initial judgements).
6. Set up an outline of your program (that is, day of week, time of day, place and what you will do during this time).
7. Review your program after completion and write a similar program for another one of the five areas for improvement.

PERSONAL CREATIVITY PROGRAM WORKSHEET

Area of improvement
Specific objective

Number of hours per week
Duration of program
Actions/exercises

Outline of program
Day of the week
Time of day
Place
Actions that day

CASE 5.1: POST-IT NOTES

One way new products are developed is to take a current product and modify it in some way. Another way is to determine how a previously developed product can be marketed or used by a particular group of customers.

The 3M Company is famous for many products, among them adhesives and abrasives. A few years ago one of the 3M managers, a member of a church choir, wanted to mark the pages of his hymnal so he could quickly find them. A bookmark would not do because the piece of paper could easily fall out. The manager needed something that would adhere to the page but not tear it. Back at work, the manager asked one of the members of the research and development department if an adhesive existed that would do this. One did, but it never had been marketed because the company found that the adhesive was not strong enough for industrial use. At the manager's request, a batch of the glue was prepared and applied to small pieces of paper that could be used as bookmarks.

As the manager who had requested the product began to think about the new product, he concluded it had uses other than as a bookmark. Secretaries could use it to attach messages to files and managers could use it to send notes along with letters and memos. In an effort to spur interest in the product, the manager had a large batch of these 'attachable' notes, now called Post-it Notes, made and began distributing them to secretaries throughout the company. Before long more people began to ask for them. The manager then ordered the supply cut off and told everyone who wanted them that they would have to contact the marketing department. When that department became inundated with calls for Post-it Notes, it concluded that a strong demand existed throughout industry for these notes and full production began. Today Post-it Notes is one of the largest and most successful product lines at the 3M Company.

QUESTIONS

1. In the development of this product, how did the creative thinking process work? Describe what took place in each of the four steps.
2. Why did the manager have the Post-it Notes sent to secretaries throughout the company? What was his objective in doing this?
3. What type of innovation was this – invention, extension, duplication, or synthesis? Defend your answer.
4. Which of the innovation sources discussed in the chapter help account for this product's success? Explain in detail.

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Motivation for Creativity in Organisations

Publication date: 23 January 1996
Author(s): Teresa M. Amabile
Product number: 396240

People will be most creative when they feel motivated primarily by the interest, enjoyment, satisfaction and challenge of the work itself – when they are driven by a deep involvement in their work and a passion for it. This note describes the ways in which creativity can be stimulated by this intrinsic motivation and by certain forms of extrinsic motivation, such as rewards that signal competence or support future achievement. Managerial implications are discussed.

Creativity is Not Enough

Publication date: 01 August 2002
Author(s): Theodore Levitt
Product number: R0208K

Creativity is often touted as a miraculous road to organisational growth and affluence. But creative new ideas can hinder rather than help a company if they are put forward irresponsibly. In this classic HBR article from 1963, the author, a professor emeritus at Harvard Business School and a former HBR editor, offers suggestions for the person with a great new idea.

Incat

Publication date: 30 August 2000
Author(s): Jonathan West, Christian G. Kasper
Product number: 9-601-045

Incat is a cutting-edge manufacturer of high-speed aluminium catamaran ferries. The company has been an entrepreneurial success story, growing to be the largest private employer in its home state of Tasmania, Australia. By 2000, Robert Clifford, the company's dynamic CEO and founder, must choose between two lucrative orders for different ferry designs. One order builds off the current 96-metre design while the other would push Incat to make a quantum jump to 200 metres. Analysis of the trade-offs in this 'bet-the-company' decision raises issues of manufacturing complexity, operations capabilities and the challenges of sustainable growth.

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6

ETHICS AND SOCIAL ENTREPRENEURSHIP

> That's the test of your ethics, when you're staring straight at the shame of failure. Each week your ethics are challenged by the promises you make. How much do you embellish your financial condition, the resources behind you, the success of your customers? What do you tell employees? Prospects? To get the sale, do you promise things you know you can't deliver? Do you make promises to your employees that you know in your heart you can't keep? I found I couldn't do those things … Because it's business we're talking about and because it's cutthroat and you can rationalise almost anything and because – especially when you're bootstrapping as we were – it's a matter of survival.
>
> Scott Cook, founder of Intuit[1]

CHAPTER OBJECTIVES

1. To discuss the importance of ethics for entrepreneurs
2. To define the term ethics
3. To study ethics in a conceptual framework for a dynamic environment
4. To review the constant dilemma of law versus ethics
5. To examine the role of ethics in the free enterprise system
6. To present strategies for establishing ethical responsibility
7. To examine cross-cultural concepts of ethics and corruption
8. To introduce the concept of social entrepreneurship
9. To emphasise the importance of entrepreneurs taking a position of ethical leadership

INTRODUCTION

This chapter serves a dual purpose. In the first half, we look at entrepreneurial **ethics** around the world. Then we turn to the fascinating topic of **social entrepreneurship**, which partially provides a response to unethical entrepreneurs.

Throughout the Asia–Pacific area, business crime is rife. This includes embezzlement, bribery, insider trading, industrial espionage, money laundering and computer crime. We should even look critically at the common practice in our region of giving and receiving gifts. Limited liability companies set up to safeguard the entrepreneur against the loss of personal as well as business assets are often abused. Incredibly, even in Australia and New Zealand, business fraud is rising. Unethical behaviour was detected in four out of 10 businesses according to a survey by accounting firm KPMG New Zealand. The typical fraud would be conducted by a mid-level management employee, about 30 to 35 years of age who had been with the organisation for 10 years or more in a trusted position. The person was usually in the finance section and would normally engage in a false invoicing-type fraud. Sexual harassment was the most commonly reported unethical behaviour, followed by running a private business during work hours, falsely claiming sick leave, unauthorised disclosure of information and conflict of interests.[2]

Ethics in the business world is certainly not a new topic. Ethics has figured prominently in philosophical thought at least since Socrates, Plato and Aristotle. Derived from the Greek word ethos, meaning custom or mode of conduct, ethics has challenged philosophers for centuries to determine what exactly represents right or wrong conduct. About 560 BC, the Greek thinker Chilon offered the opinion that a merchant does better to take a loss than to make a dishonest profit. His reasoning was that a loss may be painful for a while, but dishonesty hurts forever – and that still is timely advice.[3]

Ethical issues in business are of great importance today. And why not? The prevalence of scandals, fraud and various forms of executive misconduct in corporations has spurred the watchful eye of the public. Notorious scandals of the 1980s and 1990s involved some of our most famous entrepreneurs. The problem is that entrepreneurs sometimes see what works as right, within limits. As a result, they do not always adhere to conventional morality. Principle, propriety, protocol, even friendship and laws, all can seem incidental to the entrepreneur.

Today's entrepreneurs are faced with ethical decisions every day, especially during the early stages of their new ventures. As Sir Adrian Cadbury observes:

> There is no simple universal formula for solving ethical problems. We have to choose from our own codes of conduct whichever rules are appropriate to the case in hand; the outcome of these choices makes us who we are.[4]

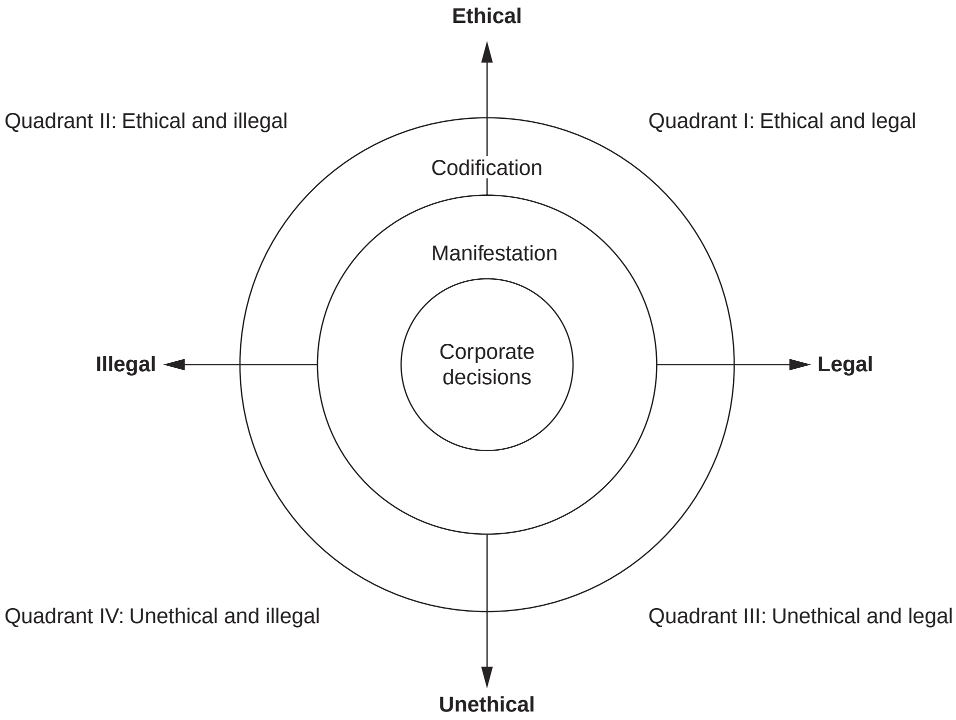
The purpose of this chapter is to examine issues surrounding ethics and entrepreneurship in a global environment. We also treat the question of **social responsibility** as the most pressing ethical imperative facing entrepreneurs today.

DEFINING ENTREPRENEURIAL ETHICS

In the broadest sense, ethics provide the basic rules or parameters for how society conducts any activity in an 'acceptable' manner.[5] More specifically, ethics represent a set of principles prescribing a behavioural code that explains what is good and right or what is bad and wrong at any given time. Morals are values held by an individual (or a moral community) and define what constitutes a good life. Ethics are essentially a system of moral duty and obligations.

The problem with most definitions of the term ethics is not in the description but rather in the implications for how to lead an ethical life. Definitions are static, but society is operating in a dynamic and ever-changing environment, so a consensus often does not exist.[6] In fact, continual

FIGURE 6.1 CLASSIFYING DECISION USING A CONCEPTUAL FRAMEWORK



Source: Verne E. Henderson, 'The ethical side of enterprise', *Sloan Management Review*, 23(3) (1982): 37–48.

conflict over the ethical nature of decisions is quite prevalent. The other problem is that a person's morals don't always match the ethics of the moment.

Conflict arises for many reasons. First, entrepreneurs are confronted by many interests, both inside and outside the organisation – for example, stockholders, customers, managers, the community, the government, employees, private interest groups, unions, peers and so on. Second, our society is undergoing dramatic change. Values, mores and societal norms all constantly fluctuate. A definition of ethics in such a rapidly changing environment must be based more on a process than on a static code.

Figure 6.1 illustrates a conceptual framework for viewing this process. As one ethicist states, 'Deciding what is good or right or bad and wrong in such a dynamic environment is necessarily "situational". Therefore, instead of relying on a set of fixed ethical principles, we must now develop an ethical process'.[7]

The quadrants depicted in figure 6.1 demonstrate the age-old dilemma between law and ethics. Moving from the ideal ethical and legal position (quadrant I) to an unethical and illegal position (quadrant IV), one can see the continuum of activities within an ethical process. Yet legality provides societal standards but not definitive answers to ethical questions.

THE RISE, FALL AND RISE OF ENTREPRENEURS IN AUSTRALIA

Back in the 1980s, it all looked so easy, the way the Aussie business magazines told it. The answer was simple. Australia's ideal was the high-flying entrepreneur: not in the sense of risk-taker developing a new enterprise, but more as a corporate predator making money from shuffling paper assets.[8] Such were the excesses that it cost Australia's commercial standing and the reputation of its entrepreneurs dearly and that damage continues to this day.

In 1992, the Australia Institute of Criminology described **entrepreneurial crime** this way:

> Entrepreneurial crime as a concept refers to punishable acts which are committed by individuals in controlling positions within corporations, using the resources and power deriving from the corporate form as a vehicle to achieve ends which benefit the entrepreneur personally … Factors contributing to the commission of entrepreneurial crime range from the psychological characteristics of individuals operating in a corporate culture which values risk-taking, to factors at the macro-economic level which may provide opportunities for such individuals.[9]

Here's a rogue's gallery of Australia's criminal entrepreneurs.

- Christopher Skase's activities are now the stuff of legend. Born in Melbourne in 1948, Skase became Australia's most wanted white collar criminal when he lost $1.5 billion of other people's money and then skipped the country. He exploited the adventurous spirit of Australian investors and then, when it all unravelled, began a perverse appeal to the Australian sense of a fair go. Skase fled to Majorca, lived in material comfort, complained at every attempt to bring him back and died thumbing his nose at the prosecutors. The Brisbane *Courier Mail* editorialised philosophically after Skase's death in 2001: 'If Skase represented most of the failings of corporate behaviour in the 1980s, the failure to bring him to justice spoke of the inability of successive governments to protect ordinary investors'.[10]
- Alan Bond came to Perth from England as a boy. He put together a land speculation company with just $1000 and interests eventually included Swan brewery, TV Channel 9, radio, property development and oil exploration. By the mid-1980s his personal wealth was put at some $400 million and he splashed it around with abandon. The stock market crash of 1987 gave him a $980 million loss. In 1997 Bond went to jail for criminal dishonesty in his business dealings. He was released from prison in 2000 but he still owes thousands of investors.
- Abe Goldberg, Australia's biggest bankrupt, is one 1980s entrepreneur who found a refuge in Poland. His Lintner textiles group, which produced garments under the Speedo, King Gee, Stubbies and Bradmill labels, collapsed owing $1.5 billion. Goldberg himself had personal debts of more than $790 million when he left the country in 1990, just days before his bankruptcy action began. However, in 1995 his creditors accepted $5.1 million and Abe Goldberg was discharged from his bankruptcy.
- George Herscu is also living in exile after his property and retail business Hooker Corporation went into liquidation in 1989 with debts of nearly $1.7 billion. Herscu had mortgaged Hooker to the hilt, then he expanded into the US with a series of disastrous shopping malls that increased debts by $1 billion in three years. He completed a five-year jail term for paying $100 000 in bribes to a Queensland minister.
- John Spalvins resides on Hamilton Island following the mid-1990s disintegration of his $2 billion Adelaide Steamship group, one of the country's largest industrial and retail combines, with debts of $470 million. In the 1980s Adelaide Steamship was one of Australia's largest industrial groups with a market capital of $2 billion and ownership of Woolworths, Penfolds Wines, Petersville and David Jones. By the mid-1990s it was worth a mere $10 million with debts of $470 million.
- New Zealander Bruce Judge built up a small Brisbane quarry operation called South Pine Quarries in Ariadne, a $1.8 billion conglomerate before the global share market crash of October 1987 sent the company down. He was behind a myriad of acquisitions and projects that were often done on the telephone or over lunch and often on a handshake with the paperwork done later. Judge's voracious expansion appetite led to Ariadne acquiring companies in a dozen countries with assets ranging from frozen bean curd to Alaskan oil, American building societies to the Wet 'n Wild

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theme park on the Gold Coast, swimming pools in Cincinnati, a finance company in England and property developments in Hong Kong. Judge has retired to the south of France and obscurity.

From an ethical perspective, these men led the Australian public to shun entrepreneurs for many years. Fortunately that has been changing. Today's Australian entrepreneurs are regarded as people prepared to have a go and take some risks. That's the finding of the 'Eye on Australia 2005' survey.[11] 'People have stopped associating the word entrepreneur with the likes of the Bonds and Skases and now see them as battlers prepared to take on the big corporations', *BRW* said. Some 97 per cent of people who responded to the survey said they admired anyone who went out and started their own company, whereas 64 per cent said they did not trust big companies.

ETHICS AND LAWS

Just in passing we might make mention of criminal entrepreneurs as they have been the subject of some very interesting study. Van Duyne looks at the 'enduring hostile entrepreneurial landscape' for criminals.[12] Moselli has looked at career opportunities in the Cosa Nostra.[13] Bolton and Thompson have a fascinating chapter on the likes of Al Capone. Just as social and business entrepreneurs share personality traits, there are many of those traits that they share with criminal entrepreneurs. These people have to be excellent risk managers and information managers. They are future-oriented organisation builders. Like business entrepreneurs, they are continually working the 'edge'. They are leaders with vision and delegate to trusted associates. Whether engaged in petty crime like Martha Stewart, large-scale embezzlement like Michael Milken, or organised crime like the Gambinos, criminal entrepreneurs share one thing in common: they steal from innocent people. Entrepreneurs who value their companies and hope to see them prosper must take a firm stand on these ethics.

ENTREPRENEURSHIP
IN PRACTICE

TRUE LIES

To grow their companies, some entrepreneurs have engaged in an astounding amount of embellishment verging on lying. Here's a taste of the hyperbole chronicled in *Inc.* magazine.

Customers can't live without us. When Jim Zona, CEO of Pittsburgh Plastics, was trying to sell his company's shoe-insole inserts to retail outlets, he'd have someone stop in a store and ask if it carried Gel-Soles. Two days later he'd have somebody else stop at the same store. After a few days he'd have a salesperson call on the store to see if it wanted to carry his product. 'And they'd say, "Come on down"', recalls Zona. 'Once we got in those stores, we'd tell everybody to go there to buy the product.'

Sure, we can do that. To get started and bring in much-needed capital, Steve Burkhart, cofounder of Advanced Micro-Electronics, an Indian computer-maintenance company, put a bid on the service contract for a local university. The problem was that he didn't have a clue how to price the contract or what would be involved in maintaining all the computers on campus. 'We just didn't know a lot of things at that point', says Burkhart. He bid $41 000 with payment due up front. Since everyone else bid more than $100 000, Advanced Micro got the job. The college never asked for references. The college is still a customer and Burkhart is still bidding on projects he claims to know nothing about. 'Right now we're trying to put together a bid for seven GE plants in Mexico. We don't have a clue how to do international business', he says.

I've got a closet full of people. In 1990, when Robert Luster started Luster Construction Management, a San Francisco-based consulting firm that caters to large construction projects, he couldn't afford to hire any employees. 'But', he says, 'I had 25 individuals I'd already interviewed that as I found a job I could hire.' That's how Luster says he built his business. He had permission from the 25 applicants to use their resumes, which he would bring to prospective construction-project clients. 'In professional services', says Luster, 'they're not so much interested in the company as in the individual you can deliver'. All that posturing was done with one aim: to paint a picture of a company that was more established than it was.

Source: Jeffrey L. Seglin, 'True lies', *Inc*, October 1998.

Here we are considering the real-life business entrepreneur, who sometimes faces the dilemma of legal versus ethical behaviour (figure 6.2). Just how far down the road towards illegality can an entrepreneur go to establish a new venture? Survival of the firm has to be a strong motivation for entrepreneurs and, although law provides the boundaries for what is illegal (even though the laws are subject to constant interpretation), it does not supply answers for ethical considerations.

Ethical rationalisations

In fact, one researcher suggests that legal behaviour represents one of four **rationalisations** that business people use for justifying questionable conduct. The four rationalisations are believing that:

- the activity is not 'really' illegal or immoral
- it is in the individual's or the corporation's best interest
- it will never be found out anyway
- because it helps the firm's growth, the company will condone it.[14]

These rationalisations appear realistic, given the behaviour of many business enterprises today. However, their legality can be dubious. This is because the business world and society itself rely heavily on the law to qualify the actions of various situations. The law interprets the situations within the prescribed framework. Unfortunately, this framework does not always include ethical or moral behaviour. This is left up to the individual, which is the precise reason for the dilemma.

In any examination of the realm of business rationalisations, the idea of morally questionable acts becomes a major concern for understanding ethical conduct. One research study developed a typology of morally questionable acts.[15] Table 6.1 summarises the distinctions made in this typology. Morally questionable acts are either 'against the firm' or 'on behalf of the firm'. In addition, the role behaviour of the manager or entrepreneur differs according to the various acts. **Non-role** acts are those the person takes outside of their role as manager or entrepreneur, yet they go against the firm. Examples would include expense account cheating and embezzlement. **Role failure** acts are also against the firm, but they involve a person failing to perform their role, including superficial performance appraisals (not totally honest) and not confronting someone

TABLE 6.1: TYPES OF MORALLY QUESTIONABLE ACTS

TYPE	DIRECT EFFECT	EXAMPLES
Non-role	Against the firm	Expense account cheating Embezzlement Stealing supplies
Role failure	Against the firm	Superficial performance appraisal Not confronting expense account cheating Palming off a poor performer with inflated praise
Role distortion	For the firm	Bribery Price fixing Manipulating suppliers
Role assertion	For the firm	Investing in Zimbabwe Using nuclear technology for energy generation Not withdrawing product line in face of initial allegations of inadequate safety

Source: James A. Waters and Frederick Bird, 'Attending to ethics in management', *Journal of Business Ethics* 5 (1989): 494.

who is cheating on expense accounts. **Role distortion** acts and **role assertion** acts are rationalised as being 'for the firm'. These acts involve managers/entrepreneurs who rationalise that the long-run interests of the firm are foremost. Examples include bribery, price fixing, manipulating suppliers and failing to withdraw a potentially dangerous product from the market.

All four of these roles involved in the morally questionable acts, whether 'for' or 'against' the firm, illustrate the types of rationalisations that can occur. In addition, this typology presents an interesting insight into the distinctions involved in rationalisation.

The matter of morality

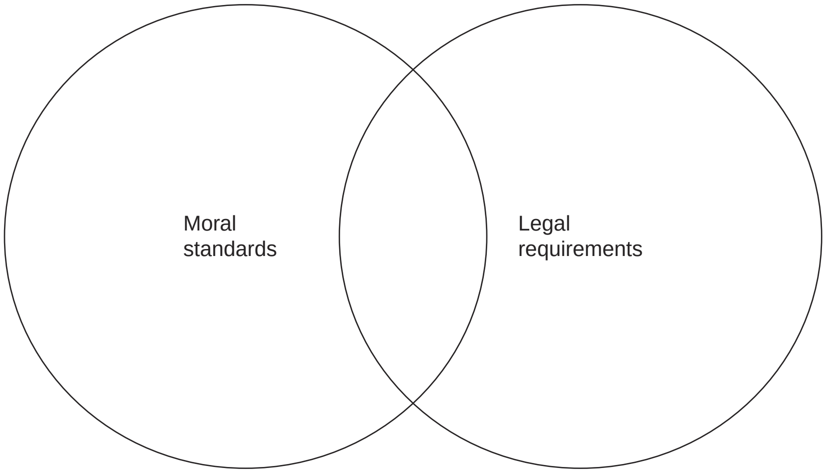
Ethical conduct may sometimes actually go beyond the limits of the law (just think of Greenpeace's harassment of whaling ships).[16] Morality and the law are not identical but may be viewed as two overlapping circles with considerable grey area (see figure 6.2). The area covered by both the moral standards circle and the legal requirements circle represents the body of ideas that are both moral and legal. The law may overlap but often does not duplicate society's moral standards.

Hosmer outlines three important conclusions regarding the relationship between legal requirements and moral judgement. First, some laws have no moral content whatsoever (which side of the road one drives on), some laws are morally unjust (plundering companies) and some moral standards have no legal basis (telling a white lie or fluffing up a story). Second, legal requirements tend to be negative (forbidding acts), whereas morality tends to be positive (encouraging acts). Third, legal requirements usually lag behind the acceptable moral standards of society.[17] In the end, though, the largest expanse of area is outside this overlapping portion, indicating the vast differences that usually exist between morality (ethics) and the law.[18]

Economic and ethical trade-offs

Innovation, risk-taking and venture creation are the backbone of the free enterprise system. From this system emerge the qualities of individualism and competition. These qualities have produced an economic system that creates jobs and enormous growth in new ventures. However, these

FIGURE 6.2 OVERLAP BETWEEN MORAL STANDARDS AND LEGAL REQUIREMENTS



same qualities also have produced complex trade-offs between profits and ethical standards, as revealed by the following situations:

- Tour operators bring the tourists to certain shops where the salespeople charge higher prices than other shops and later the profits are shared between the operators and the shop owners.
- Tobacco companies based in Britain and the USA are largely responsible for the spread of the smoking habit to developing countries. Advertisements for Marlboro cigarettes show young, athletic, outdoorsy men and women, yet cigarettes kill millions each year.
- Alcoholic drinks are advertised as products that will bring sexual prowess, success and power.
- Harry Potter is now selling Coca-Cola to kids. Coke and other sodas are filled with empty calories that are making kids fatter than ever before. That puts young kids at risk of serious diseases, not to mention dental cavities.
- Nestlé ads promote infant formula as a substitute for breast milk around the world. International activist groups have criticised the infant formula manufacturers for their marketing strategies to promote their products, particularly in the developing countries.

These vignettes demonstrate the conflicting needs that the free enterprise system puts on people. On the one hand are profits, jobs and efficiency; on the other hand personal and social respect, honesty and integrity. A utilitarian ethical norm would calculate what the greatest good for the greatest number would be.[19] This calculation also would take into account future generations. Unfortunately, although the calculation sounds easy, in practice it borders on the impossible.

So why do entrepreneurs commit crimes? Some explanations include:

- greed
- distinctions between activities at work and activities at home
- a lack of a foundation in ethics
- survival (bottom-line thinking)
- a reliance on other social institutions to convey and reinforce ethics.

One body of thought believes that unethical and illegal behaviours are actually learned in the workplace. 'White-collar criminals as well as street criminals should be viewed as conformists rather than as deviants because they have taken over behaviour patterns that are dominant in their social worlds'.[20] Moreover, wealth and corporate success are highly prized values. To play 'chicken' with the maze of sometimes contradictory taxation and company laws and win, may be seen as a culturally legitimate challenge in the entrepreneur's world.[21] Whatever the reasons, ethical decision making is a challenge that confronts everyone involved in large or small enterprises.[22]

A STRATEGY FOR ETHICAL RESPONSIBILITY

Scottish philosophers in the eighteenth century saw the market economy as the new 'civil society', a path towards freedom and a new morality, separate from the monarchy. They (perhaps foolishly) expected markets to be self-regulating and to function with ties to a moral life. But that vision was destroyed when corporations rose to power in succeeding centuries, monarchies disappeared and governments were enlarged to regulate markets. Because the free enterprise system in which the entrepreneur flourishes is fraught with countless conflicts, entrepreneurs now need to commit to an established strategy for ethical responsibility. In this section we offer some compass points for orienteering through this labyrinth.

Ethical practices and codes of conduct

Highly publicised episodes of corporate misconduct occur with disturbing frequency. Firms produce defective products, release toxic substances into the environment, hire child labour, buy products produced with exploited labour and permit dangerous conditions to exist in their workplaces. The propensity for irresponsible acts is not confined to rogue companies, but crops up in even the most respectable firms.[23]

Great advances have taken place in the 1990s towards codes of conduct for entrepreneurs and business managers. A **code of conduct** is a statement of ethical practices or guidelines to which a company adheres. Many such codes exist – some related to industry at large and others related directly to corporate conduct. These codes cover a multitude of subjects, ranging from misuse of corporate assets, conflict of interest, use of inside information to equal employment practices, falsification of books or records and anti-trust violations. They have gained some measure of acceptance but they also raise many awkward issues, from the inconsistency of their coverage and requirements – often at variance with public regulatory frameworks – to the looseness of their implementation and assessment procedures.[24]

How prevalent are codes of conduct today? A Conference Board survey in 1991 put the proportion of companies that had codes of conduct at 82 per cent (possibly because companies with such codes are more likely to fill out the survey).[25] A 1997 KPMG survey of Canadian companies showed that 66 per cent reported having a code of conduct, but another survey showed that only one in five Canadian companies had codes of conduct.[26]

Whatever the proportions, there has been a dramatic increase of interest in voluntary codes of conduct for entrepreneurs and business managers. Interest has grown as labour standards and working conditions in consumer products industries have deteriorated. This is in the wake of trade liberalisation, globalisation and restructuring of production and distribution networks. For many companies, a voluntary code of conduct is seen as preferable to increased government regulation.[27]

In addition, unethical practices have a corrosive effect on free markets, free trade and the free enterprise system. Unethical practices subvert the laws of supply and demand and they short-circuit competition based on classical ideas of product quality, service and price. Entrepreneurship cannot survive in unnatural markets.[28] Only time will tell whether codes of conduct will serve to improve business practices.

Ethical differences among entrepreneurial firms

Faced with the disadvantage of being new, the massive scarcity of resources and concerns of the firm's very survival, start-up entrepreneurs encounter difficult ethical decisions and might be pressured to make choices that run counter to more developed ethical and moral reasoning.[29] Michael Morris and colleagues have looked at the formal and informal ethical structures that emerge in entrepreneurial firms over the life cycle of a firm.[30] These structures have many sources, including the entrepreneur's psychological profile, life cycle stage of the business and other characteristics of the venture.

There are four distinct types of firms based on their formal and informal ethical structures:

- **Superlatives:** Superlative firms place a priority on ethics and have procedures in place to ensure dependable adherence to ethical norms. According to Morris' research, about one in five firms falls into this category.
- **Deficients:** At the other end of the spectrum are the 'deficients'. Here the ethical climate is not considered a managerial responsibility, although some of these firms may select out an employee who acts ethically. These account for half of all firms.

ENTREPRENEURIAL EDGE

A PRINCIPLED APPROACH

Entrepreneurs can develop specific principled positions that will assist them in making ethical decisions as their ventures develop. Here are the principles that Carl Schramm of the Kauffman Foundation advocates:

> The ethical principles in business remain simple and clear. Their essence can be stated clearly in a few rules. Honour contracts. Be truthful about the condition of a good or commodity. Do not engage in sharp practices in the negotiation and performance of a contract. Treat customers fairly and in every way as you would want to be treated. Be fair – and transparent – with investors. Consolidate accounting, report all revenue and expenses in the appropriate period using truth-based accounting that accurately represents the state of your enterprise.[31]

Mark Twain summed it up brilliantly: 'Always do the right thing. This will surprise some people and astonish the rest'. Other principles include:

ETHICAL RESPONSIBILITY

Establishing a strategy for ethical responsibility is not an easy task for entrepreneurs. No single ideal approach to organisational ethics exists. Entrepreneurs need to analyse the ethical consciousness of their organisation, the process and structure devised to enhance ethical activity and, finally, their own commitment to institutionalise ethical objectives in the company.[32] Keeping these points in mind, entrepreneurs eventually can begin to establish a strategy for ethical responsibility. This strategy should encompass three major elements: ethical consciousness, ethical process and structure, and institutionalisation.[33]

ETHICAL CONSCIOUSNESS

The development of ethical consciousness is the responsibility of the entrepreneur since their vision created the venture. The key person who sets the tone for ethical decision making and behaviour is the entrepreneur. An open exchange of issues and processes within the venture, established codes of ethics for the company and the setting of examples by the entrepreneur are all illustrations of how this is done. One British company that produces T-shirts only from organic cotton describes it this way:

> Bring products to market in a way that makes sense. In a way that's good for people and good for the environment. To offer conscious consumers an ethical choice. To contribute to the global civil movement's struggle. To create a world that makes sense.[34]

ETHICAL PROCESS AND STRUCTURE

Ethical process and structure refer to the procedures, position statements (codes) and announced ethical goals designed to avoid ambiguity. Having all key personnel read the venture's specific ethical goals and sign affidavits affirming their willingness to follow those policies is a good practice for ventures.

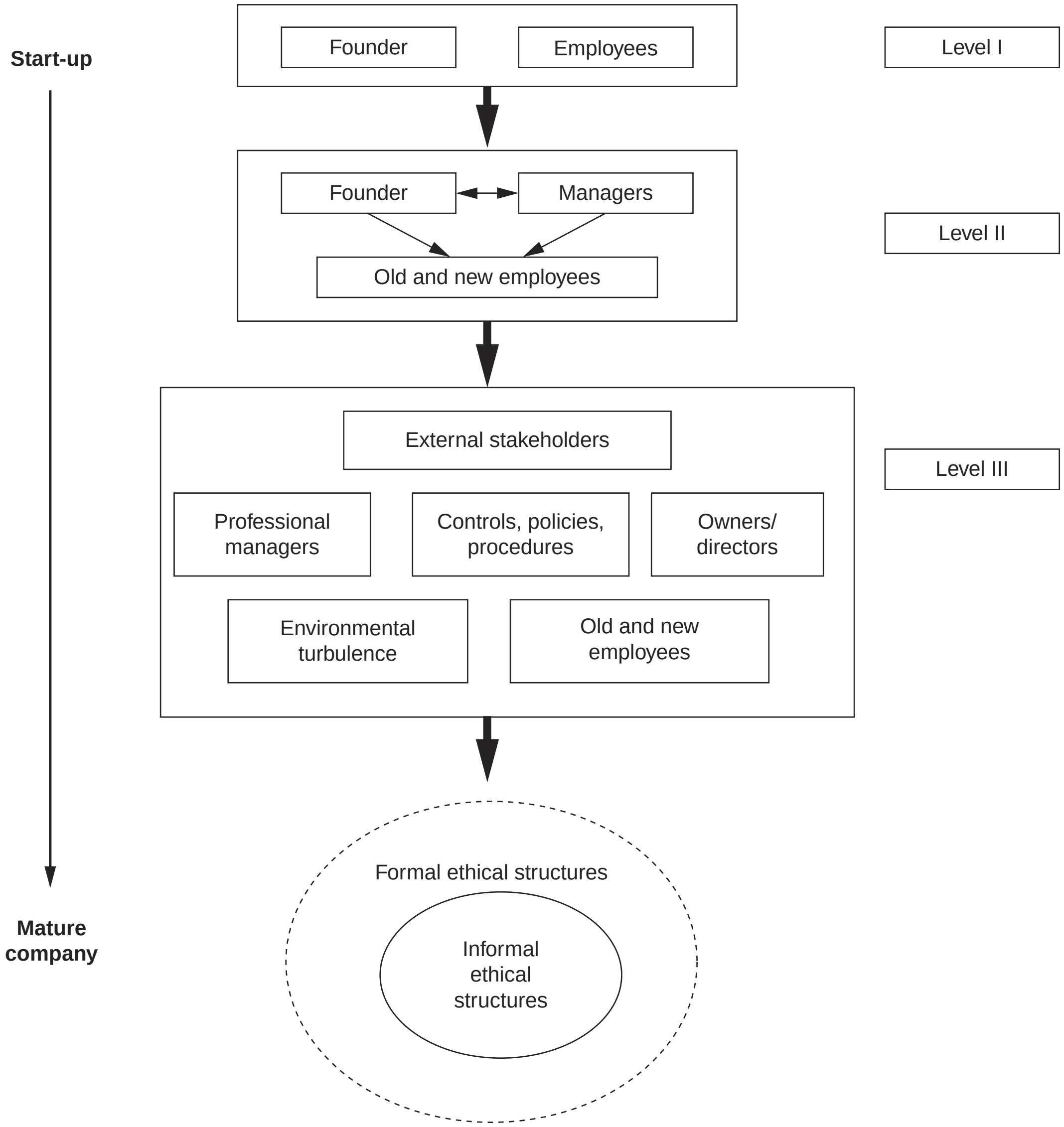
INSTITUTIONALISATION

Institutionalisation is a deliberate step to incorporate the entrepreneur's ethical objectives with the economic objectives of the venture. At times an entrepreneur may have to modify policies or operations that become too intense and infringe on the ethics of the situation. This is where the entrepreneur's commitment to ethics and values is tested. Constant review of procedures and feedback in operations are vital to institutionalising ethical responsibility.

- **Core proponents:** These firms may mention ethics in their core mission statements or they may have a code of conduct. But beyond this, it is hands off – no training, few incentives, rare discussion.
- **Pain and gain:** These firms differ from the 'core proponents' in that they do not do the symbolic things such as mission statements and codes of conduct. Yet, they do carry out more interventionist strategies, make role models out of exemplary employees and talk to employees about ethical behaviour.

The entrepreneurial context moves from level to level as the firm grows and develops over time (see figure 6.3). The greatest change involves the ethical reference point that a firm has. It starts out comprising simply the individual entrepreneur's values and judgement but then evolves

FIGURE 6.3 EVOLUTION IN THE ETHICAL REFERENCE POINT AS VENTURES GROW



Source: Michael H. Morris, Minet Schindehutte, John Walton and Jeffrey Allen, 'The ethical context of entrepreneurship: Proposing and testing a developmental framework', *Journal of Business Ethics* 40(4) (2002): 336.

when a professional team enters the picture. At level I, the entrepreneur's own moral values are the firm's compass. There are fewer formal structures, looser control systems and less documentation. The focus is on 'doing' not contemplating ethical considerations. At level II, the firm has acquired specialist employees and may set up an administrative core. Here, the complex interaction between the employees' different personal value systems makes the operations more complex. Moral and ethical considerations from the early days may hold back company growth. Also, the firm moves from fund-raising mode to marketing mode and this changes the ethical dynamics. Numerous ethical dilemmas emerge, including cash flow constraints, CEO overload, low sales, quality control and product limits. Finally, at level III, large firms are more likely to have formal and systematic ethical guidelines. There's a greater distance between the owners and the managers. When the firm goes public, stockholders have an impact, sometimes lowering ethical standards. But in this environment, decision making becomes a group effort and self-interest plays less of a role. Indeed, at this stage the company should have a heightened sense of ethical responsibility due to a professionalised management, strong organisational norms and reward systems.

BUSINESS ETHICS IN THE CROSS-CULTURAL WORLD

One vexing problem we face is how to address global issues in entrepreneurship from very different, often conflicting, perspectives within and across cultures. Given the enormous variety in the ways business is undertaken around the world, there simply may not be one single set of ethics that applies to everyone. The system of entrepreneurship norms may well be relative to particular cultures and even particular communities within those cultures. Several frameworks have been proposed to address this conundrum in a global context.[35]

What all the scholars say is that there is no simple answer to what is right and wrong ethical behaviour across different cultures. The two extreme positions are **relativist ethics** or **absolutist ethics**. The relativist says 'when in Rome, do as the Romans do'. The absolutist argues that the home country's values must be applied everywhere as they are at home.

The *Global Corruption Report* is an annual evaluation of the state of **corruption** around the world, produced by Transparency International, the world's leading anti-corruption non-government organisation (NGO). The Corruption Perceptions Index relates to perceptions of the degree of corruption as seen by business people, academics and risk analysts and ranges between 10 (highly clean) and 0 (highly corrupt). The scores for the Asia–Pacific countries are shown in table 6.2.

Clearly the globally oriented entrepreneur is going to face a myriad of business environments in the Asia–Pacific ranging from virtually uncorrupt New Zealand and Singapore through to the most vile forms of business corruption in such countries as Philippines, Papua New Guinea and Indonesia. Doing business in the otherwise quite enlightened South Korea means running the gauntlet of petty officers and bribes. Big markets such as China require a whole new orientation to dealing with corruption.

Global entrepreneurs are on the front line in the struggle against corruption. If they pay bribes too easily, they help perpetuate the problem. In the best case, they can serve as positive agents for change by implementing high standards within their own firms. But, sadly, more than half of the Hong Kong and Singaporean companies believed they had lost business in the previous year because a competitor had paid a bribe. The figure was lower for companies from the United States and Europe but, even so, a quarter of British companies thought they had lost business to corrupt competitors in the last five years.[36]

As an example, take **bribery** (an offer or receipt of any gift, loan, fee, reward or other advantage to or from any person as an inducement to do something which is dishonest, illegal or a breach of trust, in the conduct of the enterprise's business).[37] There is growing awareness of the risks posed by bribery, particularly in the light of recent scandals and the public is expecting greater accountability from the business sector. The adoption in December 1997 of the OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions was widely hailed as the most promising development in the fight against international corruption. But a study by the Control Risks Group (CRG) showed that general awareness of the Anti-Bribery

ENTREPRENEURSHIP IN PRACTICE

SHAPING AN ETHICAL STRATEGY

The development of an organisational climate for responsible and ethically sound behaviour requires continuing effort and investment of time and resources. A code of conduct, ethics officers, training programs and annual ethics audits do not necessarily add up to a responsible, ethical organisation. A formal ethics program can serve as a catalyst and a support system, but organisational integrity depends on the integration of the company's values into its driving systems.

Here are a few key elements entrepreneurs should keep in mind when developing an ethical strategy.

- The entrepreneur's guiding values and commitments must make sense and be clearly communicated. They should reflect important organisational obligations and widely shared aspirations that appeal to the organisation's members. Employees at all levels must take them seriously, feel comfortable discussing them and have a concrete understanding of their practical importance.
- Entrepreneurs must be personally committed, credible and willing to take action on the values they espouse. They are not mere mouthpieces. They must be willing to scrutinise their own decisions. Consistency on the part of leadership is key. Entrepreneurs must assume responsibility for making tough calls when ethical obligations conflict.
- The espoused values must be integrated into the normal channels of the organisation's critical activities: planning innovation, resource allocation, information communication and personnel promotion and advancement.
- The venture's systems and structures must support and reinforce its values. Information systems, for example, must be designed to provide timely and accurate information. Reporting relationships must be structured to build in checks and balances to promote objective judgement.
- Employees throughout the company must have the decision-making skills, knowledge and competencies needed to make ethically sound decisions every day. Ethical thinking and awareness must be part of every employee's skills.

Source: Adapted from Lynn Sharp Paine, 'Managing for organisational integrity', *Harvard Business Review* (March/April 1994): 106–17.

TABLE 6.2: ASIA–PACIFIC CORRUPTION PERCEPTIONS INDEX 2005

WORLD RANK	COUNTRY	2005 CORRUPTION PERCEPTIONS INDEX SCORE
2	New Zealand	9.6
5	Singapore	9.4
9	Australia	8.8
15	Hong Kong	8.3
17	USA	7.6
21	Japan	7.3
39	Malaysia	5.1
40	South Korea	5
59	Thailand	3.8
78	China	3.2
107	Vietnam	2.6
117	Philippines	2.5
130	Papua New Guinea	2.3
137	Indonesia	2.2

ENTREPRENEURIAL EDGE

ENTREPRENEURIAL ETHICS IN CHINA

Tong Liqun founded the entrepreneurial start-up Runway Technology Co. in Beijing in 1994. Runway is a provider of application software and system-integration services to the telecommunications industry.

Our toughest challenge in the beginning was our lack of credibility and legitimacy. Much of our time was spent networking with government officials and making connections in large companies. We knew we needed to do something entrepreneurial to establish our credibility as a company. There was an instance once when I wanted to win a contract with a multinational company, except I couldn't speak English and I had no experience in negotiations.

So I went to a top university and hired a doctoral student to negotiate the deal. The student posed as my research and development director. The company also wanted to see our facilities. At the time, we had no other employees and no facilities. So I secured a favour from a friend who worked in a state research institute. We took the foreign representatives to the well-equipped research institute and presented it as our research and development centre. The representatives were impressed and we were awarded the contract. With the contract, we were able to establish credibility and secure the capital to build our company's infrastructure and meet the order. That contract was a significant turning point, as after that, we were seen as a credible player in the industry and were able to compete with other companies.

Indeed, looking back at the way we started our initial growth, it is what you summarized in our class as 'getting on the bus first and then paying for the ticket' approach. Strictly speaking, we didn't do it the right way by buying the ticket before we got on the bus, but then neither did we cheat and lie to our client in a way that broke any law or violated the client's interest. We delivered on our promise on time and the client became a long-time partner. We didn't know when our ride would come in, but we couldn't afford to check a timetable and wait. We would have missed it. In fact, there was no timetable. We were lucky to be at the right time in the right place and to meet the right people.

Source: Justin Tan and David Tan, 'Entry, growth and exit strategies of Chinese technology start-ups: Choosing between short-term gain or long-term potential', *Journal of Management Inquiry* 13(1) (2004) 49–54.

Convention is low. German companies appeared more cynical: 52 per cent of respondents were aware of new national legislation, but only 24 per cent had reviewed their business practices.[38]

BEYOND SOCIAL RESPONSIBILITY: THE PROMISE OF SOCIAL ENTREPRENEURSHIP

Do entrepreneurs owe a debt to society? The idea that once people become financially successful, they have a moral obligation to give something back to society is based on four fallacious assumptions, according to American Tom Kane. First, business activities are fundamentally exploitative. Second, free-market transactions are a zero-sum game in which one party wins and the other loses. Third, actions motivated by self-interest are harmful

TABLE 6.3: PERCENTAGE OF COMPANIES THAT LOST BUSINESS BECAUSE A COMPETITOR PAID A BRIBE

	… IN THE LAST 12 MONTHS (%)	… IN THE LAST 5 YEARS (%)
Hong Kong	56	60
Singapore	52	64
Netherlands	24	40
Germany	24	36
United States	18	32
Great Britain	16	26

to society. Fourth, income, like rainfall and winning lottery tickets, is randomly distributed and completely unrelated to individual merit or productivity. Rather, he says, it is the economically successful members of society who are owed a debt of gratitude for providing the jobs, goods and services that enrich lives. In the end, his argument goes, consumers receive more economic benefit from using products than entrepreneurs earn from producing them. To Kane, entrepreneurs are under no obligation to return to society.[39]

For some years now, business social responsibility has emerged as a major issue. Although it takes different forms for different industries and companies, the basic challenge exists for all. Social responsibility consists of obligations a business has to society, for both altruistic and material reasons. These obligations extend to many different areas – table 6.4 presents some of them.

But since the mid-1990s a new form of social responsibility has emerged. We call it *social entrepreneurship*. What business entrepreneurs are to the economy, social entrepreneurs are to social change. The difference is interesting because the common myth is that entrepreneurs are always supposed to take a Machiavellian view of business – a view that says that the ultimate and

TABLE 6.4: WHAT IS THE NATURE OF SOCIAL RESPONSIBILITY?

Environment	Pollution control
	Restoration or protection of environment
	Conservation of natural resources
	Recycling efforts
Energy	Conservation of energy in production and marketing operations
	Efforts to increase the energy efficiency of products
	Other energy-saving programs (e.g. company-sponsored car pools)
Fair business practices	Employment and advancement of women and minorities
	Employment and advancement of disadvantaged individuals (disabled, Vietnam veterans, ex-offenders, former drug addicts, mentally retarded and hardcore unemployed)
	Support for minority-owned businesses
Human resources	Promotion of employee health and safety
	Employee training and development
	Remedial education programs for disadvantaged employees
	Alcohol and drug counselling programs
	Career counselling
	Child day-care facilities for working parents
	Employee physical fitness and stress management programs
Community involvement	Donations of cash, products, services, or employee time
	Sponsorship of public health projects
	Support of education and the arts
	Support of community recreation programs
	Cooperation in community projects (recycling centres, disaster assistance and urban renewal)
Products	Enhancement of product safety
	Sponsorship of product safety education programs
	Reduction of polluting potential of products
	Improvement in nutritional value of products
	Improvement in packaging and labelling

Source: Richard M. Hodgetts and Donald F. Kuratko, *Management*, 3rd edn (San Diego: Harcourt Brace Jovanovich, 1991), 670.

TABLE 6.5: STAGES OF GROWTH FOR SOCIAL ENTREPRENEURS

STAGE ONE APPRENTICESHIP	STAGE TWO LAUNCH	STAGE THREE TAKE-OFF	STAGE FOUR MATURITY
Acquire skills and experience Learn the field, problems, players and existing approaches Conceive of, investigate and flesh out new ideas	Devote 100% of energy to implementing new ideas Create motivational base of operations Test and refine role model programs Attract support	Spread ideas to regional and national levels Consolidate institution and funding Ideas are recognised and respected	Innovations are widely accepted as a new pattern in society Social entrepreneur is recognised as a change-maker in their field Social entrepreneur may start other innovations and/or play a broader leadership role in society
Duration 10+ years	Duration 3–5 years	Duration 5–15 years	Duration unlimited

Source: Ashoka Institute, 'Innovators for the public', cited in *The Jobs Newsletter: Essential Information on an Essential Issue* (147) (27 June 2001) [www.jobsletter.org.nz/jbl14700.htm].

only responsibility of an entrepreneur is to make money and/or to make a profit, hence the end justifies the means in so doing.

London Business School Dean Laura Tyson has defined social entrepreneur as a person 'driven by a social mission, with a desire to find innovative ways to solve social problems that are not being or cannot be addressed by either the market or the public sector'.[40] Bill Drayton, founder of the US 'Ashoka Fellows' (a network of social entrepreneurs), distinguishes the spectrum this way:

> The professional succeeds when she solves a client's problem. The manager calls it quits when he has enabled his organisation to succeed. Social entrepreneurs go beyond the immediate problem to fundamentally change the system, spreading the solution and ultimately persuading entire societies to take new leaps'.[41]

Social entrepreneurship is not a new phenomenon. While the name may be relatively new, individuals who adopt entrepreneurial strategies to tackle social issues are not.

- **Vinoba Bhave** (India, 1895–1982): Founder and leader of the Land Gift Movement, he caused the redistribution of nearly 7 000 000 hectares of land to aid India's untouchables and landless. Mahatma Gandhi described him as his mentor.
- **Maria Montessori** (Italy, 1870–1952): Developed the Montessori approach to early childhood education.
- **Florence Nightingale** (UK, 1820–1910): Founder of modern nursing, she established the first school for nurses and fought to improve hospital conditions.
- **Susan B. Anthony** (US, 1820–1906): Fought for women's rights in the United States, including the right to control property, and helped spearhead adoption of the nineteenth amendment.
- **Jean Monnet** (France, 1888–1979): Responsible for the reconstruction and modernisation of the French economy following World War II, including the establishment of the European Coal and Steel Community (ECSC), which led to the European Common Market and the European Union.[42]

Personality traits of social entrepreneurs

Social entrepreneurs have many of the personality traits of business entrepreneurs. They are the same driven, creative individuals who question the status quo, exploit new opportunities, refuse to give up – and remake the world for the better. In many parts of the world, the fastest-growing

ENTREPRENEURSHIP IN PRACTICE

THE SOCIAL ENTREPRENEUR: DOING GOOD WHILE GOING WELL

Doing well means being able to build an economically sustainable enterprise. This means that the cash flow, income statement and balance sheet reflect a going concern. There is a sustainable market that can be supported by operations that can consistently meet the quality and delivery needs of the market.

Doing good means:

- being able to help individuals improve the quality of their lives
- being able to alleviate poverty
- having a sustainable environment.

Doing good after doing well is to donate to charitable institutions after the enterprise has generated returns on the investment. This means that the act of charity happens because there is surplus from the economic activity. It also means that the economic activity happened first and is separate from the socially responsible activity. Many firms practise this form of social responsibility.

A social entrepreneur does not make a distinction between the activities that do good and the activities that do well. Activities that do good also do well. A typical social entrepreneur may be a leader of a foundation, a non-governmental organisation (NGO), a cooperative or an enlightened classic organisation. The new types along the same context are microfinance practitioners and enlightened classic entrepreneurs.

Microfinance practitioners lend to the enterprising poor. They do good because they are able to provide capital to people who are not considered creditworthy in the formal credit systems. They do good because the object of their lending is to have the enterprising poor set up a poverty-alleviating, sustainable enterprise which otherwise would not have been possible for lack of capital. They do good because the enterprising poor is able to create job opportunities for the less enterprising poor.

They do well because their lending system is efficient. They have 400 to 450 active borrowers per account officer. Their collection efficiency is a shade below 100 per cent. These are, of course, higher than traditional or formal lending. They do well because their efficient collection is able to generate funds for re-lending to other enterprising poor. They do well because they are able to have returns that are often better than those of formal lending systems.

They measure their success not by their customers or beneficiaries borrowing from them again but by the number of customers or beneficiaries who graduate from poverty and become 'bankable' in the formal system. They view success when the customer or beneficiaries say politely , 'I no longer need … thank you. Now I can borrow from the traditional bank at lower interest rates'.

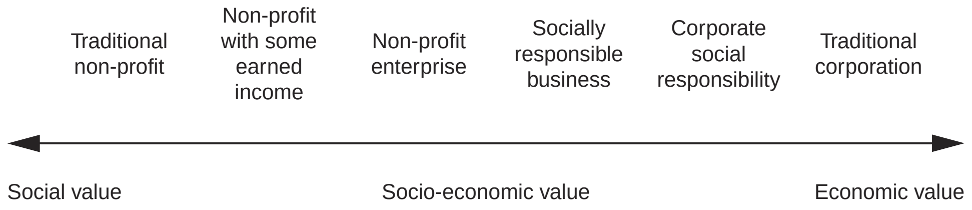
Source: Prof. Alejandrino J. Ferreria, 'The social entrepreneur: Doing good while going well', *BusinessWorld* (24 June 2005).

segment of society is actually the non-profit sector, as millions of social entrepreneurs are increasingly stepping in to solve problems where governments and bureaucracies have failed. One recent book, *How to Change the World*, shows that, with determination and innovation, even a single person can make a surprising difference.[43]

Social enterprise is the term used for a 'market-based venture addressing social aims'. Social enterprises have three common characteristics:

- **Enterprise oriented:** They are directly involved in the production of goods and the provision of services to a market. They seek to be viable trading concerns, making a surplus from trading.
- **Social aims:** They have explicit social aims, such as job creation, training and provision of local services. They are based on ethical values, including a commitment to local capacity building. They are accountable to their members and the wider community for their social, environmental and economic impact.
- **Social ownership:** They are autonomous organisations with governance and ownership structure based on participation by stakeholder groups (users or clients, local community groups etc.) or by trustees. Profits are distributed as profit sharing to stakeholders or used for the benefit of the community.[44]

FIGURE 6.4 VALUE CREATION CONTINUUM



Social entrepreneurs tackle a wide range of social and environmental issues and operate in all parts of the economy. Where they differ is in the motive of individual self-maximisation. A social enterprise 'is a business with primarily social objectives whose surpluses are principally reinvested for that purpose in the business or in the community, rather than being driven by the need to maximise profit for shareholders and owners'.[45] The movement now enjoys significant support in the UK from the Blair government with a range of network-based organisations, particularly the Community Action Network (CAN).[46] The US uses the terminology 'social venture' and Canada uses the term 'community economic development'.

Alter considers the value creation 'continuum' created by both profit-making and non-profit organisations (see figure 6.4).[47] This ranges from the predominantly social value of the traditional non-profit to the predominantly economic value of the traditional corporation. There are also interesting gradations in the middle, such as the socially responsible business. Indeed, social enterprises can be found at any place along this continuum except the extremes. Where the value generated by an enterprise can be seen as a blend of social and economic values, then it can be called a social enterprise.

Like any business entrepreneur, the social entrepreneur identifies opportunities and designs business models. But the social entrepreneur emphasises social improvement all the while balancing that with profitability and growth. The success of their activities is measured first and foremost by their social impact.[48]

Here are some leading social entrepreneurial companies.[49]

- Cognisense Labs Inc., California – solves environmental problems with science, software and sensing, focusing on removing land mines from farmland [www.cognisenselabs.com/projects.html] (English).
- Asociacion Abj'atz' Enlace Quiche, Guatemala – enables indigenous peoples to reach their full potential through the innovative use of information and communication technologies [www.enlacequiche.org.gt] (Spanish/English).
- Comite para Democratizacao da Informatica de Brasilia, Brazil – provides free computers, software, community-based training and technical maintenance through Information Technology Citizenship Schools [www.cdi-df.org.br] (Portuguese).
- Frost Protection Corporation, Uruguay – provides environmental and economic solutions to the global problem of frost damage for fruit-growing producers [www.frostprotection.com] (English/Spanish).
- New York-based iEARN-USA – enables students to interact with individuals from different cultures over the Internet to address environmental, cultural and social issues [www.iearn.org] (English).

TWENTY STEPS TOWARDS BECOMING A SOCIAL ENTREPRENEUR

- **Know what you feel strongly about and why:** If you want to be a social entrepreneur, ask yourself: 'What specifically do I feel strongly about? What do I want to change?' Know why you are doing it before you jump.
- **Envision the problem and an ideal world:** Open your eyes and identify the problem. Picture what the solutions should look like, how they would work and what they would do. It doesn't mean that you have all of the answers, but if you can't articulate a solution that is inspiring to others, you won't be able to solve the problem.
- **Make your vision big:** Have a vision that is completely beyond you – one that is impossible for you. If it is beyond you, then you are going to be open to the ideas and participation of other people and you are going to realise that you, too, are participating in something much bigger than yourself.
- **Be passionate – commit to risk:** Do a gut check because pursuing a social vision requires a deeply rooted passion. And you have to be willing to make a commitment and assume a high level of risk, personally and financially.
- **Have faith:** This is connected to faith – believing in yourself and in something larger than yourself. Having faith gives you the vision. You have to know where you are going and how you'd like to see the end result. Being able to go back to your faith daily gives you strength to take that journey.
- **Listen – share ownership of your cause:** Articulate your own vision first, but your vision can't be carved in stone. Be open to new information, new connections and new perspectives because none of us can solve this all by ourselves. Your vision needs to be refined and massaged by others because it needs to be a cause that others can own. Always keep your ears and your heart open to the wisdom and ideas of others. Even those who disagree with you have much to teach you.
- **Build a team – peers plus mentors:** Look at your peer group and mentorship structure and make sure you have quality people in both. Make sure your peer structure is solid and that you have a vertical structure where you have a mentor who is a few steps ahead of you – someone who is a real 'silver back' (male gorilla). You will never be more successful than your team.
- **Get the right mentors:** A mentor is somebody whom you respect and is wise. They may not know anything in particular about the system that you are trying to influence, but they are going to be invaluable to you if they have life experience and wisdom. Use your mentors well. You want to have two or three people who are significantly ahead of you in line – at least five years older than you, if not much more and who think well enough of you to give you 15 minutes on the phone, at least four or five times a year. People like to nurture other people's success.
- **Surround yourself with leaders:** You've got to have top performers in your peer group whom you respect. Make sure you have people in your peer group who are running, starting and trying to do things. If you look at your peer group and there are more followers than leaders – unless they are following you, you probably need to find other people who are leaders to form community with.
- **Get a partner:** Aggressively seek a partner in this process. It is so helpful to have the support, encouragement, challenge of a partner and the give-and-take to spur on a big systems-changing idea. It's really lonely and difficult to try to spearhead that on your own.
- **Be accountable:** Make yourself accountable to somebody. Even the best laid plans too often come to nought in the absence of some kind of accountability. It is too easy to allow self pity or a false sense of power and/or ego to set in without accountability.
- **Know your friends and opponents:** Identify who your issue affects – who might care about this issue that you are holding so dear. Then start by connecting with them to understand their needs. Figure out what they believe and if they are generally in agreement with you so you can identify your potential allies and obstacles.
- **Act – don't over analyse:** Many people get stuck in 'paralysis by analysis' – by wanting to research and categorise things to death. It's more important to start than to have the best idea in the world on paper. Don't analyse the thing to death – not 'read this', 'write that', or 'study this'. Having a series of

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false starts is actually a blessing. It's better to start three different things that didn't make a mark than never to try.

- **Focus on collaboration – not starting an organisation:** Focus on issues, not solely building an organisation, so that your purpose is social change. You may find an existing group of people already working in your area. If so, work with them and let them revitalise your idea or bring their strengths to it. Whether you start a new organisation or not, collaboration is absolutely necessary in order to succeed!
- **Pick the right battles – make significant impact:** Imagine that you are sitting in the middle of puddles, ponds and oceans and you only have three pebbles to throw. If you throw your pebble into a constituency that is the ocean, your small pebble won't be big enough to matter. If instead you throw your pebble into a tiny puddle, you'll impact that puddle in a big way, but ultimately you won't impact the larger cause.
- **Create models:** Because when you are articulating a new vision, people may not get it. You may know what you are talking about it, but others need to see it. You may know what you are talking about it, but others need to see it. You need to be able to execute your vision in successful models.
- **Be flexible – expect to fail, learn and change:** As you work to make change, your plans for getting there will likely change over time and that's great! That means you are getting smarter and better informed about how to make things happen. Don't think of that as a failure. Be open to the fact that the 'how to get there' is going to change.
- **Experience others' lives:** Reading biographies and autobiographies is very important. It doesn't have to be just people in your own field. Your best company will be people who are dead and gone: people who were ahead of you in line a long time ago.
- **Bounce back:** If you do this work long enough, you are going to make some mistakes. You may hire or fire the wrong person, or bet the family farm on something that doesn't come through. If, in your drama, you roll the credits on your own social entrepreneur career with the first setback, you will never get to the top of the field. The biography of anyone who did anything remarkably interesting will reveal years where they were not productive.
- **Celebrate!** Focus on your vision and keep fighting for it. And remember to enjoy the journey. It's easy to get burned out when you're striving for big change. It will come, but incrementally. Be sure to celebrate the little victories!

Source: Adapted and condensed from Changemakers, 'How to change the world: First steps towards becoming a social entrepreneur', *Changemakers Journal* (February 2004) [www.changemakers.net/journal/04february]

THE OPPORTUNITY FOR ETHICAL LEADERSHIP BY ENTREPRENEURS

Even though ethics and social responsibility present complex challenges for entrepreneurs, the value system of an owner-entrepreneur is the key to establishing an ethical organisation.[50] An owner has the unique opportunity to display honesty, integrity and ethics in all key decisions. The owner's actions serve as a model for all other employees to follow.

In small businesses the ethical influence of owners is more powerful than in larger corporations because their leadership is not diffused through layers of management. Owners are easily identified and usually employees constantly observe them in a small business. Therefore, entrepreneurs possess a strong potential to establish high ethical standards in all business decisions.

To illustrate, one study examined the ethical concern of owner-entrepreneurs regarding specific business issues.[51] Table 6.6 provides a list of the issues owners believed needed a strong ethical stance as well as the issues the same entrepreneurs viewed with greater ethical tolerance. These differences show that ethical decision making is a complex challenge due to the nature and personal perception of various issues.[52]

In another research study, it was found that an owner's value system was a critical component of the ethical considerations that surround a business decision. This study also had implications for entrepreneurs who are seeking to establish an ethical environment within which employees

ENTREPRENEURIAL GENEROSITY IN NEW ZEALAND

ENTREPRENEURIAL EDGE

He gave away $3 million worth of shares last year but Tony Falkenstein describes himself as 'a bit selfish'. The 57-year-old founder and chief executive of listed water cooler company Just Water is sincere in that unflattering assessment of his philanthropic efforts.

The recipients of his generosity – the staff and students at Onehunga High's business school, Auckland University's business school and Unitec New Zealand's School of Management & Entrepreneurship – are unlikely to be as dismissive. In June 2004 Falkenstein donated $1 million worth of Just Water shares to each organisation. Based on the company's performance over the last year that ought to generate about $84 000 a year in dividends.

It's no small gesture for a man who, while obviously wealthy, doesn't yet feature on the New Zealand *National Business Review*'s Rich List. What Falkenstein means is that he is not prepared to pour money into any abstract cause, however charitable that might be.

'I suppose I'm probably a bit selfish in that I really want to have an impact. I'm less inclined to give money to something general where someone else was spending it', he says.

There is one other reason Falkenstein can claim a degree of selfishness. The personal satisfaction he has achieved from the Onehunga business school project is greater than any of his more financially lucrative successes. 'This has been the best thing I've ever done', he says. 'As an entrepreneur I take on projects and this is just another project. It happens not to be giving me money but it is certainly giving me much greater reward than anything I've done before'.

The Onehunga business school was launched in 2003 with $300 000 backing from Just Water. Based at the high school it offers year 10 to 13 students courses covering international and entrepreneurial business skills. By years 12 and 13, students take tertiary-level papers, including commercial law, marketing, management studies and economics. Its stated vision is 'to position Onehunga High School as the business secondary school and the model adopted by other schools and/or government'. It has already achieved that goal. The Ministry of Education plans to adopt it as the model for the introduction of business studies into the national curriculum in 2006.

Falkenstein is himself a former pupil of Onehunga. He was 'never a star' and admits to taking two attempts to pass his University Entrance exams. He had no further contact with the school until 1992 when his company was opening a building nearby. The then Prime Minister Jim Bolger was coming so he asked the school if they wanted to send some students to meet him. To his surprise they sent a group of musicians who livened up the opening ceremony. 'I thought, gee what can I give them in return. So we ended up creating a music award that was worth about $3000'.

A few years later, when he was living in the UK, he had the idea for a business school. 'I was reading *New Zealand Herald Online* and saw a story about the Global Entrepreneurship Monitor (GEM) survey. It found that New Zealanders were good at starting businesses but right down the bottom of 29 countries measured when it came to creating wealth out of them'.

He looked at how the idea might work in New Zealand and was disturbed to find this country was just about the only one in the developed world that didn't have business studies in the curriculum.

'So a kid studying French can start at 12 and have a pretty good understanding of the subject by the time they get to university. But a person at the business school at Auckland University is starting back at the 12-year-old level', he says. 'I just thought, if we can bring in better kids coming out of schools then we'll get better graduates coming out of universities'.

The decision he had to make was whether to set up a pressure group to lobby government or to set up an example and have that as a model. Having successfully achieved the latter, Falkenstein has no immediate plans for further donations but is optimistic that he can boost his contribution to the school by raising the profits at Just Water and increasing the dividend.

Despite his being one of the most notable philanthropic works of 2004, the biggest charitable distributor of personal wealth in New Zealand was, once again, Warehouse entrepreneur Stephen Tindall and family. The Tindall Foundation – funded by 66.3 million Warehouse shares gifted by the Tindalls – made donations of $7 million in the year to July 2004.

To Falkenstein it comes as no surprise that people with such generous streaks should be successful in business. 'People talk about go-getters but they're not the ones that make it', he says. 'I've always said to our staff that you get a hell of a lot more back if you are a go-giver.'

Source: Adapted and edited from Liam Dann, 'Making it and giving it away', *New Zealand Herald* (10 January 2005).

TABLE 6.6: ETHICAL ISSUES VIEWED BY SMALL-BUSINESS OWNERS

DEMANDS STRONG ETHICAL STANCE	GREATER TOLERANCE REGARDING ETHICAL POSITION
Faulty investment advice	Padded expense account
Favouritism in promotion	Tax evasion
Acquiescing in dangerous design flaw	Collusion in bidding
Misleading financial reporting	Insider trading
Misleading advertising	Discrimination against women
Defending healthfulness of cigarette smoking	Copying computer software

Source: Justin G. Longenecker, Joseph A. McKinney and Carlos W. Moore, ‘Ethics in small business’, *Journal of Small Business Management* (January 1989): 30.

and other constituents can work. For example, it was shown that the preparation of a specific policy statement on ethics (code of ethics) by the owner and their other employees may provide the clear understanding needed for administrative decision making. Small-business owners may also need to specifically address administrative decision-making processes. In addition, they may need to spend some time developing benchmarks or guidelines concerning ethical behaviours of employees. While these guidelines cannot be expected to cover every possible scenario, they will nevertheless help address the business development/profit motive dimension. Finally, if entrepreneurs can carefully establish explicit rewards and punishments that are based on ethical behaviours (and enforced), then the concerns of crime and theft can begin to be addressed.[53]

Overall, entrepreneurs must realise that their personal integrity and ethical example will be the key to their employees’ ethical performance. Their values can permeate and characterise the organisation. This unique advantage creates a position of ethical leadership for entrepreneurs.[54]

SUMMARY

Ethics is a set of principles prescribing a behavioural code that explains right and wrong; it also may outline moral duty and obligations. Because it is so difficult to define the term, it is helpful to look at ethics more as a process than as a static code. Entrepreneurs face many ethical decisions, especially during the early stages of their new ventures.

Decisions may be legal without being ethical and vice versa. As a result, entrepreneurs can make four types of decisions: legal and ethical, legal and unethical, illegal and ethical and illegal and unethical. When making decisions that border on the unethical, entrepreneurs commonly rationalise their choices. These rationalisations may be based on morally questionable acts committed ‘against the firm’ or ‘on behalf of the firm’ by the managers involved. Within this framework are four distinct types of managerial roles: non-role, role failure, role distortion and role assertion.

Sometimes the entrepreneur must make decisions that involve economic trade-offs. In some situations the company will make a profit but others in society may suffer. To establish ethical strategies, some corporations create codes of conduct. A code of conduct is a statement of ethical practices or guidelines to which an enterprise adheres. Codes are becoming more prevalent in organisations today and they are proving to be more meaningful in their implementation.

It is also important for entrepreneurs to realise that many decisions are complex and that it can be difficult to deal with all of a decision’s ethical considerations. Some of them may be overlooked and some may be sidestepped because the economic cost is too high. In the final analysis, ethics are sometimes judgement calls and what is unethical to one entrepreneur is viewed as ethical to another.

Social entrepreneurs have a great many of the same characteristics as business entrepreneurs, but their underlying motivations are different. Social entrepreneurs are interested in the creation of social capital. Social enterprise is the term used for a ‘market-based venture addressing social aims’.

The opportunity for entrepreneurs to exert ethical influence on their ventures creates a unique challenge of ethical leadership for all entrepreneurs. Despite the ever-present lack of clarity and direction in ethics, however, ethics will continue to be a major issue for entrepreneurs during the new century.

ASSOCIATIONS THAT PROMOTE BUSINESS ETHICS

- Association for Practical and Professional Ethics (United States) [www.indiana.edu/~appe]
- Australian Business Ethics Network [www.rmit.edu.au] follow the links: Our organisation > Business > Schools and Groups > School of Management > Research > Research Groups > Australian Business Ethics Network
- Australian Trinity College of Western Australia [www.trinity.wa.edu.au/plduffyrc/subjects/sose/business/ethics.htm]
- Business Ethics Institute of Malaysia [www.beim.org.my]
- Business for Social Responsibility (United States) [www.bsr.org]
- Center for Business Ethics (United States) [ecampus.bentley.edu/dept/cbe]
- Center for Business Ethics (United States) [www.stthom.edu/cbes]
- Center for Ethics in Business (United States) [www.ethicsandbusiness.org]
- European Business Ethics Network (United Kingdom and Europe) [www.ebenuk.org]
- Famous Quotations on Business Ethics [www.valuequotes.net]
- Hong Kong Ethics Development Centre (Hong Kong) (Chinese and English) [www.icac.org.hk/hkedc/txt_eng/about1.htm]
- Institute of Business Ethics (United Kingdom) [www.ibe.org.uk]
- International Business Ethics Institute (United States) [www.business-ethics.org]
- International Society of Business, Economics and Ethics (United States) [www.isbee.org]
- Society for Business Ethics (United States) [www.societyforbusinessethics.org]
- Transparency International [www.transparency.org]
- World Bank Institute [www.worldbank.org/wbi]
- Zicklin Center for Business Ethics Research (United States) [www.zicklincenter.org]

KEY TERMS AND CONCEPTS

absolutist ethics
bribery
code of conduct
corruption
entrepreneurial crime
ethics
non-role
rationalisations
relativist ethics
role assertion
role distortion
role failure
social entrepreneurship
social responsibility

REVIEW AND DISCUSSION QUESTIONS

1. Using your own words and experiences, what do you mean when you use the term ethics?
2. Ethics must be based more on a process than on a static code. What does this statement mean? Do you agree? Why or why not?
3. A small pharmaceutical firm has just received permission to market its new pain killing drug. Although the product has been tested for five years, management believes serious side effects may still result from its use and a warning to this effect is being printed on the label. How would you describe its actions from an ethical and legal standpoint? Use table 6.1 to help you.
4. Marcia White, the leading salesperson for a small manufacturer, has been giving purchasing managers a kickback from her commissions in return for them buying more of the company's goods. The manufacturer has a strict rule against this practice. Using table 6.1, how would you describe Marcia's behaviour? What would you suggest the company do about it?
5. Explain the four distinct roles managers may take in rationalising morally questionable acts 'against the firm' or 'on behalf of the firm'. Be complete in your answer.
6. What is a code of conduct and how useful is it in promoting ethical behaviour?

7 Describe carefully the differences between immoral, amoral and moral management. Use table 6.3 in your answer.
8 Why do complex decisions often raise ethical considerations for the entrepreneur?
9 What are the differences between business and social entrepreneurs that you know personally?
10 Do you believe social entrepreneurship to be a valuable option in modern day civil society?
11 How can entrepreneurs develop a position of ethical leadership in business today?

EXPERIENTIAL EXERCISE

GROUP EXERCISES IN ENTREPRENEURIAL ETHICS

- **Doing the right thing when no one's watching:** Divide into groups. Have one person present an ethical scenario in which there is no clear-cut right or wrong answer. Students can debate their positions and choose the most ethical resolutions to the scenarios.
- **Ethics symposium:** Create a panel discussion consisting of professors, business leaders and significant community leaders to discuss a recent ethics-related event. For comparison, field questions from the audience before and after the discussion in order to determine if their views have changed as a result of the symposium.
- **Small business social responsibility:** To help small business owners understand the importance of giving back to the community, even when a tangible or measurable benefit cannot be achieved, create a simple pamphlet that provides information on how to get involved, based on the needs of the community.
- **Whose lie is it anyway?** To help prepare for making ethical decisions when under pressure, create a series of IF/THEN ethical scenarios with pre-determined decisions on note cards. Carry out an ethical skit, where the scenarios are changed on the spot (by choosing a note card) to make an ethical decision and have audience vote for the most ethical decision.
- **Current ethical event analysis:** To help students understand the thin line between right and wrong ethical decision making, organise an ethical duel where the class is divided into groups. Each group is presented with a current event in which a top executive acted legally but his ethics were questioned. Each group conducts research on the event and is prepared to present their views in a debate – pro versus con.
- **Ethical versus unethical advertising strategies:** To help consumers understand how to filter through complicated and misleading advertisements, develop a presentation that includes specific examples of over-promising and under-delivering products/services (for example, car industry gimmicks, credit card companies that target inappropriate markets such as high school students).

Source: These exercises are from ACE (Advancing Canadian Entrepreneurship Inc.), 'SIFE Project Ideas' available from [www.acecanada.ca/material/2004-12-19] SIFEProjectIdeasbyCriterion.doc.

EXPERIENTIAL EXERCISE

THE COMPLAINT LETTER ABOUT ETHICS

1 Identify an event in which a company did something unethical in relation to you. It should ideally be an organisation for which you do not work. It must be an actual, recent, not fictitious unresolved event.

2 Send a letter directly to the CEO or top executive of the firm that caused the harm, describing the event. This letter should be addressed personally at the correct corporate address. The event should be described factually in as much detail as possible; the letter should not be threatening, or rude. In the letter there should be a statement clearly stating that the company committed an ethical infraction. It is important the words 'ethical infraction' are underlined. The letter should include a statement asking for the executive's written response in addressing particular concerns, by specific date 10 to 14 days after the letter is mailed.

(It is important to incorporate as much detail into the letter as possible. The more current the infraction, the more timely the concern will likely appear to the recipient. Providing dates, times, names of parties involved, location, details of the circumstances and any additional contacts listed in chronological order will present the situation in a rational manner to the recipient. Facts should be presented in a clear, unemotional manner, coupled with an awareness of situational factors that may have contributed to the infraction, so that the recipient focuses on the issue rather than the subjective factors involved. The letter should finally address the recipient in a respectful tone and conclude with specific call for action. Politely suggesting a specific mode (letter, phone call, email, etc.) and time period for response (next Wednesday, by the end of the month, within next two weeks, etc.) will communicate an appropriate level of seriousness regarding your concerns.)

3 Finally, provide the instructor with a photocopy and email copy of the letter and the date due and keep two copies of the letter for yourself. The original letter should be mailed no later than two weeks after the start of the semester (to provide enough time for completion of the project). If you do not receive a reply within the specified time period, mail the letter again, noting a new reply date and indicating that it is your second inquiry and provide a copy to the instructor.

Source: This exercise is from Carole L. Jurkiewicz, Robert A. Giacalone, Robin M. Bittick, 'The squeaky wheel approach to teaching ethics', *Public Integrity* 6 (3) (2003): 249–62.

EXPERIENTIAL EXERCISE

KNOWING THE DIFFERENCE

Most entrepreneurial actions are ethical and legal. Sometimes, however, they are unethical and/or illegal. The four categories of ethical/legal actions and a list of examples of each category, (a) to (h), follow. Match them up by placing the number of the category next to appropriate examples from the list (two are given for each category). Answers are provided at the end of the chapter.

1 Ethical and legal
2 Unethical and legal
3 Ethical and illegal
4 Unethical and illegal

a Giving a gift of $50 000 to a foreign minister to secure a business contract with his country (a customary practice in his country) and then writing off the gift as a tax-deductible item.
b Knowing that 1 per cent of all tyres have production defects but shipping them anyway and giving kilometre allowances to anyone whose tyres wear out prematurely.
c Manufacturing a new fuel additive that will increase fuel consumption by 10 per cent.
d Offering a member of the city council $100 000 to vote to give the entrepreneur the local cable television franchise.
e Publishing a newspaper story that wrongly implies but does not openly state that the Minister of Education (a political opponent of the newspaper) is deliberately withholding funds for education because of the newspaper's effort to win nomination support for its candidate from the teachers union.
f Obtaining inside information from another brokerage that results in the entrepreneur netting more than $2 million.
g Producing a vaccine that will retard the growth of bone cancer.
h Producing and selling a drug that will reduce heart attacks but failing to complete all of the paperwork that must be filed with the government prior to selling the product.

CASE 6.1:

SMALL ENTERPRISE SOCIAL RESPONSIBILITY

John and his wife, Alexandra, own and operate a retail jewellery store selling all types of jewellery in precious and semi-precious metals as well as selling and repairing watches and clocks in a suburban township in Australia. John's father started the business 40 years ago after emigrating from Europe and, since his death about five years ago, the business has continued to grow and now employs five full-time and seven part-time staff. In recent years competition has increased and the ways of doing business have changed. The shopkeepers are too busy focusing on reducing costs, everything is 'on special' and there is no time to talk to customers to find out what they want. Despite these trends John considers his staff to be like family and his customers to be like friends.

The business is based on service, taking the time to listen to the customers and doing what the customer wants. When customers purchase goods, particularly an item of jewellery, it is more than an article; it is a concept or emotion, frequently with romantic connotations.

'We aim to provide quality service, knowledge, expertise, professionalism – we all strive for that and we revisit it every day. Alexandra and I get a great deal of satisfaction selling quality products at a fair price to new customers with the hope that they will become, like the majority of customers, longtime supporters of our business.

'My family comes first as we need to run a profitable business but it is difficult for me to rank who is next in importance. The majority of our staff has been with us for more than six years. We do have a staff bonus system based on the level of sales, so when we have a good month, we all share in the benefits of our hard work. In addition, we have quite a lot of flexibility in hours of work. Alexandra brought to my attention that our staff are mothers with young children who sometimes need "time-off", perhaps on short notice to care for their children or go to a school activity, such as a concert. We accommodate their needs and, in return, they are more than willing to "help us out" when we need their help: of course they get paid what is due to them. My staff tells me that work flexibility is a real blessing and well beyond what is allowed by larger employers.

'My father first started the business about 40 years ago. He could hardly speak English and with no other alternatives he started a business in a town where he knew nobody. It was long, hard work with little reward as he built up a reputation with the local community as a provider of quality products. He enjoyed and appreciated the fact that an "ethnic" who neither had a beer after work each day nor could fluently speak the language could be accepted into the local community. In return, he contributed to the local community in the best ways he could.

'Today we receive an average of three requests per week for assistance or support in some way. These requests come from a wide range of community groups: local schools (private, public), sporting clubs (netball, soccer, rugby) and charities. We do not have a written, formal policy on social responsibility but we do process requests in a structured and consistent manner essentially based on location of the potential recipient of social responsibility. If it's local, within 5 kilometres, we try to give in some way. If it's not local, it makes no sense to give for they are not our customers and they are most unlikely to contribute to our business. Staff are familiar with the procedure and frequently do not consult with either me or Alexandra. Staff are allowed to use their initiative and select an appropriate piece of jewellery, such as a necklace for a female costing about $30, wrap the gift and prepare a card with our signature. We give about 100 gifts per year. We do not expect formal recognition but the community knows what we do. We neither evaluate the sales from goodwill generated by these gifts nor market the fact that we give: that would be crass. We do get a warm fuzzy feeling – it is good for the psyche. We continue the tradition, for we are a part of the community and it is the right thing to do.'

Source: Gary Mankelow

QUESTIONS

1 List and describe examples of social responsibility to employees, customers and communities.
2 Suggest motivations why John and Alexandra would participate in social responsibility with employees, customers and communities.
3 Compare and contrast large enterprise social responsibility with small enterprise social responsibility.

CASE 6.2:
THE ETHICS OF BOOTSTRAPPING

Scott Cook founded Intuit, maker of the cheque-writing-software product Quicken, in 1984 with $151 000, after being turned down by venture capitalists for the $2 million he thought he would need. The start-up cash was quickly exhausted on product development and the Menlo Park, California, company scraped through three desperate years before hitting its stride. Today Intuit has 400 employees. Sales last year were $44 million and this year's revenues are expected to reach $80 million. Despite dozens of competitors in this category, Intuit has over a 70 per cent market share.

Says Cook: 'But what I've learned and what all too many bootstrappers can miss, is that being truthful is good business. Apart from moral judgements, consider expediency – and expediency is what bootstrapping amounts to. Business is about doing right by the customer and by your business partners, which include vendors and employees. If you do right by them, your business will flourish. If you don't, your business won't. You may solve some temporary bind through a white lie, but it will come back to haunt you. It's not just wrong; it also doesn't work. Being ethical isn't a fairyland, Boy Scout idea, nor is it naive. I wanted to build a business for the long term. And trust is one of the most important sources of your power.

'Let me give you an example. We sell our software to retailers and dealers, who resell it to their customers, the end-users. It is common in our industry, as in a lot of industries, for salespeople to "load" the dealer with too much product. There is an old slogan, "a loaded dealer is a loyal dealer", because he won't want to push the competitor's product until he gets rid of yours first. With that in mind, some companies invent elaborate schemes to get dealers to buy more than they need; their salespeople overstate demand, exaggerating how well their product is going to sell or how big a promotion is.

'Well, we don't do that. We don't think it's right to tell dealers they're going to sell 100 units a month when they're really going to sell 40 – or, in our case with the major chains, 10 000 units when 4000 is more like it.

'Is this an issue of ethics or smart business? Frankly, I think the two merge. Although it means we sometimes miss higher revenues at the end of a quarter – that's why other companies load dealers, to maximise numbers so salespeople can get their commission cheques or show off to the president – in the long run, being honest has served us better. For one thing, if you produce a large chunk of product and then don't get orders for three months, your manufacturing facility sits idle. That kind of boom-and-bust cycle is inefficient – it's hell on manufacturing people, who find it much easier to produce a level, constant volume of product.

'We'll actually tell accounts they've ordered *too much*, that we'd like to ship them less because we think they're over buying. And because of that, they've started to trust us in surprising ways. When we launch a new product – we've brought out three in the last year – we get into all the chain stores instantly. They don't even question it, because they know we're not going to screw them. What's more, many of the accounts now say, "We trust you, how much should we order?" Normally that would never happen. They would try to figure it out themselves, or they'd ask the salesperson and cut that recommendation in half. Instead, they're relying on our advice in ways that are very untypical for chain-store buyers and very helpful in building long-term partnerships.

'It's amazing how uncommon it is to think about sales that way; so many companies seem to be out to mislead dealers as much as possible. That attitude is everywhere, probably because managing a company for short-term revenue is so much easier. It's all in the numbers. If the revenues aren't there, some presidents yell a lot and people learn to run around and get short-term sales. Those presidents tell their people, "I don't care if the demand isn't there, go and sell them". That's easy; any idiot can do that. And many idiots do.

'Ethical temptations continue to come up for us. For instance, we offer a consistent price to all our major accounts; it's the best price we can afford. But some of those accounts will call and say, "Hey, if you knock 5 per cent off your price, I'll place a big order right now". Well, more volume is better, especially for a bootstrapped company, right?

Wrong. It probably wouldn't mean any extra sales to end-users. What it *would* mean is less revenue per unit – 5 per cent less – and, more important, it would mean you lied. *All* your customers are concerned that they have the best deal and when we say, "Nobody gets a better price than this", that's got to be true. If we trim prices for certain accounts, we're lying. It's common, but ultimately it will hurt you.

'Some customers are always looking for you to bend your rules, but if you hold out, the benefits can be enormous – and not just financially. Recently we pitched a hot, exclusive promotion idea to a large wholesale distributor. We were going to offer a special version of a product if the consumer bought other software at the same time – a dealer-created bundle.

'The wholesaler turned us down, so we offered it to a second wholesaler, who took it. Soon dealers started changing wholesalers to get this special product and the first wholesaler was livid. Its reps screamed at our director of sales that we had to offer the same deal to them.

'We arranged a Saturday conference call with this wholesaler's chairman and he was *angry*. He threatened to stop promoting our products, start pushing our competitors' products – nothing illegal, but things that would hurt our business. "I need to get this same promotion", he said; "what are you going to do for me?"

‘And we said, “No, we offered the promotion to you first. You turned it down. The other wholesaler bought it on the agreement that it was an exclusive for them. For us to give it to you would mean going back on our word”. He said, “So don’t give me the promotion. Give me a million dollars in cash and I’ll simulate it”. And I said we couldn’t do that; it was ethically wrong. The call ended when we agreed to disagree and we said we’d talk a few days later. We went away really nervous.

‘Monday morning the wholesaler’s reps called and said they understood our point of view, they respected it, they knew we had come to them with other good ideas and in fact they thought our ideas were so good they wanted to elevate us into their top rank of vendors. They’d compensate for this promotion problem in another way.

‘It came totally out of the blue. We thought we’d have a year of really hard sliding with that account, because once an account is pissed at you, it tends to stay pissed. But not at all; our stand enhanced our relationship.

‘What’s clear is that if that wholesaler’s management had pushed us around and succeeded, we would have lost their respect. And there was great temptation. I mean, it was *really* tempting to do something that would have been against our word.

‘And this is the point: while a lot of bootstrapping companies think about the *consequences of failure* – “Gee, if I don’t fib about this, I’m going to fail and if I fail, I’ll lose all my money and my wife and kids and my self-respect” – I don’t think they consider the *consequences of success*. What happens if you lie and are successful? Your customers may know you lied and employees will definitely know you’ve lied and you’ve set up a culture in which lying’s OK – or worse, in which lying is linked with success.

‘The things that help make a company successful become the elements of its foundation, the stories through which new employees learn what’s right and what’s expected of them and how they can succeed. Do you want those cultural legends to be about tricking others? You’ve got your choice.

‘If you create the right culture, people will do the right thing. I remember when we were working on one ad, our graphic designer came to see me and she seemed hesitant about it. I said, “What do your guts tell you?” She said, “I just don’t think we’re being straight with people”. If her guts told her that, she was probably onto something. She talked to the marketing vice-president about it and we never ran the ad.

‘You have to realise that as a CEO, you’re a role model and an example. People learn from your actions more than you ever believe. Now, we’re not perfect; there are tough judgement calls every day, by people at every level in the company and we don’t always get it right. But I know that our chances of getting it right are highest only if our culture demonstrates the right values for people. The underpinnings of how you run the company give people rules they live by and people will really believe in them and hold them dear.

‘It’s a rare thing, this opportunity to create a culture; there’s almost no place in our world where you can do that. Normally, you take culture as a given. American culture is American culture; we lament that politicians can’t lead us better, that kids don’t study harder, that too many people are crooks.

‘But when you create a company, you *can* create a culture – not in wide variance with what surrounds you, but you can move values, subtly and not so subtly, in the direction you want. It’s the most powerful thing you can do, to seed that culture the right way, because ultimately, that will become more important to the success or failure of your company than you are. The culture you establish will guide and teach all your people in all their decisions. And if you’ve got a choice about the culture you create, why build it on a foundation of fraud?’

Source: Patrick Cook, ‘The ethics of bootstrapping’, *Inc. Magazine* (September 1992) [www.inc.com/magazine/19920901/4288.html].

QUESTIONS

1. What would be an example of an entrepreneurial ‘white lie’ in Scott Cook’s case?
2. What are the benefits of staying by the rules?
3. What happens if you lie, and are successful?

CASE 6.3:
LETTING THE FAMILY IN

When Carmine Guion started his retail company three years ago, he had more than enough working capital to keep operations going. This abundance of money helped him grow rapidly and today he has 16 outlets. In order to become larger, however, he is going to have to secure outside funding. Carmine has decided to issue stock. The investment house advising him has suggested that he float an issue of

1 million shares at $5 each. After all expenses, he will clear $4.50 per share. Carmine and his wife intend to hold onto 250 000 shares and sell 750 000 shares. Carmine feels that with his shares and those that will be bought by his relatives and friends, he need have little concern about the firm's being taken over by outside investors.

Carmine talked to his father, who agreed to buy 10 000 shares at $5. Carmine's two uncles are each buying 5000 shares at $5. A group of 20 other relatives is going to buy an additional 5000 shares.

Earlier this week Carmine received some good news from his accountant. His profit estimate for next year is going to be at least double what he estimated. When Carmine shared this information with the investment brokers, they were delighted. 'When this news gets out', one of them told him, 'your stock will rise to $13 to $15 per share. Anyone who gets in on the original offering at $5 will do very well indeed'.

Carmine has told only his father and two uncles the good news. Based on this information, the three of them have decided to buy three times as much stock as previously planned. 'When it rises to around $12', his father said, 'I'll sell 10 000 shares and hang on to the other 5000'. His uncles intend to do the same thing. Carmine is delighted. He also intends to tell some of his other relatives about the improved profit picture prior to the time the initial stock offering is made.

QUESTIONS

1 Has Carmine been unethical in his conduct? What is your reasoning?
2 Is it ethical for Carmine to tell his other relatives the good news? Why or why not?
3 If you were advising Carmine, what would you tell him? Why?

CASE 6.4:
A FRIEND FOR LIFE

The Glades Company is a small manufacturer. It has produced and marketed toys and appliances that have done very well in the marketplace. Late last year the product designer at the company, Tom Berringer, told the president, Paula Glades, that he had invented a small, cuddly, talking bear that might have a great deal of appeal. The bear is made of fluffy brown material that simulates fur and has a tape inside that contains 50 messages.

The Glades Company decided to find out exactly how much market appeal the bear would have. Fifty of them were produced and placed in kindergartens and nurseries around town. The results were better than the firm had hoped. One of the nurseries reported: 'The bear was so popular that most of the children wanted to take it home for the night'. Another said the bear was the most popular toy in the school.

Based on these data, the company decided to manufacture and market 1000 of the bears. At the same time, a catchy marketing slogan was formulated: 'A friend for life'. The bear was marketed as a product a child could play with for years and years. The first batch of 1000 bears sold out within a week. The company then scheduled another production run. This one was for 25 000 bears. Last week, in the middle of the production run, a problem was uncovered. The process of making the bear fur is much more expensive than had been anticipated. The company is faced with two options: It can absorb the extra cost and have the simulated fur produced, or it can use a substitute fur that will not last as long. Specifically, the original simulated fur will last for up to seven years of normal use; the less-expensive simulated fur will last for only eight months.

Some of the managers at Glades believe most children are not interested in playing with the same toy for more than eight months, so substituting the less-expensive simulated fur for the more-expensive fur should be no problem. Others believe the company will damage its reputation if it opts for the substitute fur. 'We are going to have complaints within eight months and we are going to rue the day we agreed to a cheaper substitute', the production manager argues. The sales manager disagrees, contending that 'the market is ready for this product and we ought to provide it'. In the middle of this crisis, the accounting department issued its cost analysis of the venture. If the company goes with the more-expensive simulated fur, it will lose $2.75 per bear. If it chooses the less-expensive simulated fur, it will make a profit of $4.98 per bear.

The final decision on the matter rests with Paula Glades. People on both sides of the issue have given her their opinion. One of the last to speak was the vice president of manufacturing, who said, 'If you opt for the less-expensive fur, think of what this is going to do to your marketing campaign of 'A friend for life'. Are you going to change this slogan to 'A friend for eight months'?' But the marketing vice president urged a different course of action: 'We have a fortune tied up in this bear. If you stop production now or

go to the more-expensive substitute, we'll lose our shirts. We aren't doing anything illegal by substituting the fur. The bear looks the same. Who's to know?'

QUESTIONS

1 Is the recommendation of the marketing vice president legal? Is it ethical? Why or why not?

2 Would it be ethical if the firm used the less-expensive simulated fur but did not change its slogan of 'A friend for life' and did not tell the buyer about the change in the production process? Why or why not?

3 If you were advising Paula, what would you recommend?

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Social Enterprise: Private Initiatives for the Common Good

Publication date: 30 November 1994
Author(s): J. Gregory Dees
Product number: 395116

Presents a model for understanding how private social-purpose ventures (non-profit and for-profit) differ from traditional business firms in both their objectives and methods of operation. Identifies six dimensions that are useful for understanding the differences. Also discusses the role of social enterprise in society and current trends creating opportunities for social entrepreneurship.

Caselets: Bribery and Extortion in International Business

Publication date: 27 September 1999
Author(s): Louis T. Wells Jr
Product number: 700055

'Caselets' present several examples of decisions involving bribery or other actions that could be considered as corrupt.

New Economy Ethics: YouKnowIt.com

Publication date: 20 October 2000
Author(s): Joseph L. Badaracco Jr, Kim Slack
Product number: 301050

Entrepreneur Janice Schwartz is hoping to grow her start-up company by creating a technical advisory board and compensating members with discounted company stock. Schwartz is considering six candidates that can help her online education company in a variety of ways: as a potential customer, a media maven, venture capitalist and technical adviser. The case suggests ways of compensating the advisory board and raises questions about whether there are new rules in the new economy about building professional networks and when offers of equity constitute bribery and wrong doing.

ANSWERS

a	3
b	2
c	1
d	4
e	2
f	4
g	1
h	3

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ENTREPRENEURIAL CASE ANALYSIS

DICK HUBBARD: ENTREPRENEUR AND MAYOR

Dr Jodyanne Kirkwood, University of Otago and Diane Ruwhiu, University of Otago

Dick Hubbard is an extremely well-known business personality in New Zealand. Dick founded cereal manufacturer Winner Foods in 1988 and renamed it Hubbard Foods Ltd two years later. The company has an annual turnover of approximately NZ$25 million and employs 150 staff. Hubbard's creates innovative and creatively packaged breakfast cereals that have names such as 'Berry Berry Nice' and 'Bugs 'n Mud'.

In 2005 Dick entered as a candidate for the mayor of Auckland city and won the mayoralty. He was drawn to this new role by a desire to see a more cooperative style of leadership and help create a positive future for Auckland. Dick believes that he is able to take on these new challenges due to the creation of a strong and stable management structure within Hubbard Foods Ltd. Dick continues to own the business and will be involved in the strategy of the company, but not in a hands-on management position.

AN ENTREPRENEURIAL PERSONALITY From humble beginnings, Dick has created a successful business. After being turned down for a scholarship to Massey University to study food science, he self-financed his degree. He then worked as a food technologist for many years, gaining valuable experience managing a tropical fruit factory in Niue. On his return to New Zealand, he was appointed general manager of a local food manufacturer. He also went on a teamwork and confidence building course called Outward Bound, which Dick attributes with having assisted him immensely, and he lists the completion of the course as one of his life successes.

During the early years of start up, Hubbard's experienced tough times and at one stage was within three weeks of going into receivership. Dick had to ask his employees to go home on an extended holiday because he could not afford to pay them. He also made changes in his own life, for example, on occasion he walked to work to save petrol.

Those early days of hardship have not been forgotten and Hubbard's is managed under principles of minimum waste and minimum fuss – there is very little excess at Hubbard's, with no expensive furniture or company car fleets to be seen. Dick firmly believes the early sacrifices made by him and employees helped the company to get established.

By 1993, the business was growing quickly and Dick realised he had to make changes to the way he managed the company. Until this time, he had managed it by himself, including tasks such as human resources management, purchasing, marketing and quality management. To alleviate some of the day-to-day administrative decision-making, he employed an assistant and additional office staff.

In response to the positive growth of the company, Dick appointed a formal Board of Directors in 2001 and gave the board some of the decision-making responsibility and strategy development tasks.

INNOVATION AND CREATIVITY A competition is run within New Zealand each year to identify the best new products introduced onto the market. Hubbard's has a very good track record with many products winning awards in the bread and cereal section (Fruitful Porridge, Berry Berry Nice, Coco Morning, Oranges of St Clements, Bugs 'n Mud and Honey Bumbles have all won awards). The innovative nature of these products means that Hubbard's feature in the high-end of the cereal market. The Hubbard's brand does not compete in the low-cost cereal market, although it does manufacture such products for supermarket house brands (without using the Hubbard's brand name).

Even though the company is now quite large, many of the manufacturing processes at Hubbard's remain manual operations (such as mixing of cereals). In contrast, larger competitors (Kellogg's, Sanatarium) manufacture cereal in a more equipment-intensive manner and therefore tend to have a much lower staffing ratio. However, Dick believes in creating employment and will not replace people with machinery unless absolutely necessary.

Traditionally, Hubbard's has not utilised any forms of advertising, other than a newsletter, which is included in each cereal box (the 'Clipboard'). The Clipboard enables customers to

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feel that they know Dick, his family and even his dog. By keeping customers informed and doing what they say they will do, Hubbard's has developed and maintained a good relationship with customers. The company is not afraid to publish complaints from customers, and operates as an honest and socially responsible company with regard to customers.

SOCIAL RESPONSIBILITY Hubbard's operates under a triple bottom line philosophy that places importance on financial, environmental and social results. Dick believes there are a number of key stakeholders who have an interest in the business, including shareholders, employees, customers, suppliers and the community. He has a strong vision for the business that bears his name and uses a food metaphor to outline their aim in the Triple Bottom Line (TBL) report, which is to 'provide sustenance for the "mind, body and soul"' of everyone who has contact with the company.[1] Although Hubbard's have only produced one TBL report to date, they remain committed to the basic tenets of this philosophy.

When Dick was managing the business, he had a distinctive simple no nonsense style of management. Before entering the premises you notice a large sign in front of the main doors. It states 'This is a "no nonsense" management zone. No management excesses, corporate ego trips, committee decisions, inter-company memos, buck passing, back stabbing, or any other dubious management decisions allowed on these premises'. This statement sums up his philosophy to management.

An illustration of Dick's no nonsense approach to managing staff has become folklore at Hubbard's. One employee told him she felt intimidated by him wearing a tie. Dick immediately took off the tie and cut it up. The tie is now framed in the offices at Hubbard's and is a strong visual statement of Dick's commitment to his philosophy of management.

Staff are a vital stakeholder in the business. Dick sums up his philosophy to staff as being 'based around the concept of "a group of people". As such, our people within the company are to be treated with respect, dignity and an overriding acknowledgement that, first and foremost, they are people'.[2]

The company experiences very little absenteeism and staff turnover is low. This may be indicative of the way employees embrace and show commitment to the company. Dick strongly believes that potential employees take into account the culture of the company in their employment decisions. He is well known for taking all of Hubbard's 100 staff to Samoa in the South Pacific, for a long weekend in 1998. At a total cost of approximately $170&&000, Dick chartered a plane to celebrate Hubbard's ten year anniversary for the company start-up. The trip was a tribute to the Pacific Island workforce's culture and heritage. This added to the family culture at Hubbard's as many of the employees had not been back to their homeland for years. In subsequent years, other trips have occurred within New Zealand. In 2000, Dick and the entire staff met the Prime Minister, Helen Clark to celebrate ten years of the Hubbard's brand being in business.

Recently the company has implemented a profit sharing scheme for employees. The scheme distributes 10 per cent of Hubbard's pre-tax profit as a 'dividend' to employees every six months. This profit sharing scheme works according to a formula that is based entirely on length of service. There is absolutely no recognition made of seniority or existing salary/wage rates. Staff at Hubbard's are paid a relatively mid-range rate of pay, and this is almost entirely due to Dick's desire to be socially responsible. Dick prefers to hire the long-term unemployed and works with the Work and Income New Zealand offices to create employment. The staff survey results show employees' levels of satisfaction with a range of issues regarding their employment.

Dick has consistently built a culture around caring for others, creating employment, and being socially responsible, in addition to the more usual financial results. However, his philosophy on creating employment has created some problems in the past. In 2000, an industrial dispute arose that led to a picket over wage and meal allowances. This industrial issue was resolved quickly by increasing pay and allowances, and through increased communication between management, the union and employees.

Although focusing on being a socially responsible company, financial success is vital to Hubbard's continuing success. Dick realises that in order to maintain employment levels and achieve his broader social goals, the company must be financially viable. The company is founded on Dick's vision, combined with commitment and loyalty from employees. There is great importance placed on running the company in a fiscally appropriate and responsible manner. The success and growth of the company has required financial discipline and sound profitability. Decision-making at Hubbard's combines both a human-centred and economic approach to ensure that an appropriate degree of profitability is maintained to allow for all stakeholder interests to be looked after.

Dick also believes in sharing his financial success with those outside the company. A donation of 50 cents of every packet of the 'Outward Bound' cereal sold is made to the Outward Bound outdoor pursuit's organisation. At the end of 2004, this donation had reached over $1 million, from contributions over nine years. Other sponsorships include scholarships for students studying food technology.

In order to promote social responsibility by businesses, Dick founded the New Zealand Business for Social Responsibility (NZBSR) in 1998. The company is one of the 40 members of the New Zealand Business Council for Sustainable Development (NZBCSD). Hubbard's follows a campaign of reducing or eliminating waste, informing and educating customers and

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producing innovative products that conform to the precepts of sustainable development. Hubbard's currently recycles paper and cardboard, plastic shrink wrap which comes on inward pallet, aluminium and plastic containers, raw material containers and toner cartridges.

In addition to sharing his financial success, Dick is very open to sharing his story with others. His background shows hardship and New Zealanders enjoy hearing about his rise to being a well-known businessman in New Zealand. Now that Dick is mayor of Auckland and is taking a more hands-off role with the company, it will be interesting to watch the development of the company in the years to come.

DISCUSSION QUESTIONS

1 Write a brief mission statement that summarises Dick's approach to his business. Include his personal beliefs about running the business and management philosophies.

2 There is often a tension between entrepreneurs making a profit and being socially responsible. How does Hubbard's balance these two goals?

3 Now that Dick does not have daily involvement in the business and is mayor of Auckland, will the business be able to maintain his philosophies and management style?

Endnotes

1 Triple Bottom Line report (2000–01). Hubbard Foods Limited [www.hubbards.co.nz].

2 TBL (2000–01).

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Walker, R. and Monin, N. (2001). The purpose of the picnic: Using Burke's dramatistic pentad to analyse a company event. *Journal of Organizational Change Management.* Vol. 14 (3): 266–79.

Source: Interviews with Dick Hubbard, October 2000 and 2005; interview with New Product Development Manager, October 2000

PART THREE:
DEVELOPING THE ENTREPRENEURIAL PLAN

CHAPTER

7 Environmental assessment: Regulation, industry, community

8 Entrepreneurial marketing for new ventures

9 Financial preparation for entrepreneurial ventures

10 Developing an effective business plan

7

ENVIRONMENTAL ASSESSMENT: REGULATION, INDUSTRY, COMMUNITY

Laws like cobwebs, entangle the weak, but are broken by the strong.

Ascribed to Solon c.575 BC

CHAPTER OBJECTIVES

1 To become familiar with environmental scanning to spot on-the-ground conditions for new and growing firms

2 To review the regulatory environments of the Asia–Pacific within which a new venture must exist

3 To examine the industry environment from a competitive market analysis and strategic point of view

4 To present the community environmental perspective to ensure an understanding of the local impact

5 To review the nature of business incubators and their importance to emerging ventures

ENVIRONMENTAL SCANNING FOR NEW VENTURES

To stay competitive, a new and growing business must be ever vigilant, watch for changes in the business environment and be agile enough to alter its strategies and plans when the need arises. For example, one important Australian study found that **environmental scanning** made a significant difference between high- and low-performing export companies.[1] Throughout the years, much work has gone into learning how companies can best act quickly, take advantage of opportunities before competitors do and respond to environmental threats before significant damage is done.[2]

Environmental scanning is the acquisition and use of information about events, trends and relationships in an organisation's external environment, the knowledge of which would assist management in planning the organisation's future course of action.[3] Environmental scanning casts a wide net to look at information about every external sector that can help plan a start-up's future. That includes a hard look at competitors, suppliers and customers, technology, the economy, politics and regulation, as well as social and demographic trends.

Chun Wei Choo summarises what we know about environmental scanning from the research:

- entrepreneurs who work in an uncertain environment have a greater need for environmental scanning
- a sophisticated entrepreneurial strategy requires sophisticated environmental scanning for monitoring
- the most important information for entrepreneurs is about customers, competitors and suppliers
- entrepreneurs rely heavily on personal connections to scan the environment.

Modes of environmental scanning

Scanning is something that comes naturally to many entrepreneurs, but they can develop their skills through technology and interpersonal networking. There are four types of environmental scanning:

- **Undirected viewing** – the entrepreneur 'tours' the information landscape, that is, scans the broadest spectrum of sources with the least necessary effort in order to detect early signals of change.
- **Conditioned viewing** – 'tracking' or focusing on a few selected sources in order to make sense out of the mass of information.
- **Informal searching** – the entrepreneur carries out a cursory or 'just-good-enough' search to be able to ask the right questions.
- **Formal searching** – helps the entrepreneur 'retrieve' information from a large number of sources. This is the most technological and automated scanning mode.

The external environment consists of opportunities and threats outside the firm, ones that typically are not within the short-run control of the entrepreneur (see figure 7.1). These **environmental variables** form the context within which the venture exists. This environment has three parts:

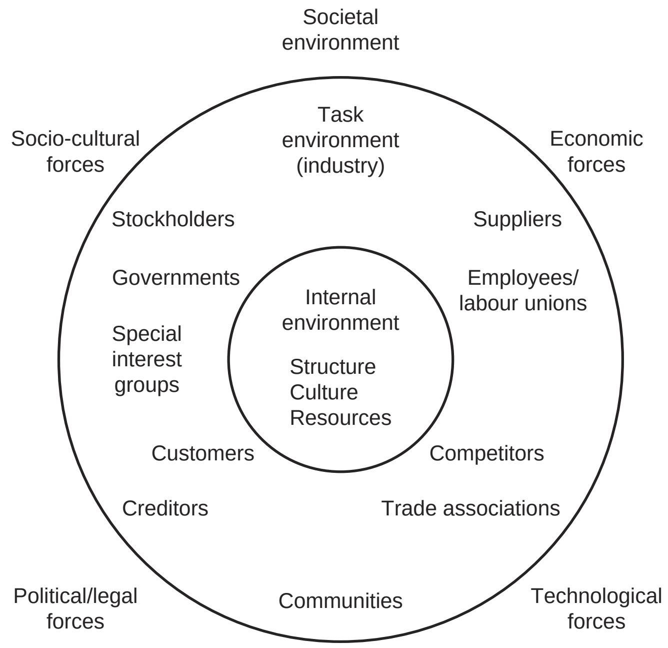
- All factors that immediately and physically surround the company are known as the **internal environment**. Here we are especially interested in the community that surrounds it. We're talking about the venture's structure (for example, chain of command), the culture (beliefs and values) in which it operates and resources (assets, raw materials, plants, etc.) which it has at its disposal.

TABLE 7.1: **MODES OF ENVIRONMENTAL SCANNING**

SCANNING MODES	INFORMATION NEED	INFORMATION USE	AMOUNT OF TARGETED EFFORT	NUMBER OF SOURCES	TACTICS
Undirected viewing	General areas of interest	Serendipitous discovery 'Sensing'	Minimal	Many	Scan broadly a diversity of sources 'Touring'
Conditioned viewing	Able to recognise topics of interest	Increase understanding 'Sense-making'	Low	Few	Browse pre-selected sources 'Tracking'
Informal searching	Able to formulate queries	Increase knowledge with narrow area 'Learning'	Medium	Few	Search focused on an issue or event, but a 'good-enough search' is satisfactory 'Satisficing'
Formal searching	Able to specify targets	Formal use of information for planning, action 'Deciding'	High	Many	Systematic information gathering using some method 'Retrieving'

- Outside of this is the **task environment**. It is called task environment because the company's tasks (or operations) are directly affected by them. Some of these are stockholders, governments, suppliers, local communities, competitors, customers, creditors, labour unions, special interest groups and trade associations. Perhaps a better word for task environment is its *industry*.

FIGURE 7.1 **ENVIRONMENTAL VARIABLES**



Source: Thomas L. Wheelan and J. David Hunger, *Strategic Management and Business Policy: Entering the 21st Century*, 6th edn (Addison Wesley Pub. Co. 1997). © Reprinted by permission of Pearson Education, Inc., Upper Saddle River, NJ USA.

ENTREPRENEURSHIP IN PRACTICE

EVALUATING ENVIRONMENTAL TRENDS

Environmental trends come in all forms and usually they are difficult to recognise early. Correctly quantifying any type of trend has been a challenge for centuries; when it comes to the bottom line, credibility then becomes the dominant factor in evaluating trends. In examining various sources that report on surveys, polls and trends, experts recommend the following when discerning the truths in trends:

Gauge the source: Media critic Jon Katz thinks most social trends and analyses are laughable, but he respects the data in business publications more than studies cited in the mainstream press because the business audience is more demanding.

Investigate the facts: Read the news items very closely. Look at two criteria: who responded to the survey and how representative was the sample. Website surveys often fail on both counts because respondents are self-selecting; possibly because they have an interest in the outcome. These respondents are also less likely to represent the public, largely because not everyone has access to computers. Also, take caution when considering conditional surveys. These typically claim people would be willing to pay $X for a particular service they do not already have.

Bear in mind when the survey was conducted: Events alter human behaviour, thus polls are more of a snapshot in time instead of a concrete change. Values and beliefs take a very long time to change.

Dig deeper: Find out what information the source left out. If you find a blurb on a survey in a local paper, go to the source and find out all the numbers. Spend a proportional amount of time on researching the information, as if you would rely upon it.

When you find the source, ask the questions good journalists ask: Find out what you should ask by reading '20 Questions Journalists Should Ask about Poll Results', written by former journalist G. Evan Witt available at (www.publicagenda.org).

Beware the hockey stick: Market projections with a sudden up-tick at the end are known as hockey sticks. At the point of the jump in the data it notes, 'estimated'; for the most part, you'll do a better job predicting the future based on recent facts or even a psychic.

Don't be too sceptical: Try not to discount a trend because it doesn't coincide with everything else you know. If the information is accurate and you choose to disregard it, it could spell doom for your business.

Source: Chris Sandlund, 'Plug in the numbers', *Entrepreneur* (June 2002): 19–21.

- At the outer level, the **societal environment** includes more general forces –those that do not directly touch the short-run activities of the organisation but can and often do, influence its long-run decisions. Here we include the regulatory and political environment in which entrepreneurs find themselves.

One Australian researcher adds an important caveat for the entrepreneur doing environmental analysis scanning. Voros says the technique is 'less about technique and methodology … and more about openness of mind'.[4] Fortunately for entrepreneurs, they are born with open minds, yet they must be alert to potential blind spots in their analysis. As Choo (above) reminds us, scanning the environment is really more an art than a science.

UNDERSTANDING ASIA–PACIFIC REGULATORY ENVIRONMENTS

Environmental assessment usually begins with a general assessment of the **regulatory environment**. We first look at regulatory environments in our region at both the international and national levels, as the lines between them are increasingly blurred.

Why do some entrepreneurs succeed while others fail in international competition? Perhaps it is better to turn the question around and ask, why is it that a particular country or economy becomes the home-base for competitive globally-oriented entrepreneurs? What makes Australia a global leader in wine exports? How did New Zealand make it to global ranks in the creative industries? Why does Singapore have the most business-friendly environment for entrepreneurs? Why is it location, location, location? One powerful factor is the regulatory environment.

Asia–Pacific country- or region-specific regulations are diverse. But they seriously affect the climate for start-up entrepreneurs. They range from best-in-the world (for example, Australia, New Zealand and Singapore) to the dreadful (Indonesia). A business must comply with governmental rules and regulations in the country of origin, but it must also be mindful of other countries of operation. Costs and profits can be affected as much by a government directive as by a management decision. Fundamental entrepreneurial decisions – such as which lines of business to go into, which products and services to produce, which investments to finance, how and where to make goods and how to market them and what prices to charge – are increasingly subject to governmental control.[5]

The entrepreneur needs to know legal frameworks in such areas as dispute settlement and arbitration; customs and tariffs; standards setting; R&D and innovation policy; anti-trust legislation; personnel and human resources; finance and taxation; securities and banking; trade and securities commissions; food and drug regulations; consumer products and protection regimes; transportation and communications; defence and security; occupation health and safety; environmental protection; energy regulation; export–import transactions; foreign relations and defence – the list boggles the mind.

Overall, some countries in our region are leaders in the global ‘ease of doing business’ sweepstakes. According to the World Bank,[6] New Zealand tops the list, followed by Singapore, the United States, Australia and Hong Kong. (We use the United States as a benchmark comparison throughout this chapter.) Japan comes in 10th and Thailand ranks 20th. Indonesia comes in 115th (see table 7.2).

Of course, being at the top of this list does not mean there is no regulation. No one would argue that it is a ‘free-for-all’ in New Zealand, that workers are abused in Australia, or that there is no fair bankruptcy process in Japan. Indeed, to make the top 20 list, countries need to put important regulations in place, such as property rights protection and labour provisions. But some countries in our region make it excessively difficult for entrepreneurs to operate. In Indonesia, it costs more than the debt itself to collect a debt. In Malaysia, it takes 143 days to register property. Ironically, the (developing) countries with the biggest obstacles for entrepreneurs are just the ones that most need them for creating jobs and wealth.

Let’s have a look at some regulatory areas for entrepreneurs, particularly those that are globally focused – all with an Asia–Pacific focus.

TABLE 7.2: **EASE OF DOING BUSINESS**

ECONOMY	EASE OF DOING BUSINESS	ECONOMY	EASE OF DOING BUSINESS
New Zealand	1	Malaysia	21
Singapore	2	Korea	27
United States	3	Taiwan	35
Australia	6	China	91
Hong Kong	7	Vietnam	99
Japan	10	Philippines	113
Thailand	20	Indonesia	115

Source: World Bank and International Monetary Fund, *Doing Business in 2005* (Oxford University Press, 2005): 2, available from [www.doingbusiness.org/EconomyRankings] accessed 5 November 2005.

Business formation

Starting a business should be easy. But an entrepreneur can face obstacles such as costs, delays and procedural complexities. Australia and New Zealand are the best in the world in the ease of **business formation** and have only two required procedures (notification of existence and registration for tax and social security) to start a business. In Australia you can be up and running in two days (see table 7.3).

Compare this to Indonesia, where it takes on average 151 days. The cost of starting a business (measured in percentage of per capita income) is very low in New Zealand and Singapore, but in Indonesia it takes more than a year's average annual salary. The minimum capital requirements to start a business (usually a frozen account) are 0 per cent in Australia, New Zealand, Singapore, Malaysia and Hong Kong, but 946 per cent of yearly income in China.

Dealing with licences and permits

Entrepreneurs often face a myriad of sector-specific licences as well as inspections to enforce compliance. The World Bank index looks at licences in the construction industry (all procedures required for a business in the construction industry to build a standardised warehouse). New Zealand comes out as the least 'procedural' economy, but other countries in the Asia–Pacific are very regulated in terms of licences (see table 7.4). In China it takes a full year to get construction licences; in India the cost is equivalent to more than six times the average annual income.

Labour regulations

Employment or **labour regulations** protect workers from discriminatory and unfair practices by their employers. These include employment law, industrial relations, health and safety and social security. Governments pass regulations to safeguard workers from 'market failure' to respect their rights. These include everything from mandatory minimum wages, to overtime bonuses, grounds for dismissal and severance pay. Governments and business communities often play a delicate see-saw

TABLE 7.3: STARTING A BUSINESS IN THE ASIA–PACIFIC

ECONOMY	PROCEDURES (NO.)	DURATION (DAYS)	COST (% GNI PER CAPITA)	MIN. CAPITAL (% GNI PER CAPITA)
Australia	2	2	1.9	0
New Zealand	2	12	0.2	0
Hong Kong	5	11	3.4	0
United States	5	5	0.5	0
Singapore	6	6	1.1	0
Taiwan	8	48	6	216.3
Thailand	8	33	6.1	0
Malaysia	9	30	20.9	0
Japan	11	31	10.7	75.3
Philippines	11	48	20.3	2
Vietnam	11	50	50.6	0
India	11	71	61.7	0
Indonesia	12	151	101.7	97.8
Korea	12	22	15.2	308.8
China	13	48	13.6	946.7

Source: World Bank and International Monetary Fund, *Doing Business in 2005*.

TABLE 7.4: **LICENSING AND PERMITS IN THE ASIA–PACIFIC**

ECONOMY	PROCEDURES (NO.)	TIME (DAYS)	COST (% OF INCOME PER CAPITA)
New Zealand	7	65	29.3
Thailand	9	147	17.3
Singapore	11	129	24
Japan	11	87	19.7
Korea	14	60	232.6
Vietnam	14	143	64.1
Australia	16	121	12.3
Indonesia	19	224	364.9
United States	19	70	16.9
India	20	270	678.5
Hong Kong	22	230	38.5
Philippines	23	197	121
Malaysia	25	226	82.7
China	30	363	126
Taiwan	32	235	250.9

Source: World Bank and International Monetary Fund, *Doing Business in 2005*.

game over the years to find the right balance between labour market flexibility and job stability. The best way to encourage job creation is through policies such as flexible working hours and term contracts, ease of contracting workers and ease of hiring and firing (see table 7.5).

The countries of the Asia–Pacific vary greatly in the difficulty of hiring and firing. Australia, Singapore, Hong Kong and Malaysia are the leaders here. New Zealand's present Labour government has put more regulations in place. But Indonesia, Taiwan and Thailand have put numerous obstacles

TABLE 7.5: **LABOUR REGULATIONS IN THE ASIA–PACIFIC**

ECONOMY	DIFFICULTY OF HIRING INDEX	RIGIDITY OF HOURS INDEX	DIFFICULTY OF FIRING INDEX	RIGIDITY OF EMPLOYMENT INDEX	HIRING COST (% OF SALARY)	FIRING COSTS (WEEKS OF WAGES)
Australia	0	40	10	17	21	4
Hong Kong	0	0	0	0	5	12.9
Malaysia	0	20	10	10	13.3	65.2
Singapore	0	0	0	0	13	4
United States	0	0	10	3	8.5	0
China	11	40	40	30	30	90
New Zealand	11	0	10	7	0	0
Japan	17	40	0	19	12.7	21.2
Thailand	33	20	0	18	5	47
Korea	44	60	30	45	17	90
Vietnam	44	40	70	51	17	98
Philippines	56	40	40	45	9.3	90
India	56	40	90	62	12.3	79
Indonesia	61	40	70	57	10.2	144.8
Taiwan	78	60	30	56	9.5	90

Source: World Bank and International Monetary Fund, *Doing Business in 2005*.

in place in the ease of hiring and firing. One of the most startling observations is how much it costs to fire a person in terms of weeks of severance pay. In New Zealand, there is no such protection, that is, required severance pay is actually zero. Singapore and Australia have modest rates of 4 weeks. In Malaysia, severance pay provisions are 65 weeks. But in Indonesia, a whopping 144 weeks of salary must be paid to see the worker leave.

Property laws

Since land and buildings make up a sizable proportion of a business's productive capacity, entrepreneurs thrive in countries where **property laws** are predictable and many Asia–Pacific countries are leaders in this regard. With secure property titles, entrepreneurs can secure more financing since banks greatly prefer 'immovable' property. Proper titles also increase land values and investment levels. To function properly, property markets must permit investments to be channelled productively. Collateral laws must make it easy for banks to seize collateral when a debtor defaults. Property registration reduces transaction costs and improves the security of property rights. This benefits small and medium enterprises especially since the rich rarely have problems protecting their property rights.

New Zealand has the greatest ease of registering property. The buyer checks the legal status of the property with the local authority and then pays a conveyancer a standard fee of 0.1 per cent of the property value to register the transfer online (see table 7.6). Registration is complete in two days. Thailand has a world-class system where all contracts are prepared in the land office as part of registration. In Singapore the buyer conducts all due diligence and pays taxes online.

Getting credit

Getting finance is one of an entrepreneur's greatest obstacles. Small businesses, especially women-owned firms, typically face high hurdles in securing credit. A good credit information regime benefits both the creditor and the debtor. It boosts productivity and growth by allowing

TABLE 7.6: PROPERTY LAWS IN THE ASIA–PACIFIC

ECONOMY	PROCEDURES (NO.)	TIME (DAYS)	COST (% OF PROPERTY VALUE)
New Zealand	2	2	0.17
Thailand	2	2	6.3
China	3	32	3.1
Singapore	3	9	2.8
Taiwan	3	5	6.2
Malaysia	4	143	2.3
United States	4	12	0.5
Australia	5	5	7.1
Hong Kong	5	83	5
Vietnam	5	67	1.2
Japan	6	14	4
India	6	67	7.9
Indonesia	7	42	11
Korea	7	11	6.3
Philippines	8	33	5.7

Source: World Bank and International Monetary Fund, *Doing Business in 2005*.

TABLE 7.7: **CREDIT REGULATIONS IN THE ASIA–PACIFIC**

ECONOMY	LEGAL RIGHTS INDEX	CREDIT INFORMATION INDEX	PUBLIC REGISTRY COVERAGE (% ADULTS)	PRIVATE BUREAU COVERAGE (% ADULTS)
Hong Kong	10	5	0	64.5
Singapore	10	4	0	38.6
Australia	9	5	0	100
New Zealand	9	5	0	95.8
Malaysia	8	6	33.7	–
United States	7	6	0	100
Japan	6	6	0	61.2
Korea	6	5	0	80.7
Indonesia	5	3	0	0.1
Thailand	5	4	0	18.4
India	5	2	0	1.7
Taiwan	4	5	0	57.1
Philippines	3	2	0	3.7
Vietnam	3	3	1.1	0
China	2	3	0.4	0

Source: World Bank and International Monetary Fund, *Doing Business in 2005*.

credit to shift to productive ventures. Transparent credit registries greatly accelerate the ease of obtaining or giving credit. Lending is easier when a debtor can pledge any type of asset (or even offer a changing pool of assets such as inventory or crops) and can do so through a collateral registry.

Hong Kong, Singapore, Australia and New Zealand have very efficient and transparent credit systems. In New Zealand, fees, taxes and stamp duties for the collateral registry are negligible and the process is complete within two days (see table 7.7). Enforcing collateral law is easy in Australia. The creditor appoints a receiver and serves notice on the borrower. The receiver seizes and sells the asset. No courts are involved as long as the debtor cooperates. Enforcement is over 10 days. Such countries as China, Vietnam and the Philippines are ranked poorly in this dimension.

Investor protection

Looting by corporate insiders happens all the time and it often goes undetected. **Investor protection** against self-dealing – the use of corporate assets for personal gain – is necessary for equity markets to develop. Entrepreneurs require regulatory regimes that provide incentives for investors to provide finance without the need to exercise daily control of the business. They need laws that prevent expropriation and expose it when it does. This requires protection of small shareholders and enforcement of defaults and irregularities. It also requires that a well-governed business should disclose ownership and financial performance information. Information on board directors and on voting agreements among the shareholders must be freely available to current and potential investors. It also means that a director should face liability for self-dealing and that shareholders should be able to sue officers and directors for misconduct.

In the **disclosure index**, the best in the world are China, Hong Kong, Malaysia, New Zealand, Singapore and Thailand (see table 7.8). But China falls way down in terms of the liability for

TABLE 7.8: **PROTECTION OF INVESTORS IN THE ASIA–PACIFIC**

ECONOMY	DISCLOSURE INDEX	DIRECTOR LIABILITY INDEX	SHAREHOLDER SUITS INDEX	INVESTOR PROTECTION INDEX
China	10	1	2	4.3
Hong Kong	10	8	8	8.7
Malaysia	10	9	7	8.7
New Zealand	10	9	10	9.7
Singapore	10	9	9	9.3
Thailand	10	2	6	6
Australia	8	2	8	6
Indonesia	8	5	3	5.3
Taiwan	8	4	4	5.3
United States	7	9	9	8.3
India	7	4	7	6
Japan	6	7	7	6.7
Kuwait	5	5	5	5
Vietnam	4	1	2	2.3
Philippines	1	2	7	3.3

Source: World Bank and International Monetary Fund, *Doing Business in 2005*.

self-dealing (director liability index). Here the best countries are Malaysia, New Zealand and Singapore. New Zealand is the easiest country for shareholders to sue officers and directors for misconduct and it comes out tops in the overall average investor protection index.

Paying taxes

Taxes are a necessary fact of life. For one thing, they help pay for the public services and the infrastructures that entrepreneurs rely upon. Business thrives in a system of simple, moderate taxes and fast, cheap administration. The World Bank measured the effective tax that a medium-size company must pay in the second year of operation (except for labour taxes). It also measures tax administration, such as number of payments and time spent to comply with tax requirements. The total amount of taxes is the sum of all the different taxes payable after accounting for deductions and exemptions. The taxes withheld but not paid by the company are not included.

Even such advanced entrepreneurial countries as New Zealand and Australia fall way behind Hong Kong in total number of taxes that must be paid (see table 7.9). Singapore has the easiest regime in terms of the time it takes to prepare, file and pay (or withhold) the corporate income tax, the value added tax and social security contributions (in hours per year). In perhaps the most controversial dimension, New Zealand and Australia are just as bad as Indonesia in terms of total amount of all taxes payable by the business, as a percentage of gross profit. New Zealanders will envy entrepreneurs in Hong Kong and Malaysia.

International trading regulations

Best practice from around the world shows that entrepreneurs who have the fewest required documents and signatures export and import more. They also make it cheaper for exporters to operate. Red tape cuts profits from trade. Inefficient customs and trade transport mean that businesses must hold larger inventories at their warehouse. Furthermore, filing more documents

TABLE 7.9: PAYING TAXES IN THE ASIA–PACIFIC

ECONOMY	PAYMENTS (NO.)	TIME (HOURS)	TOTAL TAX PAYABLE (% GROSS PROFIT)
Hong Kong	1	80	14.3
New Zealand	8	70	44.2
United States	9	325	21.5
Australia	12	107	37
Taiwan	15	296	23.6
Singapore	16	30	19.5
Japan	26	315	34.6
Korea	26	290	29.6
Malaysia	28	–	11.6
China	34	584	46.9
Thailand	44	52	29.2
Vietnam	44	1,050	31.5
Indonesia	52	560	38.8
India	59	264	43.2

Source: World Bank and International Monetary Fund, *Doing Business in 2005*.

is associated with more corruption in customs. The World Bank measured **international trading regulations** (the number of every official procedure) – from the contractual agreement between the two parties to the delivery of goods – along with the time necessary for completion (see table 7.10).

Australian and Singaporean entrepreneurs clearly have the advantage here as they lead in almost all categories. Surprisingly, it takes 79 days on average to import into Hong Kong, and New Zealand also is poor here with 42 days, according to the World Bank.

TABLE 7.10: INTERNATIONAL TRADE REGULATIONS IN THE ASIA–PACIFIC

ECONOMY	DOCUMENTS FOR EXPORT (NO.)	SIGNATURES FOR EXPORT (NO.)	TIME FOR EXPORT (DAYS)	DOCUMENTS FOR IMPORT (NO.)	SIGNATURES FOR IMPORT (NO.)	TIME FOR IMPORT (DAYS)
Australia	5	2	12	11	2	16
Japan	5	3	11	7	10	37
Korea	5	3	12	6	2	9
New Zealand	5	2	8	14	12	42
Singapore	5	2	6	9	16	49
China	6	7	20	5	3	9
Hong Kong	6	4	13	18	55	79
Malaysia	6	3	20	11	14	49
United States	6	5	9	8	8	24
Vietnam	6	12	35	11	8	24
Indonesia	7	3	25	16	38	57
Taiwan	8	9	14	15	18	43
Thailand	9	10	23	9	10	42
India	10	22	36	15	27	43

Source: World Bank and International Monetary Fund, *Doing Business in 2005*.

Enforcing contracts

Entrepreneurs rely on being able to enforce a contract with their customers. If there is no system for enforcing contracts, then trade and credit may be limited to family or a small community of people. Even where the courts enforce contracts, they may be slow, inefficient and even corrupt. Here we are looking at the number of procedures, the time it takes, the associated cost involved that must be paid to the court, receivers, lawyers, etc. (see table 7.11).

Entrepreneurs in Australia and New Zealand are clearly at an advantage in enforcing contracts. But imagine the hapless entrepreneur in Indonesia who is trying to enforce a contract. It may cost as much as 127 per cent of the actual debt to make the collection!

Political instability and corruption

Political instability and corruption can be practical barriers for entrepreneurs. Frequent government changes can lead to business policy reversals, undercut an entrepreneur's marketplace certainty and hinder the efficient functioning of business plans. It may still be possible to do business in a country with transitory governments or inconsistent policies. (See table 6.2 for Transparency International's **Corruption Perceptions Index**.)

UNDERSTANDING THE INDUSTRY ENVIRONMENT

Noted strategic consultant Michael E. Porter has suggested that at its root, environmental assessment involves asking two critical questions. First, what is the structure of your industry and how is it likely to evolve over time? If the entrepreneur's business is not in an attractive industry – and we will show how to measure its attractiveness – then the person may want to get out of it or redefine it.

Porter's second question is, what is the company's relative position in the industry? No matter how attractive the game is, entrepreneurs will not do well if their company does not hold a good position in it. Conversely, the business can be in a lacklustre industry with low

TABLE 7.11: CONTRACT ENFORCEMENT IN THE ASIA–PACIFIC

ECONOMY	PROCEDURES (NO.)	TIME (DAYS)	COST (% OF DEBT)
Australia	11	157	14.4
Hong Kong	16	211	12.9
Japan	16	60	8.6
United States	17	250	7.5
New Zealand	19	50	4.8
Singapore	23	69	9
China	25	241	25.5
Thailand	26	390	13.4
Taiwan	28	210	7.7
Korea	29	75	5.4
Malaysia	31	300	20.2
Indonesia	34	570	126.5
Vietnam	37	343	30.1
India	40	425	43.1

Source: World Bank and International Monetary Fund, *Doing Business in 2005*.

ENTREPRENEURIAL EDGE

ENTREPRENEURS FACE REGULATORY NIGHTMARES

CHICKENS IN CHINA

Since he went into business with 1000 chickens and 50 pigs in the 1980s, outspoken Chinese rural entrepreneur Sun Dawu has been battling the red tape and official interference that are the legacies of decades of communist economics. Mr Sun's toughest trial came in 2003 when he was detained for six months on charges of illegally accepting financial deposits in a case that highlighted the funding problems of rural enterprises.

He says his company repeatedly tried to raise loans for expansion from local state credit cooperatives, only to be rejected because it 'lacked scale, lacked approval and lacked (a place in lending) quotas'. Eventually, the group began to raise funds openly by accepting deposits from employees and local residents. Banks and cooperatives – many technically insolvent – rarely channel funds to productive enterprises and much of the vital capital flows to richer urban areas, he argues. Sun sees a systemic problem in an insistence by authorities on official control that is intended to shield local savers from the risk of putting their cash in private hands – even when they know best who is most transparent and trustworthy. Mr Sun is now searching for other ways to raise funds for his company, which lost 600 of its 1300 employees during his detention. And as he tours the school he built partly with money raised from local deposits, he reveals an ambition to build a university.

CAMELS IN NEW ZEALAND

New Zealander John Magill has been frustrated by red tape after returning home to New Zealand with plans to run a camel trekking business – a business he had been operating successfully in Melbourne for years. He was told camels qualified as 'new organisms' under the Hazardous Substances and New Organisms Act and to import them he would have to go through a lengthy process of Environmental Risk Management Authority hearings. After spending three years and $7000 trying to bring in his three camels – Kelly, Laura and Jenna – he had to give up and sell them. Environment Minister Marian Hobbs said camels qualified as new organisms as did other exotic animals that were only in zoos or not present in New Zealand.

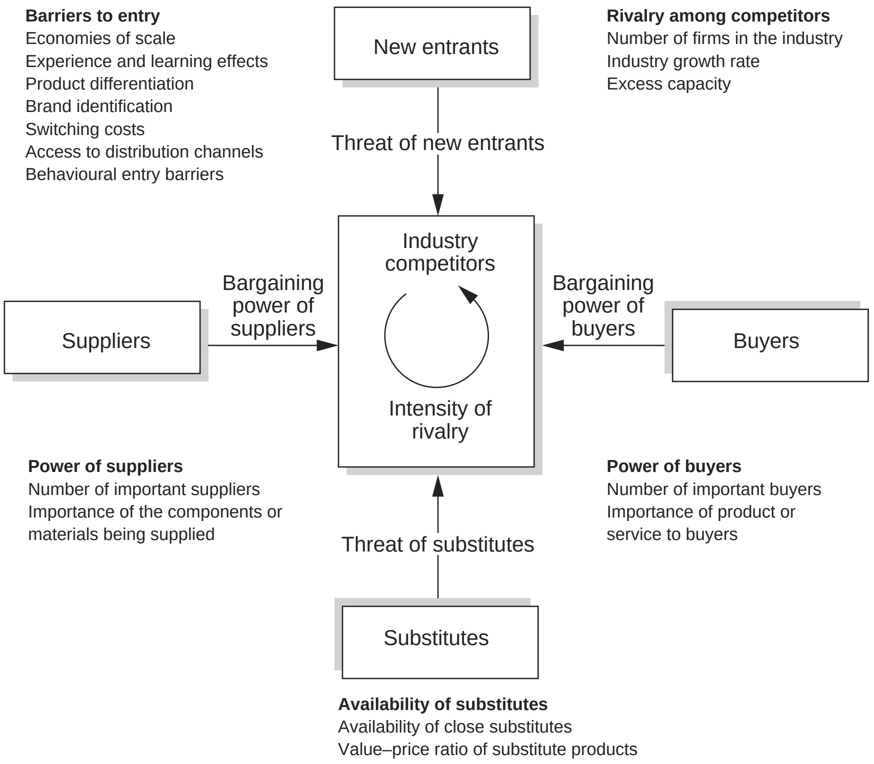
Sources: Mure Dickie, 'There's hope for China, says freed entrepreneur: Sun Dawu tells Mure Dickie about his battles with officialdom and struggle to find finance for his farm business', *Financial Times* (London), 14 November 2003; Peter Marsh, 'Red tape means hatful of problems for entrepreneur', *Financial Times* (London), 21 June 2004; Jonathan Milne, 'Camels sent packing', *The Dominion Post* (Wellington), 18 September 2002.

average profitability, yet if it occupies exactly the right niche, it can perform very well. 'Most small companies, of course, cannot change an industry's structure. What they can do, however, is establish a good position in the industry, a position based on sustainable competitive advantage', Porter says.[7]

So, evaluating the **industry environment** is the second critical step (after the regulatory environment) in the overall economic assessment of a new venture. In determining how to achieve a competitive advantage, Porter suggests that you start with an overall strategy. Porter's **five forces model** of industry analysis, depicted in figure 7.2, has been widely used.[8] The five forces analysis is designed to help companies understand how profitable an industry is and also what they can do to mitigate negative forces and thereby improve profitability.

According to Porter, five forces determine the competitive environment of an industry: threat of new entrants; bargaining power of buyers; bargaining power of suppliers; threat of substitutes; and rivalry among the existing competitors. The combined power of these five forces has a decisive effect on the success of an organisation. They influence prices, costs and required investment of the competitors in an industry. Using this model, entrepreneurs can assess an entire industry structure. Figure 7.3 presents questions that must be answered that address each of the five forces.[9]

FIGURE 7.2 **PORTER'S FIVE INDUSTRY FORCES MODEL**



Source: Michael E. Porter, *Competitive Advantage: Creating and Sustaining Superior Performance* (The Free Press, 1985; 1998): 6. Copyright © 1985, 1998 by Michael E. Porter. Adapted with permission of The Free Press, an imprint of Simon & Schuster Adult Publishing Group.

Common characteristics of new and emerging industries

Although industries vary in size and development, certain characteristics are common to new and emerging industries that today's entrepreneurs will consider. The most important of these are discussed next.

- **Technological uncertainty:** A great deal of uncertainty usually exists about the technology in an emerging industry: Which product configuration will ultimately prove to be the best? Which production technology will prove to be the most efficient? How difficult will it be to develop this technology? How difficult will it be to copy technological breakthroughs in the industry?
- **Strategic uncertainty:** Related to technological uncertainty are a wide variety of strategic approaches often tried by industry participants. Since no 'right' strategy has been clearly identified, industry participants will formulate different approaches to product positioning, advertising, pricing and the like, as well as different product configurations or production technologies.

FIGURE 7.3 USING THE FIVE FORCES MODEL FOR INDUSTRY ANALYSIS

New entrants

- What are the barriers to entry? Are we able to raise them? What factors are tending to lower them?
- What firms are potential or imminent new entrants? What are their characteristics (size, number, growth, customer base, and so on)?
- What are the entrants' competitive strategies likely to be? How might the new entrants and their strategies reshape the industry?
- When will they enter our market(s)?

Suppliers

- What firms are suppliers, and how large or concentrated are they?
- How concentrated is our industry (their buyers) relative to them? That is, how many of us buy what percentage of the output?
- Can firms in the industry switch suppliers easily?
- What percentage of their total output is purchased by our industry? How large are the quantities?
- How important is their product or service to the quality of ours?
- How much of our cost does their product or service represent?
- What is the threat of forward integration by each supplier? (Conversely, what is the opportunity for backward integration by one or more of us?)
- What is their relative bargaining power over us?

Industry competitors

- What firms are the major competitors (today)? What are their basic characteristics (size, growth, product lines, customer base, geographic coverage, and so on)?
- What are their relative positions in the industry?
- What is the competitive advantage of each? (What 'switching costs' or strategies does each use?)
- How do they compete? What 'weapons' or strategies does each use?
- What form does competition take – open warfare, polite détente, secrecy, open signalling?
- How is product differentiation achieved?
- How competitive is the industry? Are any competitors attempting to shape the industry? How?

Buyers

- What firms are the customers for this industry? How concentrated are they?
- How fast is demand growing overall and in different segments? What is the potential for finding or creating new markets or niches?
- What are the switching costs? How high are they?
- How price sensitive is each customer segment for each of the industry's services?
- How large is the threat of backward integration (that is, buyers' self-supplying our products or services)?
- What is the customer's relative bargaining power?

Substitutes

- What are the substitutes or alternatives for our product or service?
- How big an impact will the substitutes have? (That is, how viable are they as direct replacements for our product or service?)
- How quickly will they penetrate?
- Which players in the industry will consider substitutes as an opportunity for diversification?

Source: Michael E. Porter, 'How competitive forces shape strategy', *Harvard Business Review* (February 1979): 137–45. Copyright © 1979 by Harvard Business School Publishing Corporation; all rights reserved. Adapted and reprinted by permission of *Harvard Business Review*.

- **First-time buyers:** Buyers of an emerging industry's products or services are perfectionist first-time buyers. The marketing task is thus one of substitution, or getting the buyer to make the initial purchase of the new product or service.
- **Short time horizons:** In many emerging industries the pressure to develop customers or produce products to meet demand is so great that bottlenecks and problems are dealt with expediently rather than on the basis of an analysis of future conditions. Short-run results are often given major attention, while long-run results are given little consideration.

Barriers to entry

In addition to the structural components of an emerging industry, **barriers to entry** exist. These barriers may include proprietary technology (expensive to access), access to distribution channels (limited or closed to newcomers), access to raw materials and other inputs (for example, skilled labour), cost disadvantages due to lack of experience (magnified with the technological and competitive uncertainties), or risk (which raises the effective opportunity cost of capital). Other barriers to entry are presented in table 7.12. Some of these barriers will decline or disappear as the industry develops. However, it is still important for entrepreneurs to be aware of these barriers.

Competitive analysis

There is nothing more important than a thorough analysis of your competition.[10] This **competitive analysis** involves consideration of the number of competitors as well as the strength of each. Figure 7.4 provides an illustrative grid that can be used to analyse the competition.

TABLE 7.12: POSSIBLE CONSTRAINTS TO INDUSTRY DEVELOPMENT

CONSTRAINT	EXPLANATION
Inability to obtain raw materials and components	The development of an emerging industry requires that new suppliers be established or existing suppliers expand output or modify raw materials and components to meet the industry's needs. In the process, severe shortages of raw materials and components are very common.
Period of rapid escalation of raw materials prices	Because of burgeoning demand and inadequate supply, prices for key raw materials often skyrocket in the early phases of an emerging industry. This situation is partly the simple economics of supply and demand and partly the result of suppliers realising the value of their products to the desperate industry.
Absence of infrastructure	Emerging industries are often faced with difficulties, such as those of material supply, caused by the lack of appropriate infrastructure – distribution channels, service facilities, trained mechanics and complementary products.
Perceived likelihood of obsolescence	An emerging industry's growth will be impeded if buyers perceive that second- or third-generation technologies will significantly make currently available products obsolete. Buyers will wait instead for the pace of technological progress to slow down and prices to fall as a consequence.
Erratic product quality	For many newly established firms, the lack of standards and technological uncertainty often cause erratic product quality in emerging industries. This erratic quality, even if caused by only a few firms, can negatively affect the image and credibility of the entire industry.
Image and credibility with the financial community	As a result of newness, the high level of uncertainty, customer confusion and erratic quality, the emerging industry's image and credibility with the financial community may be poor. This result can affect not only the ability of firms to secure low-cost financing but also the ability of buyers to obtain credit.

Source: Michael E. Porter, *Competitive Strategy: Techniques for Analyzing Industries and Competitors* (The Free Press, 1980; 1998): 221–4. Copyright © 1980, 1998 by The Free Press. Adapted with permission of The Free Press, an imprint of Simon & Schuster Adult Publishing Group.

FIGURE 7.4 COMPETITIVE PROFILE ANALYSIS

Instructions

Place an *X* to denote any competitive factor that a competitor has or can provide/perform better than you.

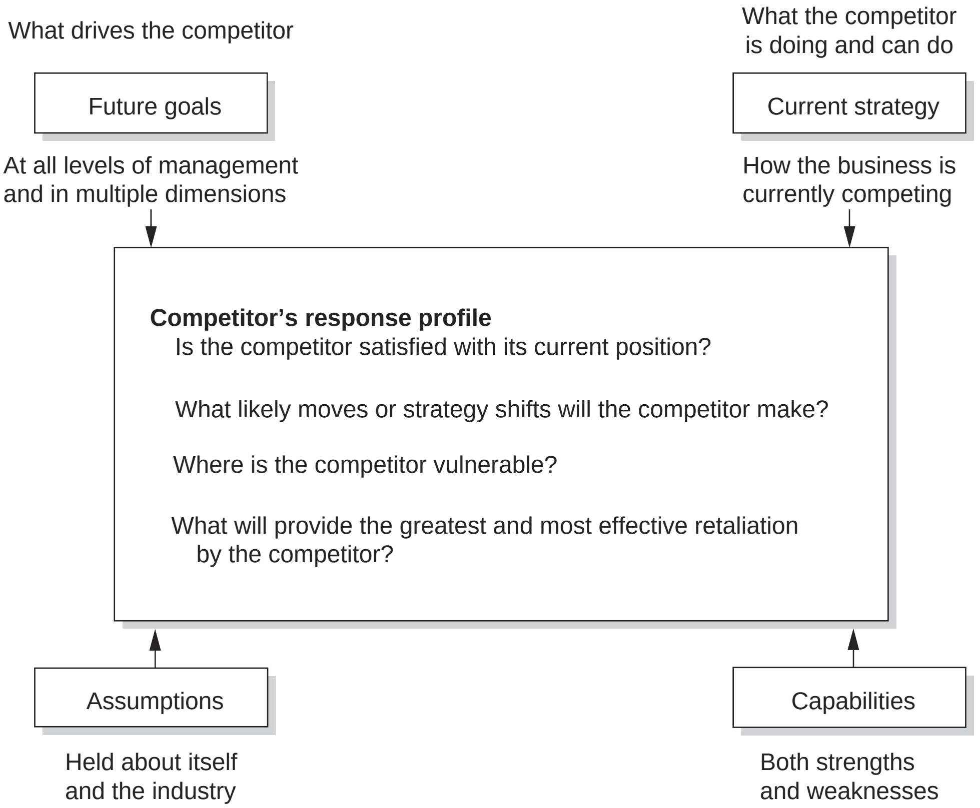
	Competitive Firms			
Competitive Factor	Company A	Company B	Company C	Your Company
Product uniqueness				
Relative product quality				
Price				
Service				
Availability/convenience				
Reputation/image				
Location				
Advertising and promotional policies/ effectiveness				
Product design				
Calibre of personnel				
Raw material cost				
Financial condition				
Production capability				
R&D position				
Variety/selection				

Figure 7.5 illustrates the components of a competitive analysis from the standpoint of:

- what drives the competition
- what the competition can do.

The competition's current strategy and future goals will help dictate its response. So too will the assumptions that each competitor has about itself as well as its perceived strengths and weaknesses.

FIGURE 7.5 COMPONENTS OF A COMPETITIVE ANALYSIS



Source: Michael E. Porter, *Competitive Strategy: Technique for Analyzing Industries and Competition* (The Free Press 1980; 1998): 49. Copyright © 1980, 1998 by Michael E. Porter. Adapted with permission of The Free Press, an imprint of Simon & Schuster Adult Publishing Group.

Taking the right steps

In addition to the analytical process already discussed, several useful steps can assist an entrepreneur in examining the industry. The following are five of the most helpful:

- **Clearly define the industry for the new venture:** The key here is to develop a relevant definition that describes the focus of the new venture. Definitions will vary, of course, depending on the venture and its specific target market. The more clearly the entrepreneur can define the industry for the new venture, the better the chance the venture will get off to a sound start.
- **Analyse the competition:** An analysis of the number, relative size, traditions and cost structures of direct competitors in the industry can help establish the nature of the competition. Will competition become more or less intense as the number and characteristics of competitors change over time? This question also can be answered through detailed analysis. For instance, what will happen to the degree of competition if:
  - market growth increases rapidly
  - direct competitors equalise in size

  - one or two direct competitors become substantially larger in size
  - product/service differentiation slows down?
- **Determine the strength and characteristics of suppliers:** The important factor here is to establish the stance of the venture in relation to the suppliers. How will the new firm be treated compared to other, more established firms? Do many suppliers offering diverse services exist, or must the new venture be prepared to accept limited services from a few?
- **Establish the value-added measure of the new venture:** The concept of value added is a basic form of contribution analysis in which sales minus raw material costs equals the value added. The purpose behind this measure is to determine how much value the entrepreneur is adding to the product or service. This introduces the concept of integration – backward or forward. Backward integration is the movement of a buyer to acquire supplier services. Forward integration is the movement of a supplier to absorb the duties of a buyer. The likelihood of integration occurring is determined substantially by the degree to which the value added is essential to the final processing and user consumption.
- **Project the market size for the particular industry:** Markets are dynamic and prone to change over time. Therefore, it is important to examine the historical progression of the market, establish its present size and extrapolate the data to project the market growth potential. This can be done in terms of the industry life cycle, consumers (numbers and trends), product/service developments and competitive analysis.

These five key points are not all-inclusive. However, they do represent an initial analysis of the industry environment that a new venture faces. This type of macro-analysis is important for establishing the framework within which a venture will start, grow and, it is hoped, prosper. Once this analysis is complete, attention can be turned to the micro-environment, which provides a community perspective.

UNDERSTANDING THE COMMUNITY PERSPECTIVE

After analysing the regulatory and industry environments, the entrepreneur needs to focus on **micro-environmental assessment**. This analysis is directed towards the community where the new venture is to be launched.[11]

Researching the location

Assessing the local community environment is as vital to the success of a new venture as assessing the regulatory economy and the industry. We shall now discuss major facets to consider.

Community demographics

A study of community demographics helps entrepreneurs determine the composition or make-up of consumers who live within the community. These data typically include such statistics as community size, the residents' purchasing power (disposable income), average educational background and types of occupation, the percentage of residents who are professionals and non-professionals and the extent of entrepreneurial activity in the community.

A few factors may be of special concern in this data analysis. One is the size of the new venture relative to the community itself and to other businesses in the community. Analysis of this factor helps the entrepreneur evaluate the new venture's potential in terms of sales, growth, employment and attraction of customers. Each variable is directly related to the size factor and all variables are interrelated. For example, a new venture may actually increase the total sales of all competitive firms in the community. A new furniture store located opposite an established furniture store often will serve to increase overall sales for both by drawing more business to the locale. People from other communities will come to comparison shop and will stay to buy. People from the local community will be more likely to purchase their furniture from one of these two stores than to drive to other communities to do so. The major reason is that furniture is a comparison good and most people like to look at the offerings of at least two stores before they buy.

Another important demographic characteristic is the amount of entrepreneurial activity in the community. To assess this factor, it is important to count the number of entrepreneurs in the community, to examine their types of business ventures and to establish their track records with suppliers (within and outside the region), their success with local banks and their customer base. If the community has a lot of entrepreneurial activity, it will be more receptive to new ventures and doors will be more easily opened. For example, local banks will be more accustomed to reviewing entrepreneurial loan applications and will have developed expertise in evaluating such applications and dealing with follow-up business.

Economic base

The extent of an entrepreneur's opportunity may be determined, in part, by the economic base of the community. This base includes the nature of employment, which influences the size and distribution of income and the purchasing trends of consumers in the area. Additionally, it is wise to examine any community dependence on one large firm or industry that may be affected by seasonal or cyclical fluctuations.

Population trends

It is important to examine population trends in order to identify expanding communities as opposed to long-term declining or static populations. Growth usually indicates solid, aggressive civic leadership with opportunities available for budding entrepreneurial ventures. Favourable signs of a growing community typically include chain or department store branches throughout the area, branch plants of large industrial firms, a progressive chamber of commerce, a good school system, transportation facilities (air, rail and highway), construction activity and an absence of vacant buildings.

Overall business climate

A summary view of the community from the business perspective includes consideration of transportation, banking, professional services, the economic base, growth trends and the solidity of the consumer income base. It is important to make an assessment of the general business climate before deciding on the location of a new venture. (See the Experiential exercise: A sample community analysis for more on this subject.)

Sources of data for environment scanning

Global entrepreneurs supplement their information with selected sources of environmental data. Table 7.13 describes some of these sources.

Business incubators

When scoping out a community, entrepreneurs will be attracted by business incubators. This is a business support process that accelerates the successful development of start-up companies

TABLE 7.13: SELECTED SOURCES OF ENVIRONMENTAL DATA FOR START-UP ENTREPRENEURS

Central Banks around the world	[www.bis.org/cbanks.htm]
CIA World Factbook	[www.cia.gov/cia/publications/factbook]
Country Risk and Economic Analysis	[www.businessmonitor.co.uk/index.html]
Country Risk Gradings	[www.efic.gov.au/static/efi/cra.htm]
Economist Country Briefings	[www.economist.com/countries/index.cfm]
Electronic Embassy	[www.embassy.org]
Export.gov Market Research	[www.export.gov/marketresearch.html]
Federation of International Trade Associations	[www.fita.org]
Google > International Business and Trade	[directory.google.com/Top/Business/International_Business_and_Trade]
International Monetary Fund	[www.imf.org]
Library of Congress Country Studies	[lcweb2.loc.gov/frd/cs/cshome.html]
Organisation for Economic Cooperation and Development	[www.oecd.org]
Political and Economic Risk in Asian Nations	[www.asiarisk.com/library.html]
US Department of State Background Notes	[www.state.gov/r/pa/ei/bgn]
United Nations	[www.un.org]
United Nations Human Development Report	[hdr.undp.org]
University of Michigan Global Edge	[globaledge.msu.edu]
Virtual International Business & Economic Sources	[library.uncc.edu/vibes]
Wikipedia	[www.wikipedia.org]
World Bank	[www.worldbank.org]
World Bank's annual World Development Report	[www.worldbank.org/wdr]
World Trade Organisation	[www.wto.org]
Yahoo > Regional > Countries	[www.yahoo.com/Regional/Countries]
Yahoo > Business and Economy > Trade > Government Agencies	[dir.yahoo.com/Business_and_Economy/Trade/Government_Agencies]

by providing entrepreneurs with an array of value-adding resources and services. In some areas of the Asia–Pacific, it is possible for a new venture to use an incubator (sometimes called a cyberpark) to get started.

- China has established a fairly comprehensive business incubator system, second in number in the world to the United States.
- Cyberparks in Brunei, Indonesia, Malaysia and the Philippines are underpinned by technical universities and commitment by the government to provide infrastructure, intellectual capital and skilled management.
- Taiwan has more than 100 small-scale incubators set up under various universities and research institutions.
- Australia has more than 80 housing some 1200 companies. In 2005 Australia launched a revamped Building Entrepreneurship in Small Business program with continued emphasis on incubation.
- New Zealand's 16 business incubators house more than 100 start-ups which together employ over 500 people.

The basic purpose of an incubator is to increase the chances of survival for new start-up businesses.[12] Four major types of incubators exist and the objectives of each type tend to vary:

- **Publicly sponsored:** These incubators are organised through city economic development departments, urban renewal authorities, or regional planning and development commissions. Job creation is the main objective of the publicly sponsored incubator.
- **Non-profit-sponsored:** These incubators are organised and managed through industrial development associations of private industry, chambers of commerce, or community-based organisations with broad community support or a successful record in real estate development. Area development is the major objective of non-profit-sponsored incubators.
- **University-related:** Many of these incubator facilities are spin-offs of academic research projects. Most are considered science and technology incubators. The major goal of university-related incubators is to translate the findings of basic research and development into new products or technologies.
- **Privately sponsored:** These incubators are organised and managed by private corporations. The major goal is to make a profit and, in some cases, to make a contribution to the community.[13]

Regardless of their type, however, most incubators provide below-market-rate rental space on flexible terms, no building maintenance responsibilities, equipment and services sharing; financial and technical assistance, cooperative environment, visibility in the community.

SUMMARY

In assessing a new venture, entrepreneurs consider different environments. Typically, they begin with the macro and then move on to the micro, focusing on data that help them decide how to establish the venture. The overall environment analysis assesses the nature of the industry and the regulatory environment that exists there. The specific industry environment that entrepreneurs address includes common industry characteristics, barriers to entry and competitive analysis.

The regulatory environment for Asia–Pacific entrepreneurs is varied and complex. Doing business in Australia or New Zealand is quite different from doing business in Singapore or other countries in our region. The most important regulatory areas that influence entrepreneurs are bankruptcy laws, business formation, contract enforcement, credit regulations, international trading regulations, investor protection, labour regulations, licensing and permits, property laws.

Michael Porter's work on competition and strategy provides the basis for entrepreneurs to grasp what is needed in doing a competitive analysis of the industry. Beyond this it is important to look at the community level to see whether the city or region in which entrepreneurs live will support their aspirations and plans.

When examining the location, entrepreneurs consider areas such as community demographics, the economic base, population trends and the overall business climate. When exploring business incubators, they focus attention on the presence of these facilities in the local area and the benefits they would hold for the specific enterprise.

KEY TERMS AND CONCEPTS

barriers to entry
business formation
competitive analysis
corruption perceptions index
disclosure index
environmental scanning
environmental variables
five forces model
industry environment
internal environment
international trading regulations
investor protection
labour regulations
micro-environmental assessment
property laws
regulatory environment
societal environment
strategic uncertainty
task environment
technological uncertainty

REVIEW AND DISCUSSION QUESTIONS

1 To assess the regulatory environment of a venture, an entrepreneur would like several questions answered. Identify and discuss five of these questions.
2 Briefly discuss each of the following effects of governmental regulations on small ventures: bankruptcy laws, business formation, contract enforcement, credit regulations, international trading regulations, investor protection, labour regulations, licensing and permits, property laws.
3 Of what value is figure 7.2 to helping an entrepreneur make a new-venture assessment?
4 What are barriers to entry? How do they affect new-venture assessment?
5 How could an entrepreneur use figure 7.3 to conduct a competitive profile analysis? What would the results provide? What types of decisions could the individual make from the analysis?
6 Identify and describe four of the steps to take when making an industry assessment.
7 How can an entrepreneur go about researching the location for a venture? What information can community demographics and population trends provide?

EXPERIENTIAL EXERCISE

IS YOUR COMMUNITY ENTREPRENEUR-FRIENDLY?

Take the yes–no quiz below to find out if your community is entrepreneur-friendly. If you're not sure of an answer, take your best educated guess.

1	When the mayor, provincial executive, or governor meets with business leaders in your community, are there as many CEOs of small and mid-size companies present at the meeting as there are bankers and CEOs of large companies?	Yes	No
2	Does the local newspaper follow the fortunes of start-ups and mid-size companies in your community with the same intensity as it does large corporations?	Yes	No
3	Do innovative growth companies recruit most of their professional workforce from the local area?	Yes	No
4	Is there a sizable, visible venture capital network in your community?	Yes	No
5	Does your local university or college encourage faculty and students to participate in entrepreneurial spin-offs and do they participate?	Yes	No
6	Do small and mid-size growth company CEOs and venture capitalists hold at least a quarter of the seats on the boards of the three largest banks in your community?	Yes	No
7	Does your government's economic development department spend more time helping local companies grow than it does pursuing out-of-area companies?	Yes	No
8	Can you think of five recent spin-offs – that is, growth companies started by entrepreneurs – who left large companies?	Yes	No
9	Can you name five entrepreneurs in your community who have thriving businesses?	Yes	No
10	Are entrepreneurs in your community invited to join the best athletic, social and country clubs and do they?	Yes	No

SCORING

For each 'yes' answer, add 10 points. For each 'no' reply, add 0 points.

- 0–30: Your community needs improvement in several areas in order to foster entrepreneurial activity.
- 40–60: Your community takes steps to foster entrepreneurial activity but can improve in some areas.
- 70–100: Your community provides a healthy environment for entrepreneurial growth. Congratulations!

Source: National Policy Research Council, [www.nprcouncil.com/hotsites] accessed 8 November 2005.

EXPERIENTIAL EXERCISE

GLOBAL ENVIRONMENT SCANNING

From the global or from the local community perspective, pick a company (or create one!) that intends to launch an entrepreneurial venture in another country in the Asia–Pacific. Give a report on the following factors.

- The economy:
  - GNP or GDP per capita
  - unemployment rate
  - inflation rate
  - consumer and investor confidence
  - inventory levels
  - currency exchange rates
  - merchandise trade balance
  - financial and political health of trading partners
  - balance of payments
  - future trends
- Government:
  - political climate – amount of government activity
  - political stability and risk
  - government debt
  - budget deficit or surplus
  - corporate and personal tax rates
  - payroll taxes
  - import tariffs and quotas
  - export restrictions
  - restrictions on international financial flows
- Legal:
  - minimum wage laws
  - environmental protection laws
  - worker safety laws
  - union laws
  - copyright and patent laws
  - anti-monopoly laws
  - Sunday/religious observance day closing laws
  - municipal licences
  - laws that favour business investment
- Technology:
  - efficiency of infrastructure, including: roads, ports, airports, rolling stock, hospitals, education, healthcare, communication, etc.
  - industrial productivity
  - new manufacturing processes
  - new products and services of competitors
  - new products and services of supply chain partners
  - any new technology that could impact the company
  - cost and accessibility of electrical power

- Ecology:
  - ecological concerns that affect the firm's production processes
  - ecological concerns that affect customers' buying habits
  - ecological concerns that affect customers' perception of the company or product
  - socio-cultural
- Demographic factors such as:
  - population size and distribution
  - age distribution
  - education levels
  - income levels
  - ethnic origins
  - religious affiliations
- Attitudes towards:
  - materialism, capitalism, free enterprise
  - individualism, role of family, role of government, collectivism
  - role of church and religion
  - consumerism
  - environmentalism
  - importance of work, pride of accomplishment
- Cultural structures including:
  - diet and nutrition
  - housing conditions
- Potential suppliers
  - labour supply: quantity of labour available, including; quality of labour available; stability of labour supply; wage expectations; employee turn-over rate; strikes and labour relations; educational facilities
  - material suppliers, including: quality, quantity, price and stability of material inputs; delivery delays; proximity of bulky or heavy material inputs; level of competition among suppliers
  - service providers including: quantity, quality, price and stability of service facilitators; special requirements

Source: Licensed under the GNU Free Documentation Licence from the Wikipedia article 'Environmental Scanning'.

EXPERIENTIAL EXERCISE

A SAMPLE COMMUNITY ANALYSIS

Assume you are in the process of opening a small retail hardware store. Choose a site location in your community and then answer the following questions about the community, potential customers, competition and location.

POTENTIAL OF THE TRADING AREA

1 How big is the trading area? .... sq km
2 What is the customer potential within five kilometres? .... customers
3 What is the density of population? .... people per sq km
4 Is transportation adequate for supplies? .... yes .... no
5 What is the income level of the trading area? .... per capita
6 What is the local employment pattern, based on number of people employed? .... % people employed
7 What is the general make-up of the community? .... residential .... old ....

8 What are the trends in population and income? .... up .... down
9 Are new constructions increasing? .... yes .... no
10 Are school enrolments up? .... yes .... no
11 Are retail sales increasing? .... yes .... no
12 Have average business improvements been made recently?............ yes .... no
13 Does business property have a high vacancy rate? .... yes .... no
14 Have shopping patterns changed drastically in recent years? .... yes .... no
15 Are customers moving to or away from the potential location? .... to .... from
16 What are the present zoning restrictions?

CAN CUSTOMERS GET TO THE LOCATION?

1 Is the area served by adequate public transportation? .... yes .... no
2 How broad an area does the transportation service encompass? .... sq km
3 Is the area generally attractive to shoppers? .... yes .... no
4 Can it be easily reached by car? .... yes .... no
5 Is public parking adequate and relatively inexpensive? .... yes .... no
6 How many spaces in the available nearby car park are taken up by all-day parkers? .... many .... few
7 If located on a highway, is the location easily accessible from the main traffic flow? .... yes .... no
8 What are restrictions on signs and store identification? ....
9 If the location is on a limited access road, how close is the nearest interchange? .... kilometres
10 Is the location accessible to delivery trucks? .... yes .... no
11 Is the traffic speed too fast to encourage entrance by car? .... yes .... no
12 Are most customers who drive past the location on their way to work or on shopping trips? .... on way to work .... on shopping trips
13 Will nearby stores help you? Are the other stores in the shopping centre, neighbourhood, or highway location of a nature that will attract customers who also will become patrons of your store? .... yes .... no .... maybe .... likely
14 What are the prospects for changes in traffic flow in the near future? .... slight .... likely
15 Will anticipated changes improve or damage the location? .... improve .... damage
16 Are zoning changes planned that would affect accessibility of the location? .... yes .... no

JUDGING THE COMPETITION

1 How many other businesses of the same kind exist between the prospective location and the most highly populated area? .... stores
2 Is this spot the most convenient store location in the area? .... yes .... no
3 How many other stores of the same kind are in this trading area? .... stores
4 How many of them will compete with you for customers? .... stores
5 Do these other stores have better parking facilities? .... yes .... no
6 Do these other stores offer the same type of merchandise? .... yes .... no
7 Do you consider these other stores more aggressive or less aggressive than your own operation will be? .... more .... less
8 What other competing stores are planned for this trading area in the near future? ....
....
9 Are other potential sites that are closer to the majority of customers likely to be developed in the near future? .... yes .... no
10 Are your major competitors well-known, well-advertised stores? .... yes .... no
11 Does a need for another store of this kind in the area actually exist? .... yes .... no

12. How well is the demand for this product being met in the area? .... very well .... moderately well _ _ _ _ _ _ _ _ _ _ _ not at all
13. If any empty stores or vacant lots are near the location, is a competitive store planned for them? .... yes .... no

CAN THE LOCATION ATTRACT NEW BUSINESS?

1. Is the location in an attractive district? .... yes .... no
2. Do numerous stores exist that will draw potential customers for you into the area? .... yes .... no
3. Is the location near well-known and well-advertised stores? .... yes .... no
4. Is this location the most attractive one in the area? .... yes .... no
5. Is the location on the side of the street with the busiest customer traffic? .... yes .... no
6. Is the location nearer to the general parking area than locations of competing firms? .... yes .... no
7. Is the location in the centre of or on the fringe of the shopping district? .... centre .... fringe
8. Is it near common meeting places for people, such as public offices? .... yes .... no
9. Are most of the people passing the store prospective customers? .... yes .... no
10. Are the people who pass usually in a hurry, or are they taking time to shop? .... in a hurry .... taking time to shop

COST OF THE LOCATION

1. What will your rent be? .... per month
2. Who will pay the utility costs? .... you .... others
3. Who pays additional costs, such as taxes, public services and costs of improvements? .... you .... others
4. What are the possibilities for eventual expansion? .... good .... poor
5. Are good employees available? .... yes .... no
6. Will your potential income justify your costs? .... yes .... no

FINAL ANALYSIS

Based on your analysis, is this a good community in which to open a retail hardware store? Explain.

EXPERIENTIAL EXERCISE

SCANNING ASSIGNMENT

'360 scanning' – review of any relevant media covering the social, technological, economic, ecological and political (STEEP) environments – is a foundation skill in futures research and a survival skill for any forward-looking person. Our class will work together to create a shared environmental scan resource.

1. Scan the entire set of periodical shelves in the library, looking at the covers of all periodicals and browsing those that might have particular interest to you and relevance to the future you expect to pursue. Also pay attention to journals from the fields you think of as farthest from your own interests and expertise. That is, if you are an engineer, consider reading *Women's Wear Daily*. If you are a manager, consider *New Scientist* or a similar technical journal. Include both general and technical titles. Identify several Internet sites you find of particular interest or potentially useful.
2. Select seven periodicals or websites which you will scan several times through the semester, looking for interesting articles that indicate a 'change-driving' factor of importance. The *Economist* must be one of these. You may also note scan items from sources on the radio, on television, or in conversations. Just cite them to the best of your ability to pin down source and date.
3. What are you looking for? Changes, innovations, value shifts, new ideas, programs, policies, businesses, consumer goods – anything new, or any change of which you were not previously

aware. When you first begin scanning, you will discover it easy to find changes or innovations new to you; what will be more difficult is finding changes and innovations that are new to everyone, even to experts in the field from which the change is emerging. Only practice and a continually widening awareness of change, will allow you to identify the emerging edge of change. So keep at it.

4 Report on what you find in the periodicals or at the websites both verbally (in the informal 'scanning' discussions during each class) and in writing, using the following format:

Title/date	Source/author	Substance and significance	STEEP category /impacts

Source: Wendy L. Schultz, 2001 [www.infinitefutures.com/essays/fs8.shtml#links].

CASE 7.1:
EXAMINING THE INDUSTRY

John Hargan and Rita Maylor decided to launch a new business to produce and distribute non-carbonated, high-quality soft drinks. They decided on a location in Victoria, Australia, partly because they believed access to high-quality, pure water would provide them with a competitive edge. A business consultant recommended they construct a comprehensive business plan that would include a clear and thorough assessment of the beverage industry. This exercise should help them understand their challenges and help position this new product. The two partners have spent two months of their spare time (since they both work for another employer full-time) trying to gather research to validate their idea. Because their current employer is not in the beverage industry, they are struggling to find sources of information. John and Rita realise that before any type of viable business plan can be developed, the beverage industry needs to be assessed. The specific elements of this type of assessment are unclear to both of them, however.

QUESTIONS

1 What elements of the industry should John and Rita examine?
2 How would the five forces model help them?
3 Describe what potential barriers to entry they might encounter.

CASE 7.2:
FOREIGN ENTREPRENEURS FLYING SOLO IN CHINA

When Harry Yu set out to sell Bikram and Ashtanga yoga to yuppies in Shanghai, he followed all the usual steps that foreigners have traditionally taken when starting a business in China, except one: finding a local business partner.

On his own, Yu scoured the city for a studio location, navigating a maze of zoning regulations to finally nail down a beautiful, colonial-style home in the city's historic French concession area where he could install showers. He then hired staff and renovated the interior to look like a New York-style loft.

Increasingly, entrepreneurs such as Yu are skipping what was a required cornerstone, but often just a big headache, to doing business in China. Instead of spending time and money to identify contacts and nurture business relationships with Chinese companies, they are flying solo into the market. Forgoing 'joint-venture' partners, they are establishing so-called wholly owned foreign enterprises (WOFEs) or more colloquially, 'woofies'.

Woofies 'have become the investment vehicle of choice for the international investor in China … as they negate the need for a Chinese partner', according to Beijing-based accountancy firm Dezan Shira. Partly, these woofies have emerged following China's joining of the World Trade Organisation.

The rise of woofies could be an important milestone. China's large and low-cost market has promised riches since it was opened to foreign interests in the late 1970s. Unfortunately, the track record of overseas companies making money there is blighted with many cases of bungled and bitterly contested joint-venture partnerships. Individual entrepreneurs and weighty corporations alike have been duped by everything from phantom partners who turn out not to exist or not to have certain connections or assets, to very real partners who use local know-how not to pave the way, but to strongarm deals and siphon off profits.

Woofies are thriving, but the limited controls aren't without some of the same old challenges of trying to figure out how to do business locally.

First, says Yu, it was difficult to sign up real estate. 'I thought, I have capital and a business plan. How difficult can it be to get some real estate agents and start renovations? It took me nine months and a lot of formal and informal channels.'

Another problem is copycats. Local investors, flush with private capital, don't have many channels because they are restricted to the local stock market and limited other options. So they like to back small businesses.

'Many aren't too innovative; they just imitate and pour cash', says Yu.

Competing with multinationals that pay big salaries for skilled staff trained in Western-style service and management is also tough. 'We are going after the same staff that hotels and spas want', says Yu.

Still, the 35-year-old entrepreneur isn't looking back. He chose Shanghai because, as China's most international city, it 'embraces Western ideas quickly'.

In July, his Y+ Yoga Centre will open a second studio in Shanghai. This one will be 10 000 square feet, three times the size of his current one.

The building will include retail space, a Thai massage outlet and a health deli.

Source: Joanne Lee-Young, 'Foreign entrepreneurs flying solo in China: A local partner is no longer required for many businesses', *Vancouver Sun* (British Columbia), 18 April 2005.

QUESTIONS

1 Is it such a misstep *not* to find a local business partner in China?
2 What are some of the challenges that 'woofies' face in doing business in China?
3 How would you go about finding a local business partner in China?

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Publication date: 15 August 2001
Author(s): Su Han Chan, Ko Wang, Mary Ho
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Since the completion of its merger deal with Cable & Wireless HKT Ltd in August 2000, Pacific Century CyberWorks Ltd had been gripped by the full teeth of the bear. By early April 2001, the company had seen its share price plummet by nearly 90 per cent. While many retail investors in Hong Kong were mourning their losses, some corporate insiders managed to find a clean exit route and were able to earn substantial profits. An interesting question to the general investors was: if they had followed the inside track, would they have been able to beat the market?

Competitive Analysis: Understand Your Opponents, Harvard Business School Press Chapter

Publication date: 21 November 2005
Product number: 2572BC

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8

ENTREPRENEURIAL MARKETING FOR NEW VENTURES

> Two shoe salesmen find themselves in a rustic backward part of Africa. The first salesman wires back to his head office: 'There is no prospect of sales. Natives do not wear shoes!' The other salesman wires: 'No one wears shoes here. We can dominate the market. Send all possible stock.'
>
> Attributed to Akio Morita, Sony co-founder

CHAPTER OBJECTIVES

1. To review the importance of entrepreneurial marketing and associated research for new ventures
2. To distinguish entrepreneurial marketing and guerrilla marketing from ordinary marketing
3. To outline the processes of undertaking marketing research
4. To present factors that inhibit the use of marketing
5. To examine the entrepreneurial marketing concept – philosophy, segmentation and consumer orientation
6. To establish the areas vital to marketing planning
7. To characterise the marketing stages of growing ventures
8. To examine entrepreneurial marketing on the Internet
9. To discuss the key features of a pricing strategy

INTRODUCTION

Marketing is just as critical to new businesses as it is for established ones. But for start-ups it is particularly important because the entrepreneur must be intimately in touch with customers and with their needs. A sound **entrepreneurial marketing plan** provides a strong foundation for growth. Marketing is civilised warfare. It takes products and 'drive[s] them to commanding positions in defensible market segments.'[1]

For the entrepreneur, a **market** is a group of consumers (potential customers) who have purchasing power and unsatisfied needs.[2] A new venture will survive only if a market exists for its product or service.[3] This is so obvious that it would seem every entrepreneur would prepare thoroughly the market analysis needed for establishing a target market. However, many entrepreneurs know very little about their market. They even attempt to launch new ventures without identifying any market.

Entrepreneurial marketing defined

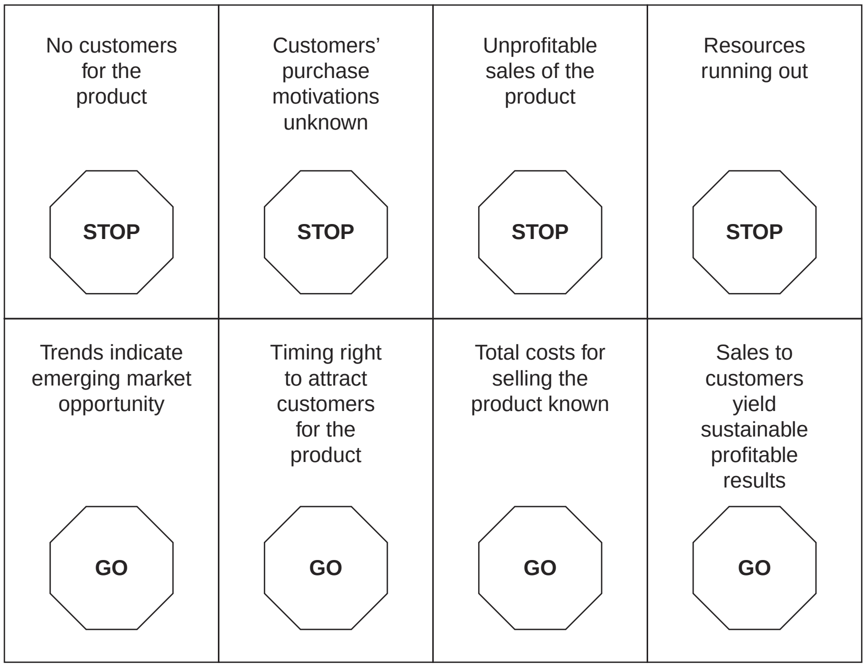
Entrepreneurial marketing is 'the proactive identification and exploitation of opportunities for acquiring and retaining profitable customers through innovative approaches to risk management, resource leveraging and value creation.'[4] Entrepreneurial marketing is the restless pursuit of opportunity, the obsession with the customer, a focus on sales above all else. Instead of concentrating on brand recognition or market share, the entrepreneurial marketer has to concentrate on sales. Investors care more whether an entrepreneur can demonstrate demand and is bringing in the cash than if the entrepreneur has a tidy business plan or a recognised label.[5] Without much money to spend, the return on investment (ROI) of every advertisement, of every campaign, is that much more important. In essence, it means learning how to manage the risk of misjudgements.[6] Because of a lack of resources, entrepreneurial marketing must necessarily rely on small sample sizes and qualitative data techniques. The key skill is speed, that is, rapidly matching the gigantic wants of customers against the limited capabilities and solutions that the firm can provide.[7]

Welsh and White remind us that 'a small business is not a little big business'.[8] Entrepreneurs are not corporations but rather self-maximising profit-seeking autonomous individuals leading small teams. They need the broad thinking of a generalist and must be able to tolerate disorder. Worse still, they suffer from 'resource poverty', what is known as **liquidity constraints.** This is both a problem and an opportunity. It means the entrepreneur must adopt an entirely different approach to marketing. Entrepreneurial marketing can save the day and secure the bottom line for start-up ventures. Another word for this is **guerrilla marketing**, a phrase that has taken on the meaning of non-traditional, low-cost, highly effective marketing effort.[9] It all requires research and answering some fundamental questions. Buskirk and Lavik have put together an innovative way to assess entrepreneurial marketing opportunities (see figure 8.1).

Here are the foundations and principles of guerrilla marketing:

- guerrilla marketing is specifically geared for the small business
- it should be based on human psychology instead of experience, judgement and guess-work
- instead of money, the primary investments of marketing should be time, energy and imagination
- the primary statistic to measure your business is the amount of profits, not sales
- the marketer should also concentrate on how many new relationships are made each month
- create a standard of excellence with an acute focus instead of trying to diversify by offering allied products and services

FIGURE 8.1 STOP AND GO SIGNS FOR ASSESSING MARKETING OPPORTUNITIES



Source: Bruce D. Buskirk and Molly Lavik, *Entrepreneurial Marketing: Real Stories and Survival Strategies* (Mason, OH: Thomson/South-Western, 2004), xxi.

- instead of concentrating on getting new customers, aim for more referrals, more transactions with existing customers and larger transactions
- forget about the competition and concentrate more on cooperating with other businesses
- guerrilla marketers should always use a combination of marketing methods for a campaign
- use current technology as a tool to empower your marketing.[10]

It all comes down to relationships.[11] In relationship marketing, emphasis is placed on building longer term relationships with customers rather than on individual transactions. It involves understanding the customers' needs as they go through their life cycles. It emphasises providing a range of products or services to existing customers as they need them. Relationship marketing is most appropriate for relatively high-value consumer products, when the costs of switching are high and when customer involvement is high.

Several well-known techniques and strategies can assist entrepreneurs with effectively analysing a potential market. By using them, entrepreneurs can gain in-depth knowledge about the specific market and can translate this knowledge into a well-formulated business plan. Effective marketing analysis also can help a new venture position itself and make changes that will result in increased sales.[12] The key to this process is marketing research.

ENTREPRENEUR IN PRACTICE

GUERRILLA MARKETING TACTICS

The following guerrilla marketing tactics can help you to wage an inexpensive, yet highly effective, marketing campaign for your consulting firm or freelance business.

- Start a webzine related to your industry that will bring potential clients to your site. Advertise your services there.
- Send email newsletters to current, past, or potential customers on a regular basis.
- Send cards or e-cards to clients on special dates: their birthday, the day of your first meeting, a thank-you card after you give a pitch, etc.
- Regularly participate in online newsgroups and forums. Include your business name and contact information in a signature file at the bottom of every post you make. Don't use them strictly for advertising. Provide solutions for real problems and help build your reputation.
- Offer to give speeches to companies, schools or organisations about your field of expertise. You can hand out business cards or brochures at most events.
- Get referrals using your business cards. Trade sets of business cards with other businesses in your field, but not directly competing with yours, or give them to clients who have good things to say about you and a good contact list. Tell them to write 'referred by:' or something similar on the back of your cards and have them pass them out to potential clients. You can give them discounts or some other form of reward for bringing in a certain number of referrals.
- Make yourself newsworthy. If you do, you can get free exposure in your local and sometimes even national, media. Give a free speech. Do something environmentally conscious. Donate your services to a charity that could use your help. Just try doing something that no one else has done before.
- Offer to serve as a resource to your local media. Sometimes reporters need help when researching a story that could be in your field and sometimes they like to run interviews with professionals about hot news topics. Let them know you're available and willing to help them out.
- Give free samples, trials, consultations, etc. Everyone loves getting something for free. If you're a freelance business writer, write a company's first press release for free. If you're a legal consultant, give a free first consultation. Tailor your freebie to what your clients want and to what might convince them to buy.
- Do whatever your competition isn't doing. You have to keep your finger on the pulse of the market at all times. If they're charging for consultations, offer a free one. If their message is dry and boring, add a touch of humour. If they're advertising in big media, advertise in all of your area's small media outlets. If they're offering a discount, offer a bigger one. No matter what your competition is doing, they're missing out on clients somewhere. It's your job to find who those lost prospects are and scoop them up for yourself.

Source: Jennifer Mattern, 'Your guide to consulting/freelance', [consulting.about.com/od/marketingtactics/a/guerillatactics_p.htm].

MARKETING RESEARCH

Marketing research involves the gathering of information about a particular market, followed by analysis of that information.[13] Before undertaking a campaign, the entrepreneur must know and understand marketing research procedures for gathering, processing and interpreting market information.

Defining the research purpose and objectives

The first step in marketing research is to define precisely the informational requirements of the decision to be made. Although this may seem too obvious to mention, the fact is, needs are too often identified without sufficient probing. If the problem is not defined clearly, the information gathered will be useless.

In addition, specific objectives should be established. For example, one study has suggested the following set of questions for establishing objectives for general marketing research:

- Where can potential customers go to purchase the good or service in question?
- Why do they choose to go there?
- What is the size of the market? How much of it can the business capture?
- How does the business compare with competitors?
- What impact does the business's promotion have on customers?
- What types of products or services are desired by potential customers?[14]

Gathering secondary data

Information that has been compiled by others is known as **secondary data**. Generally speaking, secondary data are less expensive to gather than are new, or primary, data. The entrepreneur should exhaust all the available sources of secondary data before going further into the research process. Marketing decisions often can be made entirely with secondary data from the Internet or from other entrepreneurs.

Secondary data may be internal or external. Internal secondary data consist of information that exists within the venture. The records of the business, for example, may contain useful information. External secondary data are available in numerous periodicals, trade association literature and government publications.

Unfortunately, several problems accompany the use of secondary data. One is that such data may be outdated and, therefore, less useful. Another is that the units of measure in the secondary data may not fit the current problem. Finally, the question of validity is always present. Some sources of secondary data are less valid than others.

Gathering primary data

If secondary data are insufficient, a search for new information, or **primary data**, is the next step. Several techniques can be used to accumulate primary data. These are often classified as observational methods and questioning methods. Observational methods avoid contact with respondents, whereas questioning methods involve respondents in varying degrees. Observation is probably the oldest form of research in existence. Observational methods can be used very economically. Furthermore, they avoid a potential bias that can result from a respondent's awareness of their participation under questioning methods. A major disadvantage of observational methods, however, is that they are limited to descriptive studies.

Surveys and **experimentation** are two questioning methods that involve contact with respondents. Surveys include contact by mail, telephone and personal interviews. Mail surveys are often used when respondents are widely dispersed; however, these are characterised by low response rates. Telephone surveys and personal interview surveys involve verbal communication with respondents and provide higher response rates. Personal interview surveys, however, are more expensive than mail and telephone surveys. Moreover, individuals often are reluctant to grant personal interviews because they feel a sales pitch is forthcoming. (Table 8.1 describes the major survey research techniques.)

Experimentation is a form of research that concentrates on investigating cause-and-effect relationships. Normally the experimenter will actively manipulate one variable (the independent), attempt to hold all other variables constant and observe changes in the other (the dependent variable).

For the entrepreneurial marketer, experimentation may be necessary since many messages fall on deaf ears, fail to hit their targets and do not elicit the desired response. Experimentation may actually make it easier – and more cost effective – for companies to target the right customers. Marketers can model hundreds or even thousands of marketing messages accurately and efficiently – and they can adjust their messages accordingly.

TABLE 8.1: **COMPARISON OF MAJOR SURVEY RESEARCH TECHNIQUES**

CRITERIA	DIRECT/COLD MAILING	MAIL PANELS	TELEPHONE	PERSONAL IN-HOME	MALL INTERCEPT
Complexity and versatility	Not much	Not much	Substantial, but complex or lengthy scales difficult to use	Highly flexible	Most flexible
Quantity of data	Substantial	Substantial	Short, lasting typically between 15 and 30 minutes	Greatest quantity	Limited, 25 minutes or less
Sample control	Little	Substantial, but representativeness may be a question	Good, but non-listed households can be a problem	In theory, provides greatest control	Can be problematic; sample representativeness may be questionable
Quality of data	Better for sensitive or embarrassing questions; however, no interviewer is present to clarify what is being asked	Positive side, interview can clear up any ambiguities; negative side, may lead to socially accepted answers	In addition, there is the chance of cheating	In addition, unnatural testing environment can lead to bias	
Response rates	In general, low; as low as 10%	70–80%	60–80%	Greater than 80%	As high as 80%
Speed	Several weeks; completion time will increase with follow-up mailings	Several weeks with no follow-up mailings, longer with follow-up mailings	Large studies can be completed in 3 to 4 weeks	Faster than mail but typically slower than telephone surveys	Large studies can be completed in a few days
Cost	Inexpensive; as low as $2.50 per completed interview	Lowest	Not as low	Can be relatively expensive, but considerable variability	Less expensive than in-home, but higher than telephone; again, length and incidence rate will determine cost
Uses	Executive, industrial, medical and readership studies	All areas of marketing research, particularly useful in low-incidence categories	Particularly effective in studies that require national samples	Still prevalent in product testing and other studies that require visual cues or product prototypes	Pervasive-concept tests, name tests, package tests, copy test

Source: Peter R. Dickson, *Marketing Best Practices* (Fort Worth, TX: Harcourt College Publishers, 2000): 114. Reprinted with permission of South-Western, a division of Thomson Learning [www.thomsonrights.com].

Here are some examples:

- What effect will a price change have on sales? Here the price is the experimental variable and sales volume is the dependent variable. Measuring the relationship between these two variables would not be difficult if it were not for the many other variables involved.
- Direct marketers have long used simple techniques such as split mailings to compare how customers react to different prices or promotional offers.
- Another example would be to roll out a product in a test market. A new product is typically introduced in a select number of cities. These cities must be representative of the overall national (or international) population. They should also be relatively unpolluted by outside influences (for example: media from other cities).[15]

Developing an information-gathering instrument

The questionnaire is the basic instrument for guiding the researcher and the respondent through a survey. The questionnaire should be developed carefully before it is used. Several major considerations for designing a questionnaire are listed here:

- make sure each question pertains to a specific objective in line with the purpose of the study
- place simple questions first and difficult-to-answer questions later in the questionnaire
- avoid leading and biased questions
- ask ‘How could this question be misinterpreted?’; reword questions to reduce or eliminate the possibility they will be misunderstood
- give concise but complete directions in the questionnaire; succinctly explain the information desired and direct respondents around questions that may not relate to them
- when possible, use scaled questions rather than simple yes/no questions to measure intensity of an attitude or frequency of an experience – for example, instead of asking ‘Do we have friendly sales assistants?’ (yes/no), ask ‘How would you evaluate the friendliness of our sales assistants?’ and have respondents choose a response on a five-point scale ranging from ‘Very unfriendly’ (1) to ‘Very friendly’ (5).[16]

Interpreting and reporting the information

After the necessary data have been collected, they should be developed into usable information. Large quantities of data are merely facts. To be useful, they must be organised and moulded into meaningful information. The methods of summarising and simplifying information for users include tables, charts and other graphic methods. Descriptive statistics, such as the mean, mode and median, are most helpful in this step of the research procedure.

Marketing research questions

The need for marketing research before and during a venture will depend on the type of venture. However, typical research questions might include the following, here divided by subject:

Sales

- Do you know all you need to know about your competitors’ sales performance by type of product and territory?
- Do you know which accounts are profitable and how to recognise a potentially profitable one?
- Is your sales power deployed where it can do the most good, maximising your investment in selling costs?

Distribution

- If you are considering introducing a new product or line of products, do you know all you should about distributors' and dealers' attitudes towards it?
- Are your distributors' and dealers' salespeople saying the right things about your products or services?
- Has your distribution pattern changed along with the geographic shifts of your markets?

Markets

- Do you know all that would be useful about the differences in buying habits and tastes by territory and kind of product?
- Do you have as much information as you need on brand or manufacturer loyalty and repeat purchasing in your product category?
- Can you now plot, from period to period, your market share of sales by products?

Advertising

- Is your advertising reaching the right people?
- Do you know how effective your advertising is in comparison to that of your competitors?
- Is your budget allocated appropriately for greater profit – according to products, territories and market potentials?

Products

- Do you have a reliable quantitative method for testing the market acceptability of new products and product changes?
- Do you have a reliable method for testing the effect on sales of new or changed packaging?
- Do you know whether adding higher or lower quality levels would make new profitable markets for your products?

INHIBITORS TO MARKETING RESEARCH Despite the fact that most entrepreneurs would benefit from marketing research, many fail to do it. A number of reasons for this exist, among them cost, complexity, level of need for strategic decisions and irrelevancy.

Cost of marketing

Marketing research can be expensive and some entrepreneurs believe that only major organisations can afford it. Indeed, some high-level marketing research is expensive, but very affordable marketing techniques also can be used by smaller companies.

Complexity

Some marketing research techniques rely on sampling, surveying and statistical analysis. This complexity, especially the quantitative aspect, is frightening to many entrepreneurs and they shun it. The important point to remember is that the key concern is interpretation of the data and an entrepreneur can always obtain the advice and counsel of those skilled in statistical design and evaluation by calling on the services of marketing research specialists or university professors trained in this area.

Strategic decisions

Some entrepreneurs feel that only major strategic decisions need to be supported through marketing research. This idea is tied to the cost and complexity issues already mentioned. The contention is that because of the cost and statistical complexity of marketing research, it should be conducted only when the decisions to be made are major. The problem lies not only in the misunderstanding of cost and complexity but also in the belief that marketing research's value is restricted to major decisions. Much of the entrepreneur's sales efforts could be enhanced through the results of such research.[17]

Irrelevancy

Many entrepreneurs believe marketing research data will contain either information that merely supports what they already know or irrelevant information. Although it is true that marketing research does produce a variety of data, some of which may be irrelevant, it is also a fact that much of the information is useful. In addition, even if certain data merely confirm what the entrepreneur already knows, it is knowledge that has been tested and thus allows the individual to act on it with more confidence.

As indicated by these inhibitors, most of the reasons for entrepreneurs not using marketing research centre either on a misunderstanding of its value or on a fear of its cost. However, the approach to marketing does not have to be expensive and can prove extremely valuable.

DEVELOPING THE MARKETING CONCEPT

Effective marketing is based on three key elements: marketing philosophy, **market segmentation** and **consumer behaviour**. A new venture must integrate all three elements when developing its **marketing concept** and its approach to the market. This approach helps set the stage for how the firm will seek to market its goods and services.

Marketing philosophy

Three distinct types of marketing philosophies exist among new ventures: production driven, sales driven and consumer driven.

The **production-driven philosophy** is based on the belief 'produce efficiently and worry about sales later'. Production is the main emphasis; sales follow in the wake of production. New ventures that produce high-tech, state-of-the-art output sometimes use a production-driven philosophy – and likely will suffer from it. A **sales-driven philosophy** focuses on personal selling and advertising to persuade customers to buy the company's output. When an over-abundance of supply occurs in the market, this philosophy often surfaces. New car dealers, for example, rely heavily on a sales-driven philosophy. A **consumer-driven philosophy** relies on research to discover consumer preferences, desires and needs before production actually begins. This philosophy stresses the need for marketing research in order to better understand where or who a market is and to develop a strategy targeted towards that group.

Three major factors influence the choice of a marketing philosophy:

- **Competitive pressure:** Many times the intensity of the competition will dictate a new venture's philosophy. For example, strong competition will force many entrepreneurs to develop a consumer orientation in order to gain an edge over competitors. If, on the other hand, little competition exists, the entrepreneur may remain with a production orientation in the belief that what is produced will be sold.

- **Entrepreneur's background:** The range of skills and abilities entrepreneurs possess varies greatly. While some have a sales and marketing background, others possess production and operations experience. The entrepreneur's strengths will influence the choice of a market philosophy.
- **Short-term focus:** Sometimes a sales-driven philosophy may be preferred due to a short-term focus on 'moving the merchandise' and generating sales. Although this focus appears to increase sales (which is why many entrepreneurs pursue this philosophy), it also can develop into a hard-selling approach that soon ignores customer preferences and contributes to long-range dissatisfaction.

Any one of the three marketing philosophies can be successful for an entrepreneur's new venture. It is important to note, however, that over the long run the consumer-driven philosophy is the most successful, although many ventures do not adopt it. This approach focuses on the needs, preferences and satisfactions of the consumer and works to serve the end-user of the product or service.

Market segmentation

Market segmentation is the process of identifying a specific set of characteristics (subgroups) that differentiate one group of consumers from the rest. The total market is often made up of submarkets (called segments).[18]

Here are some examples:

- Wine-related lifestyle segments in the Australian wine market have been classified as: ritual-oriented conspicuous wine enthusiasts; purposeful inconspicuous premium wine drinkers; fashion/image oriented wine drinkers; basic wine drinkers; and enjoyment-oriented social wine drinkers.[19]
- Ecotourists in outback Australia have been segmented into: 'harder' ecotourists, who reflect a high level of environmental commitment and affinities with wilderness-type experiences; 'softer' ecotourists, who are much less committed on either dimension; and 'structured' ecotourists, by comparison, who reveal a strong pattern of commitment but a level of desire for interpretation, escorted tours and services/facilities that is usually more associated with mass tourism.[20]
- OG now means 'occupational group'. OG1s are people who work as managers, politicians and professionals and their favourite TV shows have included 'Desperate Housewives', 'The Da Vinci Code', the one-day cricket and Andrew Denton's interview with the Danish Royals. Meanwhile, OG5s are people who work as factory hands, cleaners and labourers and their television diet this year has included 'Big Brother', the 'State of Origin' matches, motor racing and 'Dancing with the Stars'. The bottom OGs' tastes are shared by OG4s (road and rail transport drivers; plant operators; machine operators; police). OG3s ('tradespersons') also liked the 'Mythbusters' special on 'Jaws', the 'Happy Days Reunion' and the eco-thriller 'Category 6: Day of Destruction'. The OG2s (technicians; nurses; stenographers; clerks; receptionists; school teachers; sales representatives; tellers and cashiers) had a particular fondness for 'Desperate Housewives', 'Lost', 'House', 'Grey's Anatomy', 'Little Oberon' and the 'Logies'.[21]

To identify specific market segments, entrepreneurs need to analyse several variables. As an example, two major variables that can be focused on are demographic and benefit variables. Demographic variables include age, marital status, sex, occupation, income, location and the like. These characteristics are used to determine a geographic and demographic profile of the consumers and their purchasing potential. The benefit variables help to identify unsatisfied needs that exist within this market. Examples may include convenience, cost, style, trends and the like, depending on the nature of the particular new venture. Whatever the product or service, it is extremely valuable to ascertain the benefits a market segment is seeking in order to further differentiate a particular target group. *Psychographics* is a term that is gaining greater profile in the definition of market segments. Psychographics are statistical analysis of psychological characteristics of individuals which influence their buying behaviour. Table 8.2 shows **segmentation variables** for consumers and business markets.

Consumer behaviour

Consumer behaviour is defined by the many types and patterns of **consumer characteristics**. However, entrepreneurs can focus their attention on only two considerations: personal characteristics and psychological characteristics. Table 8.3 provides an example by tying these characteristics to the five types of consumers: innovators, early adopters, early majority, late majority and laggards.

In table 8.3, the differences in social class, income, occupation, education, housing, family influence and time orientation are illustrated. So, too, are the psychological characteristics labelled

TABLE 8.2: **SEGMENTATION VARIABLES FOR THE CONSUMER AND BUSINESS MARKETS**

SEGMENTATION VARIABLES CONSUMER MARKETS	SEGMENTATION VARIABLES BUSINESS MARKETS
Demographics: Age group (e.g. teens, retirees, young adults); gender; education level; ethnicity; income; occupation; social class; marital status Geographics: Location (e.g. national, regional, urban/suburban/rural, international); climate	Demographics: Type (e.g. manufacturer, retailer, wholesaler); industry; size (e.g, sales volume; number of retail outlets); age (e.g. new; young growth, established growth, mature) Geographics: Location (e.g. national, regional, urban/suburban/rural, international); climate Business arrangement: Ownership (e.g. private versus public, independent versus chain); financial condition (e.g. credit rating, income growth, stock price, cash flow)
Current purchasing situation: Brands used; purchase frequency; current suppliers Purchase ready: Possess necessary equipment; property; knowledge and skill sets Local environment: Cultural; political; legal	Current purchasing situation: Brands used; purchase frequency; current suppliers Purchase ready: Possess necessary equipment; property; knowledge and skill sets Local environment: Cultural; political; legal Customers served by the business: Identify the business's market Business's perceived image: Identify how targeted businesses are perceived by their customers
Benefits sought: Price; overall value; specific feature; ease-of-use; service; etc. Product usage: How used; situation when used; etc. Purchase conditions: Time of day/month/year when purchased; credit terms; trade-in option; etc. Characteristics of individual buyer: Purchase experience; how purchase is made; influencers on purchase decision; importance of purchase Psychographics: Personality; attitudes and lifestyle combined with demographics	Benefits sought: Price; overall value; specific features; services; profit margins; promotional assistance; etc. Product usage: How used (e.g. raw material, component product, major selling item at retail level); situation when used; etc. Purchase conditions: Length of sales cycle; set product specifications; bid pricing; credit terms; trade-in option; product handling; etc. Characteristics of buying centre: Purchase experience; number of members; make-up of key influencers; willingness to assume risk

Source: KnowThis.com, 'Tutorial: The principles of marketing', [www.knowthis.com/tutorials/marketing/targeting_markets/3.htm]

TABLE 8.3: **CONSUMER CHARACTERISTICS**

	INNOVATORS (2–3%)	EARLY ADOPTERS (12–15%)	EARLY MAJORITY (33%)	LATE MAJORITY (34%)	LAGGARDS (12–15%)
PERSONAL CHARACTERISTICS					
1 Social class	Lower upper	Upper middle	Lower middle	Upper lower	Lower lower
2 Income	High income (inherited)	High income (earned from salary and investment)	Above-average income (earned)	Average income	Below-average income
3 Occupation	Highest professionals, merchants, financiers	Middle management and owners of medium-sized businesses	Owners of small businesses, non-managerial office and union managers	Skilled labour	Unskilled labour
4 Education	Private schooling	College	High school, trade school	Grammar school, some high school	Very little – some grammar school
5 Housing	Inherited property, fine mansions	Large homes – good suburbs or best apartments	Small houses, multiple-family dwellings	Low-income housing in urban-renewal projects	Slum apartments
6 Family influence	Not family oriented, children in private school or grown	Children's social advancement important, education important	Child centred and home centred	Children taken for granted	Children expected to raise themselves
7 Time orientation	Present oriented, but worried about impact of time	Future oriented	Present oriented	Present (security) oriented	Tradition oriented, live in the past
PSYCHOLOGICAL CHARACTERISTICS					
1 Nature of needs	Self-actualisation needs (realisation of potential)	Esteem needs (for status and recognition by others)	Belonging needs (with others and groups)	Safety needs (freedom from fear)	Survival needs (basic needs)
2 Perceptions	Cosmopolitan in outlook	Prestige, status conscious, aspire to upper class	Local aspirations and local social acceptance	Home and product centred	Live from day to day
3 Self-concept	Elite	Social strivers, peer group leaders, venturesome	Respectability from own reference groups and home	Security, home centred, aggressive, apathetic, no hope	Fatalistic, live from day to day
4 Aspiration groups	British upper class	Innovator class	In own social strata, dissociated from upper lower	Others in this classification and in early majority, dissociated from lower	Don't aspire
5 Reference groups	Sports, social and travel groups	Dominate industry and community organisations, golf, college and fraternity	Social groups of this strata – chambers of commerce, labour unions, family, church, PTA, auxiliaries	Family, labour unions	Ethnic group oriented

Source: Roy A. Lindberg and Theodore Cohn, *The Marketing Book for Growing Companies That Want to Excel* (New York: Van Nostrand Reinhold, 1986), 80–1. Reprinted with permission.

as needs, perceptions, self-concept, aspiration groups and reference groups. This breakdown can provide an entrepreneur with a visual picture of the type of consumer to target for the sales effort.

The next step is to link the characteristic make-up of potential consumers with buying trends in the marketplace. Table 8.4 shows the changing priorities that shaped buying decisions during the 1990s in the **family life cycle**. Each of these factors relates to consumer attitudes and behaviours based on education, the economy, the environment and/or societal changes. By tying together the data in tables 8.3 and 8.4, the entrepreneur can begin to examine consumer behaviour more closely.

An analysis of the way consumers view the venture's product or service provides additional data. Entrepreneurs should be aware of five major consumer classifications:

- *convenience goods* – whether staple goods (foods), impulse goods (checkout counter items), or emergency goods and services – consumers will want these goods and services but will not be willing to spend time shopping for them
- *shopping goods* are products consumers will take time to examine carefully and compare for quality and price
- *specialty goods* consist of products or services consumers make a special effort to find and purchase
- *unsought goods* are items consumers do not currently need or seek – common examples are life insurance, encyclopaedias and cemetery plots – these products require explanation or demonstration
- *new products* are items that are unknown due to lack of advertising or are new products that take time to be understood – when micro-computers were first introduced, for example, they fell into this category.

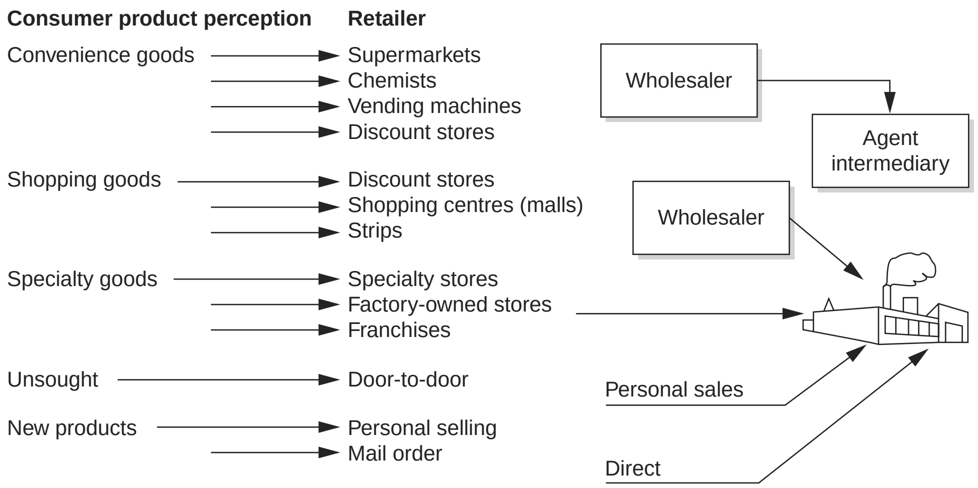
Understanding these classifications is important both for selling to consumers and for choosing distribution channels. Figure 8.2 illustrates the relationship between the consumer classification of items and the distribution channels used.

TABLE 8.4: **CHANGING PRIORITIES AND PURCHASES IN THE FAMILY LIFE CYCLE**

STAGE	PRIORITIES	MAJOR PURCHASES
Fledgling – teens and early 20s	Self; socialising; education	Appearance products, clothing, cars, recreation, hobbies, travel
Courting – 20s	Self and other; pair bonding; career	Furniture and furnishings, entertainment and entertaining, savings
Nest building – 20s and early 30s	Babies and career	Home, garden, do-it-yourself items, baby-care products, insurance
Full nest – 30 to 50	Children and others; career; mid-life crisis	Children's food, clothing, education, transportation, orthodontics, career and life counselling
Empty nest – 50 to 75	Self and others; relaxation	Furniture and furnishings, entertainment, travel, hobbies, luxury cars, boats, investments
Sole survivor – 70 to 90	Self; health; loneliness	Health care services, diet, security and comfort products, TV and books, long-distance telephone services

Source: Peter R. Dickson, *Marketing Management* (Fort Worth, TX: The Dryden Press, 1994), 91. Reprinted with permission of South-Western, a division of Thomson Learning [www.thomsonrights.com].

FIGURE 8.2 USING CLASSIFICATION OF GOODS TO SELECT CHANNEL INTERMEDIARIES



Source: William A. Cohen and Marshall E. Reddick, *Successful Marketing for Small Business* (New York: Amacon, 1981): 128.

MARKETING STAGES FOR GROWING VENTURES

In truth, most emerging ventures will evolve through a series of **marketing stages**. In each stage the marketing functions will differ; thus each requires a specific type of marketing strategy.[22] Entrepreneurial is not one monolithic stage. Indeed, we can distinguish stages – entrepreneurial marketing (stage 1), opportunistic marketing (stage 2), responsive marketing (stage 3) and diversified marketing (stage 4).[23] Table 8.5 provides a breakdown of each stage in relation to marketing strategy, marketing organisation, marketing goals and critical success factors. Notice that the strategy in each stage relates closely to the marketing goals. For example, entrepreneurial marketing (stage 1) has a

TABLE 8.5: THE EVOLUTION OF THE MARKETING FUNCTION

	STAGE 1: ENTREPRENEURIAL MARKETING	STAGE 2: OPPORTUNISTIC MARKETING	STAGE 3: RESPONSIVE MARKETING	STAGE 4: DIVERSIFIED MARKETING
Marketing strategy	Market niche	Market penetration	Product-market development	New-business development
Marketing organisation	Informal, flexible	Sales management	Product-market management	Corporate and divisional levels
Marketing goals	Credibility in the marketplace	Sales volume	Customer satisfaction	Product life cycle and portfolio management
Critical success factors	A little help from your friends	Production economies	Functional coordination	Entrepreneurship and innovation

Source: Tyzoon T. Tyebjee, Albert V. Bruno and Shelby H. McIntyre, 'Growing ventures can anticipate marketing stages', exhibit 1, *Harvard Business Review* (January/February 1983), 64. Reprinted by permission. Copyright © 1983 by the Harvard Business School Publishing Corporation; all rights reserved.

strategy of developing a market niche and a goal of attaining credibility in the marketplace. Stage 2, opportunistic marketing, seeks a strategy of **market penetration** for the purpose of attaining sales volume, thereby demonstrating the logical progression depicted in the table. Stage 3, responsive marketing, seeks to develop the product market and create customer satisfaction. Stage 4, diversified marketing, focuses on new-business development and seeks to manage the product life cycle.

It is important to realise that these stages are developed with a growing venture in mind. The idea of growth as a strategic planning factor, discussed in chapter 15, is also presented here as a marketing factor.

MARKETING PLANNING

Marketing planning is the process of determining a clear, comprehensive approach to the creation of customers. For developing this plan, the following elements are critical:

- *marketing research* – determining who the customers are, what they want and how they buy
- **sales research** – promoting and distributing products according to marketing research findings
- *marketing information system* – collecting, screening, analysing, storing, retrieving and disseminating marketing information on which to base plans, decisions and actions
- **sales forecasting** – coordinating personal judgement with reliable market information
- *marketing plans* – formulating plans for achieving long-term marketing and sales goals
- *evaluation* – identifying and assessing deviations from marketing plans.[24]

GOING FROM UNDERDOG TO TOP DOG

ENTREPRENEURSHIP IN PRACTICE

An Australian food scientist sought to supplant the veritable British Marmite from the tables of Oz with his own locally produced product. It was an uphill battle to say the least. Who'd have thought that one dark, gooey, bitter, brewer's yeast extract recommended for its B-vitamin content would be so hard to supplant … especially by another dark, gooey, bitter brewer's yeast extract made world famous by the Olsen Twins' movie *Our Lips Are Sealed* as the one substance on earth guaranteed to make a Yank toss out his (or her) cookies. A 20 year battle for supremacy ensued with various attempts – some successful, others not – to win consumer approval. It's a tribute to belief in one's mission, the value of the product and downright pig headedness (in a good entrepreneurial way).

Sportswear brand Skins has raised a few eyebrows this year, with a series of humorous ads and a few digs at its well-established rivals. In a market famous for sponsoring and idolising sports stars, the compression tights and garments maker has kept its marketing budget low by doing quite the opposite and refusing to use famous people in its ads. And the brand's cheekiest stunt to date was stealing the famous Nike swoosh, turning it upside down and plastering it on the mouths of a series of sportsmen in its ads. Nike has chosen to ignore the slight rather than respond to it. One of the Skins TVCs, created by Arnold, derides 'baby-faced multi-millionaire sports stars that get paid too much … getting paid to advertise anything'.

If you believe its creators, Absolut Cut isn't your regular pre-mixed alcoholic drink. What is an absolute is the fact that unlike many of its competitors it hasn't relied on more traditional above-the-line campaigns to get its brand message out to a new market. In fact, its launch into Australia this year has been a softly, softly, targeted approach which has focused on what its agency Naked Communications has identified as the 'cultural creatives' that it believes will form the foundation for the growth and expansion of the brand.

In Australia products such as Nudie Juice and Krispy Kreme doughnuts were largely launched using 'word of mouth' technique, that is, there was virtually no traditional advertising or promotion.[25]

Marketing research

The purpose of marketing research is to identify customers – target markets – and to fulfil their desires. For marketing research, the following areas warrant consideration:

- **The company's major strengths and weaknesses:** These factors offer insights into profitable opportunities and potential problems and provide the basis for effective decision making.
- **Market profile:** A market profile helps a company identify its current market and service needs: How profitable are existing company services? Which of these services offer the most potential? Which (if any) are inappropriate? Which will customers cease to need in the future?
- **Current and best customers:** Identifying the company's current clients allows management to determine where to allocate resources. Defining the best customers enables management to more directly segment this market niche.
- **Potential customers:** By identifying potential customers, either geographically or with an industry-wide analysis of its marketing area, a company increases its ability to target this group, thus turning potential customers into current customers.
- **Competition:** By identifying the competition, a company can determine which firms are most willing to pursue the same basic market niche.
- **Outside factors:** This analysis focuses on changing trends in demographics, economics, technology, cultural attitudes and governmental policy. These factors may have substantial impact on customer needs and, consequently, expected services.
- **Legal changes:** Marketing research performs the important task of keeping management abreast of significant changes in governmental rates, standards and tax laws.[26]

Marketing research need not be extremely expensive. Presented in figure 8.3 are some useful tips regarding low-cost research. These tips can be valuable to entrepreneurs needing research but lacking the funds for sophisticated measures.

Sales research

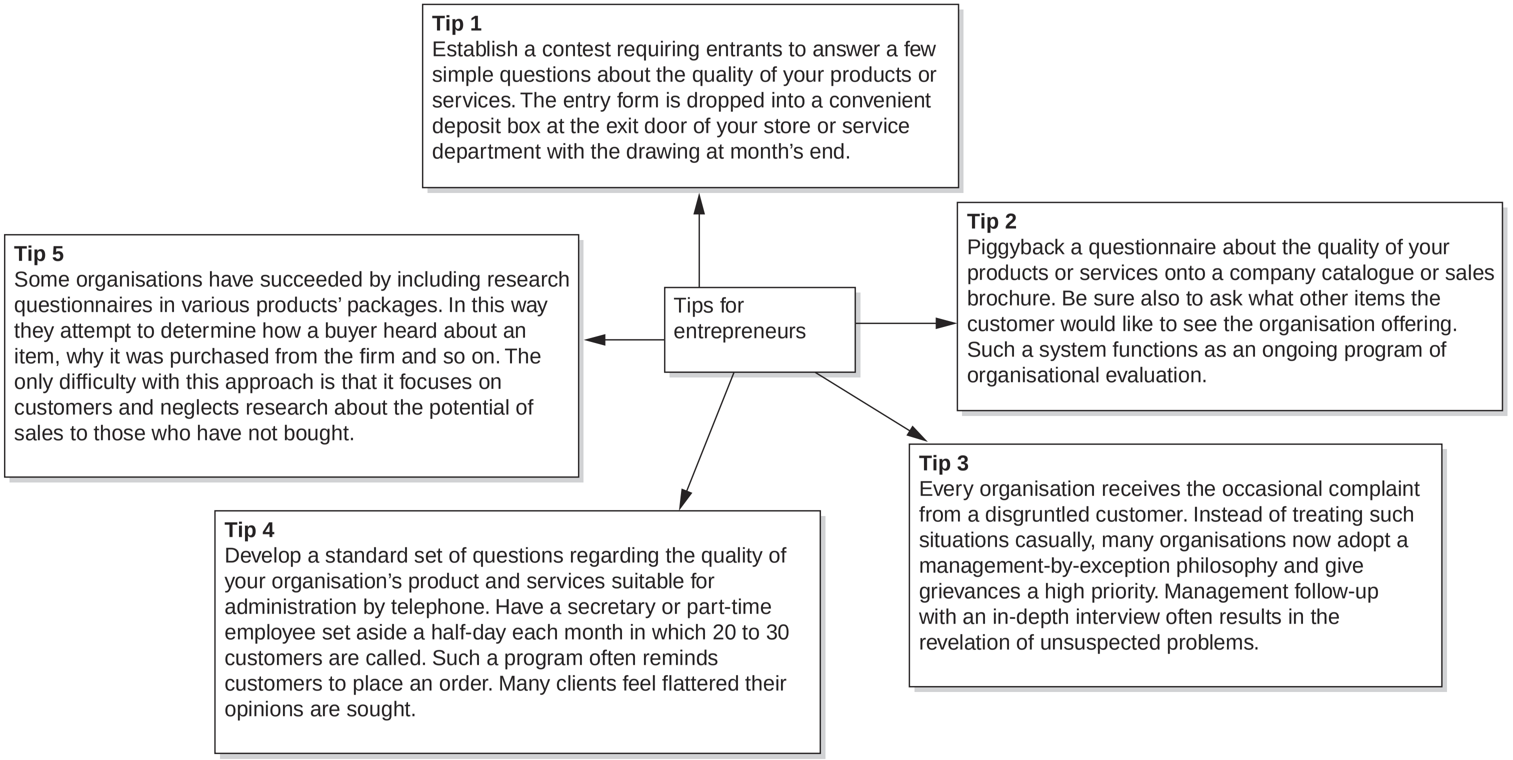
An entrepreneur needs to continually review the methods employed for sales and distribution in relation to the market research that has been conducted. Matching the correct customer profile with sales priorities is a major goal in sales research. The following is a list of potential questions to be answered by this research:

- Do salespeople call on their most qualified prospects on a proper priority and time-allocation basis?
- Does the sales force contact decision makers?
- Are territories aligned according to sales potential and salespeople's abilities?
- Are sales calls coordinated with other selling efforts, such as trade publication advertising, trade shows and direct mail?
- Do salespeople ask the right questions on sales calls? Do sales reports contain appropriate information? Does the sales force understand potential customers' needs?
- How does the growth or decline of a customer's or a prospect's business affect the company's own sales?

Sales forecasting

Sales forecasting is the process of projecting future sales through historical sales figures and the application of statistical techniques. The process is limited in value due to its reliance on

FIGURE 8.3 USEFUL TIPS REGARDING LOW-COST RESEARCH



Tip 1
Establish a contest requiring entrants to answer a few simple questions about the quality of your products or services. The entry form is dropped into a convenient deposit box at the exit door of your store or service department with the drawing at month's end.

Tip 2
Piggyback a questionnaire about the quality of your products or services onto a company catalogue or sales brochure. Be sure also to ask what other items the customer would like to see the organisation offering. Such a system functions as an ongoing program of organisational evaluation.

Tip 3
Every organisation receives the occasional complaint from a disgruntled customer. Instead of treating such situations casually, many organisations now adopt a management-by-exception philosophy and give grievances a high priority. Management follow-up with an in-depth interview often results in the revelation of unsuspected problems.

Tip 4
Develop a standard set of questions regarding the quality of your organisation's product and services suitable for administration by telephone. Have a secretary or part-time employee set aside a half-day each month in which 20 to 30 customers are called. Such a program often reminds customers to place an order. Many clients feel flattered their opinions are sought.

Tip 5
Some organisations have succeeded by including research questionnaires in various products' packages. In this way they attempt to determine how a buyer heard about an item, why it was purchased from the firm and so on. The only difficulty with this approach is that it focuses on customers and neglects research about the potential of sales to those who have not bought.

Source: Gerald B. McCready, *Marketing Tactics Master Guide for Small Business* (New Jersey: Prentice-Hall, a division of Simon & Schuster, Englewood Cliffs, 1982), 8. Reprinted by permission of the publisher.

historical data, which many times fail to reflect current market conditions. As a segment of the comprehensive marketing–planning process, however, sales forecasting can be very valuable. (The associated financial risk can be mitigated by ensuring the organisation is using accountancy rules.)

Product research

In **product research** the focus is on the competitor's product.

- What products do your competitors currently offer?
- What is the extent of their product range?
- Do they provide the consumer with a good range of choices?
- Do they have a product range that provides different levels of pricing and quality?
- Are fad items a feature of this industry?
- Are products seasonal?
- What is the life cycle of competitors' products?
- Do your products need to be quite different to the current offerings to be successful?

Entrepreneurial marketing plans

Marketing plans are part of a venture's overall strategic effort.[27] To be effective, these plans must be based on the venture's specific goals. Here is an example of a five-step program designed to help entrepreneurs follow a structured approach to developing a market plan:

- **Step 1:** Appraise strengths and weaknesses, emphasising factors that will contribute to the firm's 'competitive edge'. Consider product design, reliability, durability, price/quality ratios, production capacities and limitations, resources and need for specialised expertise.
- **Step 2:** Develop marketing objectives along with the short- and intermediate-range sales goals necessary to meet those objectives. Next, develop specific sales plans for the current fiscal period. These goals should be clearly stated, measurable and within the company's capabilities. To be realistic, these goals should require only reasonable efforts and affordable expenditures.
- **Step 3:** Develop product/service strategies. The product strategy begins with identifying the end-users, wholesalers and retailers, as well as their needs and specifications. The product's design, features, performance, cost and price then should be matched to these needs.
- **Step 4:** Develop marketing strategies. Strategies are needed to achieve the company's intermediate- and long-range sales goals and long-term marketing objectives. These strategies should include advertising, sales promotion campaigns, trade shows, direct mail and telemarketing. Strategies also may be necessary for increasing the size of the sales force or marketing new products. Contingency plans will be needed in the event of technological changes, geographic market shifts, or inflation.
- **Step 5:** Determine a pricing structure. A firm's pricing structure dictates which customers will be attracted, as well as the type or quality of products/services that will be provided. Many firms believe the market dictates a 'competitive' pricing structure. But this is not always the case – many companies with a high price structure are very successful. Regardless of the strategies, customers must believe that the product's price is appropriate. The price of a product or service, therefore, should not be set until marketing strategies have been developed.[28]

Evaluation

The final critical factor in the marketing planning process is evaluation. Since many variables can affect the outcome of marketing planning, it is important to evaluate performance. Most important, reports should be generated from a customer analysis – attraction or loss of customers with reasons for the gain or loss, as well as established customer preferences and reactions. This analysis can be measured against performance in sales volume, gross sales dollars, or market share. It is only through this type of evaluation that flexibility and adjustment can be incorporated into marketing planning.

MARKETING ON THE INTERNET

The Internet can assist a new venture's overall marketing strategy. First, the Internet allows the firm to increase its presence and brand equity in the marketplace. Company and brand sites provide the opportunity to communicate the overall mission of the company/brand, to provide information on attributes and/or ratings of the company/brand and to give information on the history of the company/brand. In addition, firms can easily communicate information on the marketing mix offered. Getting visibility and name recognition on the Internet requires a major marketing effort using leveraged approaches.

Second, the Internet allows the company to cultivate new customers around the world and the entrepreneur should be prepared for global customers from day one. It works the other way too: Competition has no borders as long as goods and services can be delivered in a timely and reliable manner. Providing important information about both the attributes of the firm's product and those of competitive products can aid in the decision-making process. In addition, the website can demonstrate products in actual use. This kind of information builds interest in the brand.

In addition, the Internet allows website visitors to match their needs with the offerings of the company. It is extremely important to remember that, while traditional marketing techniques tend to be push-oriented (the company decides what the consumer will see and where), the Internet is pull-oriented (the consumer chooses what, when and how to look in greater detail). This technique requires website designers to think differently about what should or should not appear in the site offering.

Third, the Internet can improve customer service by allowing customers to serve themselves when and where they choose. As more consumers begin to use the Internet, companies can readily serve these individuals without incurring expensive distribution costs. The expansion of the number of customers served requires only that the organisation have enough servers available.

The fourth benefit to marketers relates to information transfer. Traditionally, companies have gathered information via **focus groups**, mail surveys, telephone surveys and personal interviews. These techniques can be very expensive to implement, however. In contrast, the Internet offers a mechanism for the company to collect similar information at a fraction of the cost.

Not only can information be gathered from consumers, but information can also be shared with them. For example, the web can be used to provide expensive or specialised materials to consumers who request such information.

Internet's effects on industries

Internet marketing has had a large impact on several industries including music, banking and auction markets. In the music industry, many consumers have begun buying and downloading MP3s over the Internet instead of simply buying CDs. The debate over the legality of downloading MP3s has become a major concern for those in the music industry.

Internet marketing has also affected the banking industry. More and more banks are offering the ability to perform banking tasks online. Online banking is believed to appeal to customers because it is more convenient than visiting bank branches. Online banking is now the fastest-growing Internet activity.

Unique items that could previously be found at flea markets are being sold on Internet auction sites instead. Sites such as eBay.com has also affected the prices in the industry. Buyers and sellers often look at prices on the website before going to flea markets and the eBay price often becomes what the item is sold for. More and more flea market sellers are putting their items up for sale online and running their business out of their homes.

Techniques of Internet marketing

The best known tools to marketers in the first decade of the 2000s are currently tools grouped into two fields: online advertising and **search engine optimisation**. E-marketing tools used to drive visitors to a website include:

- **pay per click**
- search engine optimisation
- press releases
- web banners
- link campaign
- email and newsletters
- **viral marketing** and word of mouth
- affiliate marketing
- blogs
- wikis
- news headlines carried by Really Simple Syndication (RSS)
- discussion boards
- encyclopaedic sites.[29]

Smith and Chaffey describe five key online marketing activities (the '5Ss') which can be applied by an organisation to implement various online marketing tactics. For example, for an e-newsletter, the 5Ss are:

- **Sell:** Grow sales (the e-newsletter often acts as both a customer acquisition tool and a retention tool – the lastminute.com e-newsletter has this dual role).
- **Serve:** Add value (give customers extra benefits online such as an online exclusive offer or more in-depth information about your products or the industry sector).
- **Speak:** Get closer to customers by creating a dialogue, asking questions through online research surveys and learning about customers' preferences through tracking – which content are people most interested in?
- **Save:** Save costs (of print and post if you have a traditional offline e-newsletter can you reduce print runs or extend it to those customers you can't afford to communicate with).
- **Sizzle:** Extend the brand online. A newsletter keeps the brand 'front-of-mind' and helps reinforce brand values. Added value can also be delivered by the e-newsletter by informing and entertaining customers.[30]

Capturing attention of potential customers can be as simple as advertising using some of the new advertising tools the online world provides, such as advertising on search engines, but it can also be about configuring more remarkable methods that tend to spread across many sites and capturing the imagination of many people in the process. There are at least three major configurations of links and tools that have been used to capture attention online: funnel building, buzz marketing and cool tools.

- Building a sales funnel requires working with search engine optimisation, email newsletter distribution, discussion board entries, advertisements, affiliate activities and more. In fact, any way that additional links can be provided so that a potential customer can begin a conversation with a business, is educated about that business' products/services, or is provided with concepts and propositions that will eventually lead to a sale. A funnel is usually laid down over time and is the result of continuous activity of marketers in online activities.
- Buzz marketing tends to be a much quicker process and tends to involve less activity on behalf of marketers. It requires the attention of people online to spread the message by word-of-mouth, word-from-keyboards, to be fascinated or intrigued. Seth Godin's book *Purple Cow* was sold largely through buzz marketing that spread by blogs relatively quickly.
- Another tactic of gaining attention online is through the development and release of a cool tool. A cool tool is something that captures the imagination of the online browsing public and it is thought to be so cool that it should be shared with online friends. This could be a video clip, standalone software that is cute (such as a cartoon character that lives on a user's screen), or some other device that is used often for a specific purpose (such as 3Ms Post-it Notes).

Right in the middle of a new marketing practice is eBay with its data feed marketing. Essentially a store owner sets up their data in eBay and then by way of feeds make this data available to advertising avenues, such as Froogle, Yahoo Product Search and about another 20 or 30 other sites that take data feeds. All the advertising feed services point the prospective purchaser to the eBay auction. This is perhaps a little like building a sales funnel; however, it uses a specific technology that enables ease of use.

Marketing on the Internet requires that a business can be found using keyword searches or some form of online advertising. In any case, the trick to being successful in online marketing is being found within the top 30 search results. There are three ways that a company can be found:

- natural search engine ranking (70 per cent of searchers will skip over sponsored results and start with the naturally ranked sites
- paid inclusion
- pay per click.

Due to the extreme difficulty of achieving a natural high ranking on a major search engine most companies opt for the second and third choices for their online marketing. Unfortunately the third option is very costly and only the most well heeled companies can afford to market online via pay per click.

What is true of online marketing today is that one must pay to play. Since the dot com bust several years ago, search engines have discerned that in order to survive and thrive they must generate significant revenue. At first the hope was that banner advertising would be sufficient to fill the search engine coffers, but it soon became evident that searchers did not respond to banners. It then became evident that there were two primary ways to create income for search engines and online directories. Thus paid inclusion and pay per click were born.

Recently, potential greed-related challenges have emerged. There are companies that create false hits and traffic. Whether or not the charges prove to be true, actions like this make people think twice about using pay per click as part of their online marketing package.

PRICING STRATEGIES

One final marketing issue that needs to be addressed is that of **pricing strategies**. Many entrepreneurs, even after marketing research is conducted, are unsure of how to price their product or service. Many factors affect this decision – the degree of competitive pressure, the availability of sufficient supply, seasonal or cyclical changes in demand, distribution costs, the product's life cycle stage, changes in production costs, prevailing economic conditions, customer services provided by the seller, the amount of promotion done, and the market's buying power. Obviously, the ultimate price decision will balance many of these factors and, usually, will not satisfy all conditions. However, awareness of the various factors is important.

Other considerations, sometimes overlooked, are psychological in nature:

- the quality of a product in some situations is interpreted by customers according to the level of the item's price
- some customer groups shy away from purchasing a product where no printed price schedule is available
- an emphasis on the monthly cost of purchasing an expensive item often results in greater sales than an emphasis on total selling price
- most buyers expect to pay even-numbered prices for prestigious items and odd-numbered prices for commonly available goods
- the greater the number of meaningful customer benefits the seller can convey about a given product, generally the less will be the price resistance.[31]

Pricing procedures differ depending on the nature of the venture – retail, manufacturing, or service. Pricing for the product life cycle as presented in table 8.6, however, might be applied to any type of business. The table demonstrates the basic steps of developing a pricing system and indicates how that system should relate to the desired pricing goals.

Customer demand and sales volume will vary with the development of a product. Thus pricing for products needs to be adjusted at each stage of their life cycle. The outline in table 8.6 provides some suggested pricing methods that relate to the different stages in the product life cycle.

With this general outline in mind, potential entrepreneurs can formulate the most appropriate pricing strategy. Table 8.7 provides a thorough analysis of pricing strategies,

TABLE 8.6: PRICING FOR THE PRODUCT LIFE CYCLE

PRODUCT LIFE CYCLE STAGE	PRICING STRATEGY	REASONS/EFFECTS
Introductory stage		
Unique product	**Skimming** – deliberately setting a high price to maximise short-term profits	Initial price set high to establish a quality image, to provide capital to offset development costs and to allow for future price reductions to handle competition
Non-unique product	**Penetration** – setting prices at such a low level that products are sold at a loss	Allows quick gains in market share by setting a price below competitors' prices
Growth stage	**Consumer pricing** – combining penetration and competitive pricing to gain market share; depends on consumer's perceived value of product	Depends on the number of potential competitors, size of total market and distribution of that market
Maturity stage	**Demand-oriented pricing** – a flexible strategy that bases pricing decisions on the demand level for the product	Sales growth declines; customers are very price-sensitive
Decline stage	**Loss leader pricing** – pricing the product below cost in an attempt to attract customers to other products	Product possesses little or no attraction to customers; the idea is to have low prices bring customers to newer product lines

Source: Adapted from Colleen Green, 'Strategic pricing', *Small Business Reports* (August 1989): 27–33.

outlining when each strategy is generally used, what the procedures are and the advantages and disadvantages associated with each. This checklist can provide entrepreneurs with reference points for establishing and evaluating pricing strategies for their ventures.

Key lessons of entrepreneurial marketing

According to Lodish et al., entrepreneurs must focus on positioning and target segmentation.

- Price your products to produce maximum profit stream over the product's life.
- Creating 'buzz' is key and is more credible than paid advertising.
- Distribution ('bundling') is a perceived plus. Concept testing with possible partners is key.
- Choose your reference accounts wisely.
- Use unique promotional campaigns. Test them broadly for their impact on your positioning.
- Advertising 'experiments' can add much value and productivity.
- Marketing may affect capital raising more than sales in the new venture's early years.
- Entrepreneurs are more concerned with getting a magic, short-term marketing tactic that will work.[32]

SUMMARY

Entrepreneurial marketing is different from marketing in established firms. Sales are more important than brand recognition because that is what investors look at. Entrepreneurial marketing has to rely on smaller sample sizes and more data. The entrepreneur must adopt an entirely different approach to marketing. One such way is called guerrilla marketing.

Marketing research involves the gathering of information about a particular market, followed by analysis of that information. The marketing research process has five steps: define the purpose and objectives of the research; gather secondary data; gather primary data; develop an information-gathering instrument (if necessary); and interpret and report the information.

Entrepreneurs do not carry out marketing research for four major reasons: cost; complexity of the undertaking; belief that only major strategic decisions need to be supported through marketing research; and belief that the data will be irrelevant to company operations. Usually they misunderstand the value of marketing research or fear its cost.

Developing a marketing concept has three important areas. One area is the formulation of a marketing philosophy. Some entrepreneurs are production-driven, others are sales-driven and still others are consumer-driven. The entrepreneur's values and the market conditions will help determine this philosophy. A second area is market segmentation, which is the process of identifying a specific set of characteristics that differentiate one group of consumers from the rest. Demographic, benefit and psychographic variables are often used in this process. A third area is an understanding of consumer behaviour. Since many types and patterns of consumer behaviour exist, entrepreneurs need to focus on the personal and psychological characteristics of their customers. In this way they can determine a tailor-made, consumer-oriented strategy. This customer analysis focuses on such important factors as general buying trends in the marketplace, specific buying trends of targeted consumers and the types of goods and services being sold.

Most emerging ventures go through the four marketing stages of entrepreneurial marketing, opportunistic marketing, responsive marketing and diversified marketing. Each stage requires a different strategy and the entrepreneur must adjust accordingly.

Marketing planning is the process of determining a clear, comprehensive approach to the creation of customers. For developing this plan, the following elements are critical: Marketing research; sales research; a marketing information system; sales forecasting; marketing plans and evaluation.

The Internet is fast becoming the greatest marketing tool for entrepreneurs. It offers numerous benefits for the overall marketing strategy of a company, including brand recognition, information transfer and customer services.

Pricing strategies are a reflection of marketing research and must consider such factors as marketing competitiveness, consumer demand, life cycle of the goods or services being sold, costs and prevailing economic conditions.

TABLE 8.7: PRICING STRATEGY CHECKLIST

STRATEGY OBJECTIVE	WHEN GENERALLY USED	PROCEDURE	ADVANTAGES	DISADVANTAGES
Skim the cream off the market for high short-term profit (without regard for long term)	No comparable competitive products Drastically improved product or new product innovation Large number of buyers Little danger of competitor entry due to high price, patent control, high R&D costs, high promotion costs and/or raw material control Uncertain costs Short life cycle Inelastic demand	Determine preliminary customer reaction Charge premium price for product distinctiveness in short run, without considering long-run position Some buyers will pay more because of higher present value to them Then gradually reduce price to tap successive market levels (i.e. skimming the cream of a market that is relatively insensitive to price) Finally, tap more sensitive segments	Cushions against cost overruns Requires smaller investment Provides funds quickly to cover new-product promotion and initial development costs Limits demand until production is ready Suggests higher value in buyer's mind Emphasises value rather than cost as a guide to pricing Allows initial feeling out of demand before full-scale production	Assumes that a market exists at high price Results in ill will in early buyers when price is reduced Attracts competition Likely to underestimate ability of competitors to copy product Discourages some buyers from trying the product (connotes high profits) May cause long-run inefficiencies
Slide down demand curve to become established as efficient manufacturer at optimum volume before competitors become entrenched, without sacrificing long-term objective (e.g. obtain satisfactory share of market)	By established companies launching innovations Durable goods Slight barriers to entry by competition Medium life span	Tap successive levels of demand at highest prices possible Then slide down demand curve faster and farther than forced to in view of potential competition Rate of price change is slow enough to add significant volume at each successive price level, but fast enough to prevent large competitor from becoming established on a low-cost volume basis	Emphasises value rather than cost as a guide to pricing Provides rapid return on investment Provides slight cushion against cost overruns	Requires broad knowledge of competitive product developments Requires much documented experience Results in ill will in early buyers when price is reduced Discourages some buyers from buying at initial high price
Compete at the market price to encourage others to produce and promote the product to stimulate primary demand	Several comparable products Growing market Medium to long product life span Known costs	Start with final price and work back to cost Use customer surveys and studies of competitors' prices to approximate final price Deduct selling margins Adjust product, production and selling methods to sell at this price and still make necessary profit margins	Requires less analysis and research Existing market requires fewer promotion efforts Causes no ill will in early buyers since price will not be lowered soon	Limited flexibility Limited cushion for error Slower recovery of investment Must rely on other differentiating tools

Market penetration to stimulate market growth and capture and hold a satisfactory market share at a profit through low prices Become strongly entrenched to generate profits over long term	Long product life span Mass market Easy market entry Demand is highly sensitive to price Unit costs of production and distribution decrease rapidly as quantity of output increases Newer product No 'elite' market willing to pay premium for newest and best	Charge low prices to create a mass market, resulting in cost advantages derived from larger volume Look at lower end of demand curve to get price low enough to attract a large customer base Also review past and competitor prices	Discourages actual and potential competitor inroads because of apparent low profit margins Emphasises value more than cost in pricing Allows maximum exposure and penetration in minimum time May maximise long-term profits if competition is minimised	Assumes volume is always responsive to price reductions, which isn't always true Relies somewhat on glamour and psychological pricing, which doesn't always work May create more business than production capacity available Requires significant investment Small errors often result in large losses
Pre-emptive pricing to keep competitors out of market or eliminate existing ones	Used more often in consumer markets Manufacturers may use this approach on one or two products, with other prices meeting or higher than those of competitors	Price at low levels so that market is unattractive to possible competitors Set prices as close as possible to total unit cost As increased volume allows lower cost, pass advantage to buyers via lower prices If cost declines rapidly with increases in volume, can start price below cost (can use price approaching variable costs)	Discourages potential competitors because of apparent low profit margins Limits competitive activity and expensive requirements to meet them	Must offer other policies that permit lower price (limited credit, delivery, or promotions) Small errors can result in large losses Long-term payback period

Source: Roy A. Lindberg and Theodore Cohn, *The Marketing Book for Growing Companies That Want to Excel* (New York: Van Nostrand Reinhold, 1986), 116–17. Reprinted with permission.

KEY TERMS AND CONCEPTS

consumer behaviour
consumer characteristics
consumer pricing
consumer-driven philosophy
demand-oriented pricing
entrepreneurial marketing
entrepreneurial marketing plan
experimentation
family life cycle
focus groups
guerrilla marketing
Internet marketing
liquidity constraints
loss leader pricing
market
market penetration
market segmentation
marketing concept
marketing planning
marketing research
marketing stages
pay per click
penetration
pricing strategies
primary data
product research
production-driven philosophy
sales forecasting
sales research
sales-driven philosophy
search engine optimisation
secondary data
segmentation variables
skimming
surveys
viral marketing

REVIEW AND DISCUSSION QUESTIONS

1 What are the differences between entrepreneurial marketing and ‘ordinary’ marketing?
2 Why do we say that a small business is not a little big business?
3 In your own words, what is a market? How can marketing research help an entrepreneur identify a market?
4 What are the five steps in the marketing research process? Briefly describe each.
5 Which is of greater value to the entrepreneur, primary or secondary data? Why?
6 Identify and describe three of the primary obstacles to undertaking marketing research.
7 How would an entrepreneur’s new-venture strategy differ under each of the following marketing philosophies: production-driven, sales-driven and consumer-driven? Be complete in your answer.
8 In your own words, what is market segmentation? Give examples.
9 What role do demographic and benefit variables play in the segmentation process?
10 How does the way that consumers view a venture’s product or service affect strategy? For example, why would it make a difference to the entrepreneur’s strategy if the consumers viewed the company as selling a convenience good as opposed to a shopping good?
11 Identify and describe four of the major forces shaping buying decisions in the new century.
12 Most emerging ventures evolve through a series of marketing stages. What are these stages? Identify and describe each.
13 What does the entrepreneur of an emerging venture need to know about sales research and a marketing information system?
14 For developing a marketing plan, what are the five steps that are particularly helpful? Identify and describe each.
15 Describe several different methods of Internet marketing. Give examples.
16 What are some of the major environmental factors that affect pricing strategies? What are some of the major psychological factors that affect pricing? Identify and discuss three of each.

EXPERIENTIAL EXERCISE

IDENTIFYING THE CUSTOMER

One of the most important activities of entrepreneurs is identifying their customers. A list of the five basic types of consumers (A) to (E) and a list of descriptions of these types (a) to (o) follow. Identify the order in which people adopt new goods by ranking the first list from 1 (first adopters) to 5 (last adopters). Then match the descriptions with the types of consumer by placing a 1 next to those that describe initial adopters, on down to a 5 next to those that describe final adopters. (Three descriptions are listed for each of the five types of consumer.) Answers are provided at the end of the chapter.

A Early adopters
B Early majority
C Laggards
D Innovators
E Late majority

a High-income people who have inherited their wealth
b Future oriented
c Below-average-income wage earners
d Present (security) oriented
e High-income people who have incomes from salary and investment
f Highest professionals, including merchants and financiers
g Present oriented
h Average-income wage earners
i Middle managers and owners of medium-sized businesses
j Above-average-income wage earners
k Present oriented, but worried about the impact of time
l Unskilled labour
m Skilled labour
n Owners of small businesses; non-managerial office and union managers
o Tradition-oriented people who often live in the past

CASE 8.1:
DEALING WITH THE COMPETITION

Six months ago Roberta O'Flynn opened a small office supply store. Roberta sells a wide range of general office merchandise, including photocopying and typing paper, writing tablets, envelopes, writing instruments and computer diskettes, as well as a limited range of office desks, chairs and lamps.

Several office supply stores in the local area are, in Roberta's opinion, competitors. In an effort to better understand the competition, Roberta has visited four of these stores and pretended to be a customer so she could get information regarding their prices, product offerings and service. Each has a different strategy. For example, one of them sells strictly on price. It is the customer's responsibility to pick up the merchandise and carry it away. Another relies heavily on service, including a 90-day credit plan for those purchasing equipment in excess of $500. This company's prices are the highest of the four stores Roberta visited. The other two stores use a combination of price and service strategies.

Roberta believes that in order to get her new venture off the ground, she must develop a marketing strategy that helps her effectively compete with these other firms. Since her store is extremely small, Roberta believes that a certain amount of marketing research could be of value. On the other hand, her budget is extremely limited and she is not sure how to collect the information. Roberta believes that what she needs to do is develop a market niche that will be loyal to her. In this way, no matter how extensive the competition, she always will have a group of customers who buy from her. Roberta also believes that the focus of this research has to be in two general directions. First, she has to find out what customers look for from an office supply store. How important is price? Service? Quality? Second, she has to determine the general strategy of each of her major competitors so she can develop a plan of action for preventing them from taking away her customers. Right now, however, her biggest question is: How do I go about getting the information I need?

QUESTIONS

1. Will the information Roberta is seeking be of value to her in competing in this market? Why or why not?
2. How would you recommend Roberta put together her marketing research plan? What should be involved? Be as complete as possible in your answer.
3. How expensive will it be for Roberta to follow your recommendations for her marketing research plan? Describe any other marketing research efforts she could undertake in the near future that would be of minimal cost.

CASE 8.2:
FOR COOKS ONLY

When Phil Hartrack was a young man, he already knew what he wanted to be: a salesperson. His mother was delighted. 'Salespeople make great money', she explained to him, 'and with your appetite, you're going to need all of the money you can make. You've got the biggest appetite in the family.'

After graduating from college, Phil took a job with a consumer-goods firm. For the next 10 years, he was one of its leading salespeople every year. At the end of this time, however, Phil admitted to himself that although he enjoyed selling, what he really wanted to do was sell books. 'I want to own my own bookstore', he told his wife. 'I know it sounds silly because I have had no experience in bookstore selling, but I've always loved books and I'm a terrific salesperson.' After researching the market, Phil and his wife had to face a very important fact: the competition in this business is extremely aggressive. Most small bookstores do not last more than three years and the majors such as Angus & Robertson and Borders dominate the industry.

Phil refused to admit defeat. 'There has to be a market niche somewhere in this field that the majors are not addressing. I'm going to find that niche and go after it', he told his banker. Six months ago, Phil concluded that he had found this niche. 'Cookbooks are the wave of the future', he explained to his wife. 'The average person today buys twice as many cookbooks as 10 years ago. It is the fastest-growing segment of the book market. Moreover, with your cooking skills and my appetite, we're a natural for this market. We love food and we have sales skills.'

Taking all of their savings, Phil and his wife opened their bookstore in a popular suburban mall. It is called For Cooks Only and sells only cookbooks. By the end of the first month, the Hartracks realised they had made the right choice. Their wide selection of cookbooks and their familiarity with many of the books helped them build a loyal clientele. They even provide a 'Recommended Recipe' service, showcasing easy recipes that use foods in season. This service has resulted in many people coming by to look at a recipe – and then returning within a couple of weeks to buy the book.

Although Phil is quite happy over the business's success, he realises that his limited market niche could dry up in a short period of time. He feels that the best way to prevent this from happening is by conducting marketing research, seeing if he can add any additional books or services to the line and developing the strongest possible clientele loyalty. The first place to begin, in his opinion, is by examining the current purchasing habits of customers and then using this as a foundation for deciding where to go from here.

QUESTIONS

1. From the customer's viewpoint, what type of good is a cookbook? Defend your answer.
2. Why is Phil's store doing so well? Include in your answer his philosophy of marketing.
3. In his marketing research efforts, what type of information would you suggest Phil collect?
4. How can he go about doing this? Be complete in your answer.

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Publication date: 3 October 2002
Revision date: 20 October 2005
Author(s): Joseph B. Lassiter III
Product number: 9-803-036

Describes entrepreneurial marketing as both a mind-set and a process. Draws on some 30 business field cases and some 300 student projects that provide insight into what managers do in high-potential settings.

Growing Ventures Can Anticipate Marketing Stage

Publication date: 1 January 1983
Author(s): Tyzoon T. Tyebjee, Albert V. Bruno, Shelby H. McIntyre
Product number: 83116

A growing business evolves by adapting to changes in its environment through its marketing function. Usually this function goes through four stages: entrepreneurial marketing; opportunistic marketing; responsive marketing; and diversified marketing.

Sa Sa Cosmetics

Publication date: 8 May 2003
Author(s): David E. Bell, Iris T. Li
Product number: 9-502-085

Sa Sa Cosmetics has had spectacular success as a low-price retailer of branded cosmetics. But recently, growth has slackened. What are the causes? This case describes recent strategic initiatives and provides market research data to aid the students in diagnosis.

Rediscovering Market Segmentation

Publication date: 1 February 2006
Author(s): Daniel Yankelovich, David Meer
Product number: R0602G

In 1964, Daniel Yankelovich introduced in the pages of *Harvard Business Review* the concept of non-demographic segmentation, by which he meant the classification of consumers according to criteria other than age, residence, income and such. Buying patterns had become far better guides to consumers' future purchases. But more than 40 years later, non-demographic segmentation has become just as unenlightening as demographic segmentation had been. Now, Yankelovich returns to these pages, with consultant David Meer, to argue the case for a broad view of non-demographic segmentation.

Granny's Goodies, Inc.

Publication date: 25 November 1999
Revision date: 9 February 2000
Author(s): Kathy Korman, Das Narayandas
Product number: 9-500-049

The young entrepreneurs of Granny's Goodies, Inc., a corporate gift package specialist, face the challenge of finding ways to create consistent revenue streams and reduce sales costs. Outside of a few long-term contracts, the two founders have had to work very hard for each sale. Using extensive customer information that the firm has diligently collected over the previous two years, students need to develop a plan that covers market selection, product policy and relationship management strategy for the firm.

ANSWERS

A	2
B	3
C	5
D	1
E	4
a	1
b	2
c	5
d	4
e	2
f	1
g	3
h	4
i	2
j	3
k	1
l	5
m	4
n	3
o	5

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Online reading

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FINANCIAL PREPARATION FOR ENTREPRENEURIAL VENTURES

9

> Small company managers are too inclined to delegate to outside accountants every decision about their companies' financial statements. Indeed, it is most unfair to suppose that accountants can produce – without management's advice and counsel – the perfect statement for a company. Instead, I contend, top managers of growing small companies must work with their independent accountants in preparing company financial statements to ensure that the right message is being conveyed …
>
> James McNeill Stancill, 'Managing financial statements: Image and effect'[1]

CHAPTER OBJECTIVES

1. To explain the principal financial statements needed for any entrepreneurial venture – the balance sheet, income statement and cash-flow statement
2. To outline the process of preparing an operating budget
3. To discuss the nature of cash flow and to explain how to draw up such a document
4. To describe how pro forma statements are prepared
5. To explain how capital budgeting can be used in the decision-making process
6. To illustrate how to use break-even analysis
7. To describe ratio analysis and illustrate the use of some of the important measures and their meanings
8. To describe the value of decision support systems in the management of financial resources

THE IMPORTANCE OF FINANCIAL INFORMATION FOR ENTREPRENEURS

Today's entrepreneur operates in a competitive environment characterised by the constraining forces of governmental regulation, competition and resources. In regard to the latter, no firm has access to an unlimited amount of resources. So in order to compete effectively, the entrepreneur must allocate resources efficiently. Three kinds of resources are available to the entrepreneur: human, material and financial. This chapter focuses on financial resources in the entrepreneurial environment.[2]

Financial information pulls together all the information presented in the other segments of the business: marketing, distribution, manufacturing and management. It quantifies all the assumptions and historical information concerning business operations.[3]

For many budding entrepreneurs, financial analysis is a steep learning curve. There are other courses to take and there are many advisers who help along the way. Here, to start you off, are the most important concepts:[4]

- **Working capital** – that is, the **capital** you have available to work with today. This is determined by subtracting **current liabilities** from **current assets**. One rule of thumb says you should have \$1.50 to \$2 of current assets for every \$1 of current liabilities.
- **Revenue** – know your sales on a monthly, quarterly and year-to-date basis. Compare these to your financial plan/budgets to see if you are behind or ahead.
- **Gross profit** – your gross profit is your revenue less the direct costs of producing your product or service. By completing a capacity calculation you will be able to assess your target gross profit and consider ways to improve the margin.
- **Expenses** – know these numbers and be prepared to adjust them to the current business environment. Watch for wastage and regularly check for better deals from suppliers.
- **Net profit** – subtract the total of your overhead expenses from your gross profit to get net profit. Look at this as a percentage of sales. This number will tell you how profitable the business is. If the number is negative, you are losing money. Make sure your number is at least as good as others in your industry. If you are below average, you are not managing your business as well as your competitors.

Key components and assumptions of financial information

The key component of the financial segment is the **balance sheet**, which represents the financial condition of a company at a certain date. It details the items the company owns (**assets**) and the amount that the company owes (**liabilities**). It also shows the **net worth** of the company and its liquidity. The balance sheet follows the traditional accounting equation:

$$\text{Assets} = \text{Liabilities} + \text{Shareholders' Equity}$$

Or, put another way:

$$\text{Assets} - \text{Liabilities} = \text{Shareholders' Equity}$$

Another key component is the **income statement**, commonly referred to as the **profit and loss statement** (P&L statement), which provides the owner/manager with the results of operations. It measures the profitability of the business.

The statement of **cash flow** is an analysis of the cash coming in and going out of the business. The projected cash flow is a planning tool to allow management to make borrowing and investing decisions based on the expected timing of future cash receipts and cash payment. Because of swings in the business cycles, collection experiences, timing of expenditures, purchase of capital

AUSTRALASIAN ENTREPRENEURS IGNORANT ABOUT DEBT AND NUMBERS

Australians are famous for their love of credit and, according to the latest government figures, currently hold a record $28.2 billion debt on their charge and credit cards alone. Yet they remain in the dark about their personal credit history and the lasting impact bad records have on their financial futures. A downturn in the national economy could make life extremely hard for those already in debt. With a bad credit history, an entrepreneur would end up having to go to sub-prime lenders or the non-conforming lenders and pay exorbitant interest rates and end up on a treadmill. Unless their business is a bank, entrepreneurs need to make sure their customers don't treat them like one. Debtors will try and extend their terms of credit. With the cost of money going up from the banks, they will try and get cash somewhere else, even if it means stepping on another entrepreneur's goodwill. As a result, the mantra that (especially for small businesses) 'cash flow is king' becomes ever more important. Small business entrepreneurs must start to think like the big boys, who are very strict about their payment terms and are not afraid to enforce them.

New Zealand entrepreneurs mistakenly prefer bank debt over shared **equity**. Many do not appear even to recognise that the capital put into a business by the owner or family was equity and accounted for most small business funding. Many small firms do not even realise that a personal guarantee over a debt put personal assets at risk. The main reasons given for bank loan rejections are insufficient income, cash flow and security.

Sources: Sam Holmes, 'Australian consumers ignorant about bad credit risks', Australian Associated Press, 27 May 2005; James Morrow, 'Credit limit', *Investigate Magazine* (Australia), March 2005; Roeland Van den Bergh, 'Study finds small firms bad at sums', *The Dominion Post* (Wellington), 13 October 2005.

items and various other transactions that generate or deplete cash, an owner/manager must manage the cash resources of their business. A successful business manager invests idle cash and appropriately finances cash shortages (short-term financing for temporary fluctuations and long-term financing for capital improvements).

It should be remembered that entrepreneurs make assumptions to explain how numbers are derived and correlate these assumptions with information presented in other parts of the business operations. The set of assumptions on which projections are based should be clearly and precisely presented. Without these assumptions, numbers will have little meaning. It is only after carefully considering such assumptions that the entrepreneur will be able to assess the validity of financial projections. Because the rest of the financial plan is an outgrowth of these assumptions, they are the most integral part of any financial segment (see table 9.1).

In order for entrepreneurs to develop the key components of a financial segment, they should follow a clear process, described in the next section.

PREPARING FINANCIAL STATEMENTS

One of the most powerful tools the entrepreneur can use in planning financial operations is a budget. The **operating budget** is a **financial statement** of estimated income and expenses over a specified period of time. Another common type of budget is the cash budget (projected cash flow), which is a statement of estimated cash receipts and expenditures over a specified period of time. It is typical for a firm to prepare both types of budgets by first computing an operating budget and then constructing a cash budget based on the operating budget. A third common type of budget is the capital budget, which is used to plan expenditures on assets whose returns are expected to last beyond one year. This section examines all three of these budgets: operating, cash flow and capital. Then the preparation of pro forma financial statements from these budgets is discussed.

The operating budget

The operating budget is made up of a variety of forecasts, including **sales forecasts**, expense forecasts, production forecasts and operating forecasts.

Sales forecasts

Typically, the first step in creating an operating budget is the preparation of the sales forecast. An entrepreneur can prepare the sales forecast in several ways. One way is to implement a statistical forecasting technique such as simple **linear regression**. Simple linear regression is a method of estimating the expected value of one variable y given the values of some other variable or variables x. 'Linear' refers to the assumption of a linear relationship (straight line) between y and x:

$$Y = a + bx$$

Y is a dependent variable (it is dependent on the values of a, b and x), x is an independent variable (it is not dependent on any of the other variables), a is a constant (in regression analysis, Y is dependent on the variable x, all other things held constant) and b is the slope of the line (the change in Y divided by the change in x). For estimating sales, for instance, Y is the variable used to represent the expected sales and x is the variable used to represent some factor on which sales might be dependent (such as advertising expenditures or foot traffic past the store).

When using regression analysis, the entrepreneur draws conclusions about the relationship between, for example, product sales and advertising expenditures. Here is an example of how Mary Tindle, owner of a clothing store, used regression analysis.

Mary began with two initial assumptions: (1) If no money is spent on advertising, total sales will be \$200 000 and (2) for every dollar spent on advertising, sales will be increased by two times that amount. Relating these two observations yields the following simple linear regression formula:

$$S = \$200\,000 + 2A$$

where:

$$S = \text{Projected Sales}$$

$$A = \text{Advertising Expenditures}$$

[Note: It is often easier to substitute more meaningful letters into an equation. In this case, the letter *S* was substituted for the letter *Y* simply because the word sales starts with that letter. The same is true for the letter *A*, which was substituted for the letter *x*.]

In order to determine the expected sales level, Mary must insert different advertising expenditures and complete the simple linear regression formula for each different expenditure.

Here is an example of how John Wheatman, owner of Wheatman's Market, used trend line analysis to forecast sales for his retail store:

After considerable analysis of his store's sales history, John Wheatman decided to use trend line analysis and estimated that sales would increase 5 per cent during the next year, with the seasonal variations following roughly the same pattern. Since he has a personal computer with an electronic spreadsheet program, John chose to use the input of last year's sales figures in the spreadsheet and to instruct the computer to increase each month by 5 per cent. The results are shown in table 9.1.

TABLE 9.1: **WHEATMAN'S MARKET: SALES FORECAST FOR 20XX ($000)**

	JANUARY	FEBRUARY	MARCH	APRIL	MAY	JUNE
Sales	$300	$350	$400	$375	$500	$450
× 1.05	315	368	420	394	525	473
	JULY	AUGUST	SEPTEMBER	OCTOBER	NOVEMBER	DECEMBER
Sales	$475	$480	$440	$490	$510	$550
× 1.05	499	504	462	515	536	578

Expense forecasts

After a firm has forecast its sales for the budget period, expenses must be estimated. The first type of expenses that should be estimated is the **cost of goods sold**, which follows sales on the income statement. For retail firms this is a matter of projecting purchases and the corresponding desired beginning and ending inventories. Many firms prefer to have a certain percentage of the next month's sales on hand in inventory.

Here is how John Wheatman determines his store's expected purchases and inventory requirements:

For determining his purchase requirements, John Wheatman believes his gross profit will represent 20 per cent of his sales dollar. This is based on analysis of the past five years' income statement. Consequently, cost of goods sold will represent 80 per cent of the sales for the current month. In addition, John wants to have approximately one week's inventory on hand. Thus the ending inventory is estimated to be 25 per cent of next month's sales. The results are shown in table 9.2.

Production forecasts

A manufacturing firm, on the other hand, would have different requirements. It will need to establish its production budget, a material purchases budget based on the production budget

TABLE 9.2: **WHEATMAN'S MARKET: PURCHASE REQUIREMENTS BUDGET FOR 20XX ($000)**

	JAN.	FEB.	MAR.	APR.	MAY	JUNE	JULY	AUG.	SEPT.	OCT.	NOV.	DEC.
Sales revenue	$315	$368	$420	$394	$525	$473	$499	$504	$462	$515	$536	$578
Cost of goods sold calculation												
Beginning inventory	$63	$74	$84	$79	$105	$95	$100	$101	$92	$103	$107	$116
Purchases	263	305	331	341	410	383	400	395	380	416	437	413
Cost of goods available	$326	$379	$415	$420	$515	$478	$500	$496	$472	$519	$544	$529
Ending inventory	74	85	79	105	95	100	101	92	102	107	116	66
Cost of goods sold	$252	$294	$336	$315	$420	$378	$399	$403	$370	$412	$428	$462
Gross profit	$63	$74	$84	$79	$105	$95	$100	$101	$92	$103	$108	$116

- Beginning inventory = Prior month's ending inventory or current month's sales × (.80)(.25)
- Purchases = Cost of goods available − Beginning inventory
- Cost of goods available = Cost of goods sold + Ending inventory
- Ending inventory = Next month's sales × (.80)(.25) (since inventory is carried at cost)
- Cost of goods sold = Current period sales × (.80)
- Gross profit = Sales − Cost of goods sold

and the corresponding direct labour budget. The production budget is management's estimate of the number of units that need to be produced in order to meet the sales forecast. This budget is prepared by working backward through the cost of goods sold section. First, the predicted number of units that will be sold during that month is determined. Then the desired ending-inventory-level balance is added to this figure. The sum of these two figures is the number of units that will be needed in inventory. Once the inventory requirements have been determined, the entrepreneur must determine how many of these units will be accounted for by the beginning inventory (which is the prior month's ending inventory) and how many units will have to be produced. The production requirement is calculated by subtracting the period's beginning inventory from the inventory needed for that period. For example:

Tom B. Good, president and founder of General Widgets, has decided to implement a budget in order to help plan for his company's growth. After receiving the unit sales forecast from his sales manager, Tom examined last year's product movement reports and determined that he would like to have 10 per cent of the next month's sales on hand as a buffer against possible fluctuations in demand. He has also received a report from his production manager that his ending inventory this year is expected to be 12 000 widgets, which will also be the beginning inventory for the budget period. Table 9.3 shows the results.

After the production budget has been calculated, the materials required for producing the specified number of units can be determined from an analysis of the bill of materials for the product being manufactured. In addition, by examining the amount of direct labour needed to produce each unit, management can determine the amount of direct labour that will be needed during the forthcoming budget period.

Operating expenses

The last step in preparing the operating budget is to estimate the operating expenses for the period. Three of the key concepts in developing an expense budget are fixed, variable and mixed costs. A **fixed cost** is one that does not change in response to changes in activity for a given period of time. Rent, **depreciation** and certain salaries are examples. A **variable cost** is one that changes in the same direction as, and in direct proportion to, changes in operating activity. Direct labour, direct materials and sales commissions are examples. Mixed costs are a blend of fixed and variable costs. An example is utilities, since part of this expense would be responsive to change in activity and the rest would be a fixed expense, remaining relatively stable over the budget period. Mixed costs can present a problem for management in that it is sometimes difficult to determine how much of the expense is variable and how much is fixed.

TABLE 9.3: **GENERAL WIDGETS: PRODUCTION BUDGET WORKSHEET FOR 20XX ($000)**

	JAN.	FEB.	MAR.	APR.	MAY	JUNE	JULY	AUG.	SEPT.	OCT.	NOV.	DEC.
Projected sales (units)	125	136	123	143	154	234	212	267	236	345	367	498
Desired ending inventory	14	12	14	15	23	21	27	24	35	37	50	26
Available for sale	139	148	137	158	177	255	239	291	271	382	417	524
Less: Beginning inventory	12	14	12	14	15	23	21	27	24	35	37	50
Total production requirements	127	134	125	144	162	232	218	264	247	347	380	474

TABLE 9.4: **WHEATMAN'S MARKET: EXPENSE AND OPERATING BUDGETS**

	JAN.	FEB.	MAR.	APR.	MAY	JUNE	JULY	AUG.	SEPT.	OCT.	NOV.	DEC.
Operating expenses												
Rent	$2	$2	$2	$2	$2	$2	$2	$2	$2	$2	$2	$2
Payroll	32	37	42	39	53	47	50	50	46	51	54	58
Utilities	5	5	5	5	5	5	5	5	5	5	5	5
Taxes	3	4	4	4	5	5	5	5	5	5	5	6
Supplies	16	18	21	20	26	24	25	25	23	26	27	29
Repairs	2	2	2	2	2	2	2	2	2	2	2	2
Total expenses	$60	$68	$76	$72	$93	$85	$89	$89	$83	$91	$95	$102
Sales revenue	$315	$368	$420	$394	$525	$473	$499	$504	$462	$515	$536	$578
Cost of goods sold												
Beginning inventory	$63	$74	$84	$79	$105	$95	$100	$101	$92	$103	$107	$116
Purchases	263	305	331	341	410	383	400	395	380	416	437	413
Cost of goods available	$326	$379	$415	$420	$515	$478	$500	$496	$472	$519	$544	$529
Ending inventory	74	85	79	105	95	100	101	92	102	107	116	66
Cost of goods sold	$252	$294	$336	$315	$420	$378	$399	$403	$370	$412	$428	$62
Gross profit	$63	$74	$84	$79	$105	$95	$100	$101	$92	$103	$108	$116
Net profit	$3	$6	$8	$7	$12	$10	$11	$12	$9	$12	$12	$14

After the expenses have been budgeted, the sales, cost of goods and expense budget are combined to form the operating budget.

Table 9.4 outlines Wheatman's Market's anticipated expenses for the budget year and the completed operating budget for the period. Each month represents the pro forma, or projected, income and expenses for that period.

In order to identify the behaviour of the different expense accounts, John Wheatman decided to analyse the past five years' income statements. Following are the results of his analysis:

- **Rent is a constant expense and is expected to remain the same over the next year.**
- **Payroll expense changes in proportion to sales, since the more sales the store has, the more people it must hire to meet increased consumer demands.**
- **Utilities are expected to remain relatively constant over the budget period. This is because the food coolers will be running at the same level even though the sales levels may vary.**
- **Taxes are based primarily on sales and payroll and are therefore considered a variable expense.**
- **Supplies will vary in proportion to sales. This is because most of the supplies (cash register tape, vegetable trays, meat trays and plastic meat and vegetable bags) will be used to support sales.**
- **Repairs are relatively stable and are a fixed expense. John has maintenance contracts on the equipment in the store and the cost is not scheduled to rise during the budget period.**

The cash-flow budget

After the operating budget has been prepared, the entrepreneur can proceed to the next phase of the budget process, the **cash-flow budget**. This budget, which is often prepared with the assistance of an accountant, provides an overview of the cash in-flows and out-flows during the period. By pinpointing cash problems in advance, management can make the necessary financing arrangements.

The first step in the preparation of the cash-flow budget is the identification and timing of cash in-flows. For the typical business, cash in-flows will come from three sources:

- cash sales
- cash payments received on account
- loan proceeds.

Not all of a firm's sales revenues are cash. In an effort to increase sales, most businesses will allow some customers to purchase goods on account. Consequently, part of the funds will arrive in later periods and will be identified as cash payments received on account. Loan proceeds represent another form of cash inflow that is not directly tied to the sales revenues. A firm may receive loan proceeds for several reasons – for example, the planned expansion of the firm (new building and equipment) or meeting cash-flow problems stemming from an inability to pay current bills.

Some businesses have a desired minimum balance of cash indicated on the cash-flow budget, highlighting the point at which it will be necessary to seek additional financing. Table 9.5 provides an example of how Wheatman's Market prepared its cash-flow budget.

John Wheatman has successfully completed his operating budget and is now ready to prepare his cash-flow worksheet. After analysing the sales figures and the cash receipts, John has determined that 80 per cent of monthly sales are in cash. Of the remaining 20 per cent, 15 per cent is collected in the next month and the final 5 per cent is collected in the month following (see the cash receipts worksheet in table 9.5). Wheatman's purchases are typically paid during the week following the purchase. Therefore,

TABLE 9.5: WHEATMAN'S MARKET: CASH-FLOW BUDGET

WHEATMAN'S MARKET: CASH RECEIPTS WORKSHEET FOR 20XX ($000)

	JAN.	FEB.	MAR.	APR.	MAY	JUNE	JULY	AUG.	SEPT.	OCT.	NOV.	DEC.
Sales	$315	$388	$420	$394	$525	$473	$499	$504	$462	$515	$536	$578
Current month	$252	$294	$336	$315	$420	$378	$399	$403	$370	$412	$428	$462
Prior month	82	47	55	63	59	79	71	75	76	69	77	80
Two months back	26	28	16	18	21	19	26	24	24	25	24	26
Cash receipts	$360	$369	$407	$396	$500	$476	$496	$502	$470	$506	$529	$568

WHEATMAN'S MARKET: CASH DISBURSEMENTS WORKSHEET FOR 20XX ($000)

	JAN.	FEB.	MAR.	APR.	MAY	JUNE	JULY	AUG.	SEPT.	OCT.	NOV.	DEC.
Purchases	$263	$305	$331	$341	$410	$383	$400	$395	$380	$416	$437	$413
Current month	$197	$228	$248	$256	$307	$287	$300	$296	$285	$312	$328	$309
Prior month	98	66	76	83	85	102	96	100	99	95	104	109
Purchase payments	$295	$294	$324	$339	$392	$396	$396	$396	$384	$407	$432	$419
Operating expenses	$60	$68	$76	$72	$93	$85	$89	$89	$83	$91	$95	$102
Cash payments	$355	$362	$400	$412	$485	$481	$485	$485	$467	$498	$527	$521

WHEATMAN'S MARKET: CASH-FLOW WORKSHEET FOR 20XX ($000)

	JAN.	FEB.	MAR.	APR.	MAY	JUNE	JULY	AUG.	SEPT.	OCT.	NOV.	DEC.
Beginning cash	$122	$127	$134	$141	$127	$141	$143	$154	$170	$173	$181	$184
Add: Receipts	360	369	407	396	500	476	496	502	470	506	529	568
Cash available	$482	$496	$541	$537	$627	$617	$639	$656	$640	$679	$710	$752
Less: Payments	355	362	400	411	485	481	485	485	467	498	527	521
Ending cash	$127	$134	$141	$126	$142	$136	$154	$171	$173	$181	$183	$231

SMALL BUSINESS OWNERS NEED TO BRUSH UP ON THEIR MATHS

ENTREPRENEURSHIP
IN PRACTICE

Almost one in two people running small businesses struggle to understand a balance sheet, according to a survey of 1000 businesses in the UK. Owner managers were excellent when it came to questions on marketing, management and leadership but they fell down when tackling finance issues. Seven out of 10 did not know the meaning of depreciation. Almost half failed to make a basic calculation to show the borrowings of a business in a simple balance sheet. The results indicate that many owner managers might not have any real idea what their accounts are telling them, particularly on matters of profitability, according to this survey prepared for the Federation of Small Businesses.

Source: 'Quiz leaves many managers wanting to phone a friend', *Daily Telegraph*, 21 April 2003, p. 29.

approximately one-fourth of the purchases are paid for in the following month. Rent expense is paid a month in advance. However, since it is not expected to go up during the budget period, the monthly cash outlay for rent remains the same. All the other expenses are paid in the month of consumption (see the cash disbursements worksheet in table 9.5). Finally, the cash-flow worksheet is constructed by taking the beginning cash balance, adding the cash receipts for that month and deducting the cash disbursements for the same month.

Pro forma statements

The final step in the budget process is the preparation of **pro forma statements**, which are projections of a firm's financial position over a future period (pro forma income statement) or on a future date (pro forma balance sheet). Pro forma comes from Latin meaning 'according to form'. In the normal accounting cycle, the income statement is prepared first and then the balance sheet. Similarly, in the preparation of pro forma statements, the pro forma income statement is followed by the pro forma balance sheet.

In the process of preparing the operating budget, the firm will have already prepared the pro forma income statements for each month in the budget period. Each month presents the anticipated income and expense for that particular period, which is what the monthly pro forma income statements do. In order to prepare an annual pro forma income statement, the firm combines all months of the year.

The process for preparing a pro forma balance sheet is more complex. The last balance sheet prepared before the budget period began, the operating budget and the cash-flow budget are needed in preparing a pro forma balance sheet. Starting with the beginning balance sheet balances, the projected changes as depicted on the budgets are added to create the projected balance sheet totals.

Figure 9.1 provides a summary of the changes that should be added to the appropriate accounts.

After preparing the pro forma balance sheet, the entrepreneur should verify the accuracy of their work with the application of the traditional accounting equation:

$$\text{Assets} = \text{Liabilities} + \text{Shareholders' Equity}$$

If the equation is not in balance, the work should be rechecked. Table 9.6 provides a brief account of the process of preparing pro forma financial statements for Wheatman's Market.

FIGURE 9.1 SUMMARY OF ACCOUNT CHANGES FOR PRO FORMA BALANCE SHEET

- **Cash:** Begin with the original cash balance and add (or subtract) the change in cash as depicted on the cash-flow budget.
- **Accounts receivable:** Examine the last couple of months on the cash-flow budget to determine what charges will be included in the accounts receivable. Also, be sure all of the original receivables have been accounted for.
- **Inventory:** This figure can be picked up from the cost-of-goods budget.
- **Fixed assets:** This number will probably remain the same; however, any changes can be picked up on the cash-flow budget from an analysis of the loan proceeds.
- **Accounts payable:** Again, examine the last couple of months on the cash-flow budget, this time analysing the purchases to determine what purchases will not have been paid for.
- **Loans/notes payable:** Analyse the loan proceeds. In addition, interest will have to be accrued in a separate interest-payable account.
- **Capital:** The major item to be included here is the projected net income for the budget period.

At this point in the budget process, John Wheatman has the information necessary to prepare pro forma financial statements. The first set he has decided to prepare are the pro forma income statements. To do this, John simply copies the information from the operating budget (see the comparative income statements below and compare with the operating budget). The next set of pro forma statements is the pro forma balance sheets. In order to compile these, John uses the following information along with the operating budget and the cash-flow worksheet he has prepared:

- cash – the ending cash balance for each month from the cash-flow worksheet
- accounts receivable – 20 per cent of the current month's sales plus 5 per cent of the preceding month's sales
- inventory – the current month's ending inventory on the pro forma income statements
- prepaid rent – the $2000 is expected to remain constant throughout the budget period and is always paid one month in advance
- building and equipment – no new acquisitions are expected in this area, so the amount will remain constant
- accumulated depreciation – since no new acquisitions are anticipated, this will stay the same; all buildings and equipment are fully depreciated
- accounts payable – 25 per cent of current purchases
- capital – prior month's capital balance plus current month's net income.

CAPITAL BUDGETING

Entrepreneurs are usually required to make several investment decisions (that is, decisions to acquire assets with a life longer than one year) in the process of managing their firms. These are commonly referred to as capital investments or capital expenditures. A technique the entrepreneur can use to help plan for capital expenditures is **capital budgeting**.

TABLE 9.6: WHEATMAN'S MARKET: PRO FORMA STATEMENTS

WHEATMAN'S MARKET: COMPARATIVE PRO FORMA INCOME STATEMENTS FOR 20XX ($000)

	JAN.	FEB.	MAR.	APR.	MAY	JUNE	JULY	AUG.	SEPT.	OCT.	NOV.	DEC.
Sales	$315	$388	$420	$394	$525	$473	$499	$504	$462	$515	$536	$578
Cost of goods sold												
Beginning inventory	$63	$74	$84	$79	$105	$95	$100	$101	$92	$103	$107	$116
Purchases	263	305	331	341	410	383	400	395	380	416	437	413
Cost of goods available	$326	$379	$415	$420	$515	$478	$500	$496	$472	$519	$544	$529
Ending inventory	74	85	79	105	95	100	101	92	102	107	116	66
Cost of goods sold	$252	$294	$336	$315	$420	$378	$399	$403	$370	$412	$428	$462
Gross profit	$63	$74	$84	$79	$105	$95	$100	$101	$92	$103	$108	$116
Operating expenses												
Rent	$2	$2	$2	$2	$2	$2	$2	$2	$2	$2	$2	$2
Payroll	32	37	42	39	53	47	50	50	46	51	54	58
Utilities	5	5	5	5	5	5	5	5	5	5	5	5
Taxes	3	4	4	4	5	5	5	5	5	5	5	6
Supplies	16	18	21	20	26	24	25	25	23	26	27	29
Repairs	2	2	2	2	2	2	2	2	2	2	2	2
Total expenses	$60	$68	$76	$72	$93	$85	$89	$89	$83	$91	$95	$102
Net profit	$3	$6	$8	$7	$12	$10	$11	$12	$9	$12	$12	$14

WHEATMAN'S MARKET: COMPARATIVE PRO FORMA BALANCE STATEMENTS FOR 20XX ($000)

	JAN.	FEB.	MAR.	APR.	MAY	JUNE	JULY	AUG.	SEPT.	OCT.	NOV.	DEC.
Assets												
Cash	$127	$134	$141	$126	$142	$136	$154	$171	$173	$181	$183	$231
Accounts receivable	91	89	102	100	125	121	123	126	117	126	133	142
Inventory	74	84	79	105	95	100	101	92	103	107	116	66
Prepaid rent	2	2	2	2	2	2	2	2	2	2	2	2
Building and equipment	350	350	350	350	350	350	350	350	350	350	350	350
Less: Accumulated depreciation	–350	–350	–350	–350	–350	–350	–350	–350	–350	–350	–350	–350
Total assets	$294	$309	$324	$333	$364	$359	$380	$391	$395	$416	$434	$441
Liabilities												
Accounts payable	$66	$76	$83	$85	$102	$96	$100	$99	$95	$104	$109	$103
Capital	228	234	242	249	261	270	280	292	300	312	326	339
Total liabilities and equity	$294	$310	$325	$334	$363	$366	$380	$391	$395	$416	$435	$442

The first step in capital budgeting is to identify the cash flows that result from an investment. The in-flows, or returns as they are commonly called, are equal to net operating income before deduction of payments to the financing sources but after the deduction of applicable taxes and with depreciation added back, as represented by the following formula:

$$\text{Expected Returns} = X\,(1 - T) + \text{Depreciation}$$

X is equal to the net operating income and T is defined as the appropriate tax rate. An illustration follows.

John Wheatman is faced with a dilemma. He has two mutually exclusive projects, both of which require an outlay of $1000. The problem is that he can afford only one of the projects. After discussing the problem with his accountant, John discovered that the first step he needs to take is to determine the expected return on each project. In order to gather this information, he has studied the probable effect on the store's operations and has developed the data shown in table 9.7.

Table 9.7 provides a good illustration of the expected returns for John Wheatman's two projects. At this point, however, the cash in-flows of each year are shown without consideration of the time value of money. The cash out-flow is used to refer to the initial cash outlay that must be made in the beginning (the purchase price). When gathering data to estimate the cash flows over the life of a project, it is imperative to obtain reliable estimates of the savings and expenses associated with the project.

The principal objective of capital budgeting is to maximise the value of the firm. It is designed to answer two basic questions:

- Which of several mutually exclusive projects should be selected? (Mutually exclusive projects are alternative methods of doing the same job. If one method is chosen, the other methods will not be required.)
- How many projects, in total, should be selected?

The three most common methods used in capital budgeting are the **payback method**, the **net present value (NPV) method** and the **internal rate of return (IRR) method**. Each has certain advantages and disadvantages. In this section, the same proposal will be used under each method to more clearly illustrate each technique.

Payback

One of the easiest capital-budgeting techniques to understand is the payback method or, as it is sometimes called, the payback period. In this method the length of time required to 'pay back' the original investment is the determining criterion. The entrepreneur will select a maximum

TABLE 9.7: WHEATMAN'S MARKET: EXPECTED RETURN WORKSHEET

PROPOSAL A $(1 - T)$

YEAR	X	$(T = .40)$	$X(1 + T)$	DEPRECIATION	$X(1 - T)$ + DEPRECIATION
1	$500	$0.60	$ 300	$200	$500
2	333	0.60	200	200	400
3	167	0.60	100	200	300
4	–300	0.60	–180	200	20
5	–317	0.60	–190	200	10

PROPOSAL B $(1 - T)$

YEAR	X	$(T = .40)$	$X(1 - T)$	DEPRECIATION	$X(1 - T)$ + DEPRECIATION
1	–$167	$0.60	–$100	$200	$100
2	0	0.60	100	200	200
3	167	0.60	100	200	300
4	333	0.60	200	200	400
5	500	0.60	300	200	500

X = Anticipated change in net income
T = Applicable tax rate (.40)
Depreciation = Depreciation (computed on a straight-line basis) = Cost/Life = 1000/5

time frame for the payback period. Any project that requires a longer period will be rejected and projects that fall within the time frame will be accepted. Here is an example of the payback method used by Wheatman's Market:

John Wheatman has a decision to make. He would like to purchase a new cash register for his store but is unsure which of two proposals to accept. Each machine costs $1000. An analysis of the projected returns reveals the following information:

TABLE 9.8: WHEATMAN'S MARKET: ANALYSIS OF PROJECT RETURNS

YEAR	PROPOSAL A	PROPOSAL B
1	$500	$100
2	400	200
3	300	300
4	20	400
5	10	500

After careful consideration, John decides to use the payback method with a cut-off period of three years. In this case he discovers that Proposal A would pay back his investment in 2-1/3 years; $900 of the original investment will be paid back in the first two years and the last $100 in the third year. Proposal B, on the other hand, will require four years for its payback. Using the decision criterion of the shorter payback period, John chooses Proposal A and rejects Proposal B.

One of the problems with the payback method is that it ignores cash flows beyond the payback period. Thus, it is possible for the wrong decision to be made, especially in the case of an investment that has **hockey-stick growth**. Nevertheless, many companies, particularly entrepreneurial firms, continue to use this method for several reasons:

- it is very simple to use in comparison to other methods
- projects with a faster payback period normally have more favourable short-term effects on earnings
- if a firm is short on cash, it may prefer to use the payback method because it provides a faster return of funds.

Net present value

The net present value (NPV) method is a technique that helps to minimise some of the shortcomings of the payback method by recognising the future cash flows beyond the payback period. The concept works on the premise that a dollar today is worth more than a dollar in the future. How much more depends on the applicable cost of capital for the firm. The cost of capital is the rate used to adjust future cash flows to determine their value in present period terms. This procedure is referred to as discounting the future cash flows. The discounted cash value is determined by the present value of the cash flow.

To use this approach, the entrepreneur must find the present value of the expected net cash flows of the investment, discounted at the appropriate cost of capital and subtract from it the initial cost outlay of the project. The result is the net present value of the proposed project. Many financial accounting and finance textbooks have tables (called present value tables) that list the appropriate discount factors to multiply by the future cash flow to determine the present value. In addition, financial calculators are available that will compute the present value given the cost of capital, future cash flow and the year of the cash flow. Finally, given the appropriate data, electronic spreadsheet programs can be programmed to determine the present value. After the net present value has been calculated for all of the proposals, the entrepreneur can select the project with the highest net present value. Here is an example of the net present value method used by Wheatman's Market:

Not really satisfied with the results he has obtained from the payback method, John Wheatman has decided to use the net present value method to see what result it would produce. After conferring with his accountant, John learned that the cost of capital for his firm is 10 per cent.

He then prepared the information contained in table 9.9:

TABLE 9.9: **WHEATMAN'S MARKET: NET PRESENT VALUE**

PROPOSAL A

YEAR	CASH FLOW	DISCOUNT FACTOR	PRESENT VALUE
1	$500	0.9091	$454.55
2	400	0.8264	330.56
3	300	0.7513	225.39
4	20	0.6830	13.66
5	10	0.6209	6.21
			$1030.37
Less: Initial outlay			–1000.00
Net present value			$30.37

PROPOSAL B

YEAR	CASH FLOW	DISCOUNT FACTOR	PRESENT VALUE
1	$100	0.9091	$ 90.91
2	200	0.8264	165.28
3	300	0.7513	225.39
4	400	0.6830	273.20
5	500	0.6209	310.45
			$1065.23
Less: Initial outlay			–1000.00
Net present value			$65.23

Since Proposal B has the higher net present value, John selected Proposal B and rejected Proposal A.

Internal rate of return

A number that is of great significance to most entrepreneurs and investors is the return they are realising on their monetary investments. There's no point in putting in 26-hour days if the payback isn't adequate. The internal rate of return (IRR) method is similar to the net present value method in that the future cash flows are discounted. However, they are discounted at a rate that makes the net present value of the project equal to zero. This rate is referred to as the

THE INDIAN ENTREPRENEUR AND THE CUNNING NPV

ENTREPRENEURIAL EDGE

An Indian small business entrepreneur ran a small warehouse and a van for hire delivering raw material to a factory 20 kilometres away. His vehicle was reasonably new but to save money he had hired an old driver with defective vision who was working for half the salary of a regular driver. The driver could do only four trips a day covering 80 kilometres.

When he calculated his profits, the entrepreneur realised this income was not adequate for his survival and for his son's college education. He could not even maintain his vehicle properly and it was frequently breaking down. To make ends meet, he thought he had to sell the delivery business, fire the driver, sell off his vehicle, pay his son's college entrance fees and maintain his family by selling his wife's jewels and silver.

What price should he ask for the business? He decided he would take the earnings for the next few years, subtract the cost of running the vehicle and calculate the net present value (NPV) by discounting each year's earnings at around 10 per cent. Or was there another solution?

Ever the entrepreneur, he came up with a cunning plan. After some thought, he decided to fire his ageing driver and generously gave him a month's leave. He got the van tuned and repaired for better petrol consumption. Then he hired a competent driver at the full going rate and sent him on eight trips a day doing 160 kilometres of deliveries. After a fortnight he realised his earnings had gone up by two to three times because of more trips and fewer breakdowns. The service, the product and the vehicle were all the same but were operated differently.

He worked out NPV on the basis of the new earnings but with the same discount rate as before. The value was now three times higher. If he had sold it on his earlier calculations, some clever buyer would have got a bargain and benefited from the entrepreneur's first faulty calculation. Now with an efficient going concern, he could sell the delivery service and the vehicle at the higher price based on the new NPV. He was able to pay for his son's admission and also pay off some of his past debts.

Source: Adapted from 'How to polish & sell family silver', *Financial Express* (Mumbai), 29 August 2002.

internal rate of return of the project. The project with the highest internal rate of return is then selected. Thus a project that would be selected under the NPV method also would be selected under the IRR method.

Under the net present value method, it is quite simple to look up the appropriate discount factors in the present value tables. When using the internal rate of return concept, however, the entrepreneur must begin with a net present value of zero and work backward through the tables. Electronic calculators and spreadsheet programs are available that can determine the actual internal rate of return, given the cash flows, initial cash outlays and the appropriate cash-flow periods. The internal rate of return is essentially a percentage figure that relates to the money put into the investment and the cash flows that will be received from it. The purpose is to determine if the resulting number is greater than your cost of capital. Determining an appropriate discount rate, that is, cost of capital, can be very challenging for young firms with uncertain futures.

Here is an example of the internal rate of return method used by Wheatman's Market:

Having obtained different results from the payback period and the net present value method, John Wheatman is confused about which alternative to select. To alleviate this confusion, he has decided to use the internal rate of return to evaluate the two proposals and has decided that the project with the higher internal rate of return will be selected (after all, it would win two out of three times). Accordingly, he has prepared the following tables with the help of his calculator:

TABLE 9.10: WHEATMAN'S MARKET: INTERNAL RATE OF RETURN

PROPOSAL A (11.83% IRR)

YEAR	CASH FLOW	DISCOUNT FACTOR	PRESENT VALUE
1	$500	0.8942	$447.10
2	400	0.7996	319.84
3	300	0.7151	214.53
4	20	0.6394	12.80
5	10	0.5718	5.73
			$1000.00
Less: Initial outlay			–1000.00
Net present value			$0.00

PROPOSAL B (12.01% IRR)

YEAR	CASH FLOW	DISCOUNT FACTOR	PRESENT VALUE
1	$100	0.8928	$89.27
2	200	0.7971	159.42
3	300	0.7117	213.51
4	400	0.6354	254.15
5	500	0.5673	283.65
			$1000.00
Less: Initial outlay			–1000.00
Net present value			$0.00

Proposal B is selected because it has the higher internal rate of return. This conclusion supports the statement that the project with the higher net present value will also have the higher internal rate of return.

The Wheatman's Market examples illustrate the use of all three capital-budgeting methods. Even though Proposal A showed great value by the first method (payback), under the other two methods (net present value and internal rate of return) Proposal B surfaced as the better proposal. It is important for entrepreneurs to understand all three methods and to use the one that best fits their needs. If payback had been John Wheatman's only consideration, then Proposal A would have been selected. When future cash flows beyond payback are to be considered, the net present value and the internal rate of return are the methods to determine the best proposal.

The budgeting concepts discussed so far are extremely powerful planning tools. But how can entrepreneurs monitor their progress during the budget period? How can they use the information accumulated during the course of the business to help plan for future periods? Can this information be used for pricing decisions? The answer to the third question is 'yes', and the rest are answered in the following sections.

BREAK-EVEN ANALYSIS

In today's competitive marketplace, entrepreneurs need relevant, timely and accurate information that will enable them to price their products and services competitively and yet be able to earn a fair profit. **Break-even analysis** supplies this information.

Break-even point computation

Break-even analysis is a technique commonly used to assess expected product profitability. It helps determine how many units must be sold in order to break even at a particular selling price.

Contribution margin approach

A common approach to break-even analysis is the **contribution margin approach**. The contribution margin is the percentage of each sale that remains after the variable costs are subtracted. With this information, the entrepreneur can decide whether to add or subtract a product line, how to price a product or service and about how to structure sales commissions or bonuses. It starts by grouping together a business's fixed and variable costs.

John Wheatman wants to know for every dollar of sales, after the costs that were directly related to the sales were subtracted, how much remained to contribute toward paying for the direct costs and for profit.[5]

Here's an example of an income statement formatted to calculate the contribution margin:

TABLE 9.11: WHEATMAN'S MARKET: CONTRIBUTION MARGIN INCOME STATEMENT FOR 200X ($000)

Sales	$463
Less: Variable costs	
Cost of goods sold	$231
Sales commissions	$59
Delivery charges	$14
Total variable costs	$304
Contribution margin (34%)	$159
Less: Fixed costs	
Advertising	$2
Depreciation	$13
Insurance	$5
Payroll taxes	$8
Rent	$10
Utilities	$18
Wages	$40
Total fixed costs	$96
Net operating income	$66

Since the break-even point occurs where income equals expenses, the contribution margin approach formula is:

$$0 = (SP - VC)\,S - FC \text{ or } FC = (SP - VC)\,S$$

where:

SP = Unit selling price

VC = Variable costs per unit

S = Sales in units

FC = Fixed cost

Wheatman's contribution margin for the year was 34 per cent. This means that, for every dollar of sales, after the costs that were directly related to the sales were subtracted, 34 cents remained to contribute towards paying for the direct costs and for profit.

This model also can be used for profit planning by including the desired profit as part of the fixed cost.

Handling questionable costs

Although the contribution margin approach is adequate for situations in which costs can be broken down into fixed and variable components, some firms have expenses that are difficult to assign. For example, are repairs and maintenance expenses fixed or variable expenses? Can firms facing this type of problem use break-even analysis for profit planning? The answer is 'yes', thanks to a new technique designed specifically for entrepreneurial firms. This technique calculates break-even points under alternative assumptions of fixed or variable costs to see if a product's profitability is sensitive to cost behaviour.

The decision rules for this concept follow: If expected sales exceed the higher break-even point, then the product should be profitable, regardless of the other break-even point; if expected sales do not exceed the lower break-even point, then the product should be unprofitable. Only if expected sales are between the two break-even points is further investigation of the questionable costs' behaviour needed.[6]

The concept works by substituting the cost in question (QC) first as a fixed cost and then as a variable cost. The break-even formulas presented earlier would have to be modified to determine the break-even levels under the two assumptions. Under the fixed-cost assumption, the entrepreneur would use the following equation:

$$0 = (SP - VC)\,S - FC - QC$$

To calculate the break-even point assuming QC is variable, the following equation would be used:

$$0 = [SP - VC - (QC/U)]\,S - FC$$

U is the number of units for which the questionable cost normally would be appropriate. What the entrepreneur is determining is the appropriate unit cost that should be used if the cost is a variable cost. Given next is an example of how an entrepreneur could use the technique:

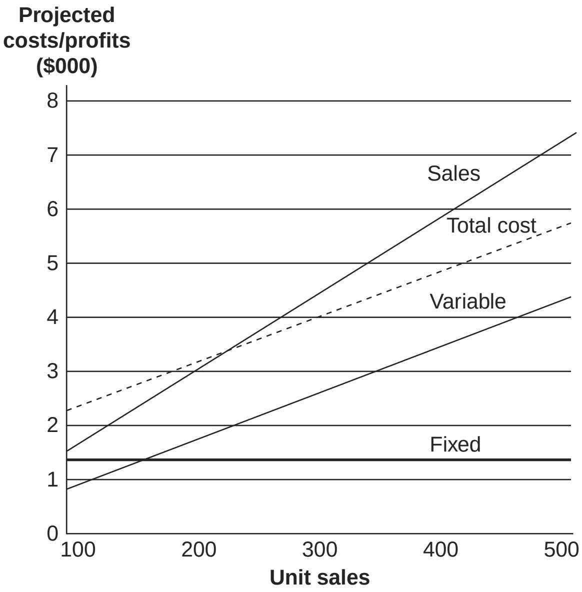
Tim Goodman, president of Goodman Industries, a small manufacturer of round widgets, has decided to use break-even analysis as a profit-planning tool for his company. He believes using this technique will enable his firm to compete more effectively in the marketplace. From an analysis of the operating costs, Tim has determined that the variable cost per unit is \$9, while fixed costs are estimated to be \$1200 per month. The anticipated selling price per unit is \$15. He also has discovered he is unable to classify one cost as either variable or fixed. It is a \$200 repair and maintenance expense allocation. This \$200 is appropriate for an activity level of 400 units; therefore, if the cost were variable, it would be \$0.50 per unit (\$200/400). Finally, sales are projected to be 400 units during the next budget period.

The first step in this process is to determine the break-even point assuming the cost in question is fixed. Consequently, Tim would use the following equation:

$$0 = (SC - VC)\,S - FC - QC$$

$$= (15 - 9)\,S - 1200 - 200$$

FIGURE 9.2 GOODMAN INDUSTRIES: FIXED-COST ASSUMPTION



$$= 6S - 1400$$

$$1400 = 6S$$

$$234 = S$$

Figure 9.2 provides a graphic illustration of the results. Notice that the final quantity was rounded up to the next unit, because a business normally will not sell part of a unit.

The next step in the process is to calculate the break-even point assuming the cost in question is a variable cost. Tim would use the following equation to ascertain the second break-even point:

$$0 = [SC - VC - (QC/U)]\ S - FC$$

$$= [15 - 9 - (200/400)]\ S - 1,200$$

$$= (6 - .50)\ S - 1,200$$

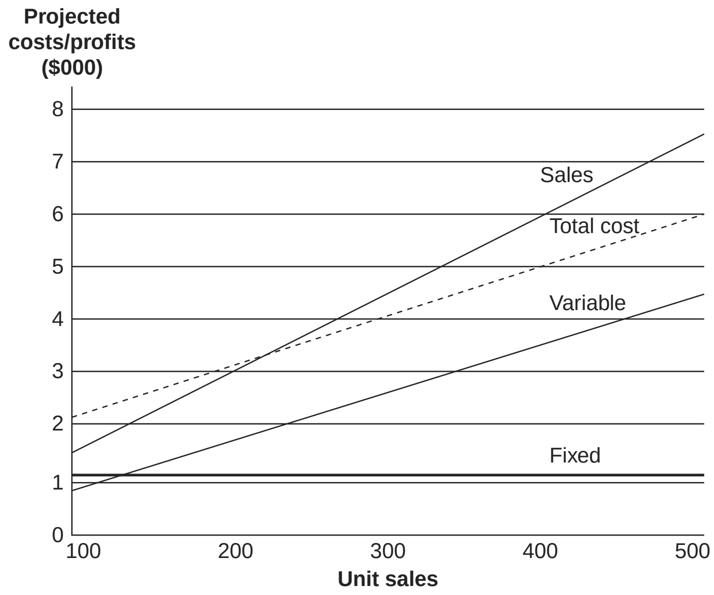
$$1,200 = 5.50S$$

$$219 = S$$

Figure 9.3 presents a graphic illustration of the results.

Now that the two possible break-even points have been established, Tim must compare them to his projected sales. The variable-cost sales of 400 units are greater than the larger break-even point of 234 units. Therefore, the product is assumed to be profitable regardless of the cost behaviour of the repair and maintenance expense. It does not matter whether the cost is variable or fixed; the firm will still be profitable.

FIGURE 9.3 GOODMAN INDUSTRIES: VARIABLE-COST ASSUMPTION



RATIO ANALYSIS

Financial statements report both on a firm's position at a point in time and on its operations over some past period. However, the real value of financial statements lies in the fact that they can be used to help predict the firm's earnings and dividends. From an investor's standpoint, predicting the future is what financial statement analysis is all about; from an entrepreneur's standpoint, financial statement analysis is useful as a way to assess financial wealth, assess trends in profitability and liquidity and, most importantly, as a starting point for planning actions that will influence the course of events.

An analysis of the firm's ratios is generally the key step in a financial analysis. The ratios are designed to show relationships among financial statement accounts. For example, Firm A might have a debt of $6 250 000 and interest charges of $520 000, while Firm B might have a debt of $62 800 000 and interest charges of $5 840 000. Which company is stronger? The true burden of these debts and the companies' ability to repay them, can be ascertained

- by comparing each firm's debt to its assets
- by comparing the interest each must pay to the income it has available for interest payment.

Such comparisons are made by ratio analysis.[7]

Table 9.12 lists **financial ratios**. It has been prepared as an entrepreneur's guide to understanding the various ratios. Note that this outline presents the ratio's importance to owners, managers and creditors. More important than the simple calculation of formulas are the categories that explain what each ratio measures and what each ratio tells an entrepreneur.

Ratio analysis can be applied from two directions. **Vertical analysis** is the application of ratio analysis to one set of financial statements. Here, an analysis 'up and down' the statements is done to find signs of strengths and weaknesses. **Horizontal analysis** looks at financial statements

TABLE 9.12: FINANCIAL RATIOS

RATIO	FORMULA	WHAT IT MEASURES	WHAT IT TELLS YOU
Owners			
Return on investment (ROI)	(Net income)/(Average owner's equity)	Return on owner's capital When compared with return on assets, it measures the extent financial leverage is being used for or against the owner	How well is this company doing as an investment?
Return on assets (ROA)	(Net income)/(Average total assets)	How well assets have been employed by management	How well has management employed company assets? Does it pay to borrow?
Managers			
Net profit margin	(Net income)/(Sales)	Operating efficiency The ability to create sufficient profits from operating activities	Are profits high enough, given the level of sales?
Asset turnover	(Sales)/(Average total assets)	Relative efficiency in using total resources to produce output	How well are assets being used to generate sales revenue?
Return on assets	(Net income)/(Sales) × (Sales)/(Total assets)	Earning power on all assets ROA ratio broken into its logical parts Turnover and margin	How well has management employed company assets?
Average collection period	(Average accounts receivable)/(Annual credit sales) × 365	Liquidity of receivables in terms of average number of days receivables are outstanding	Are receivables coming in too slowly?
Inventory turnover	(Cost of goods sold expense)/(Average inventory)	Liquidity of inventory The number of times it turns over per year	Is too much cash tied up in inventories?
Average age of payables	(Average accounts payable)/(Net purchases) × 365	Approximate length of time a firm takes to pay its bills for trade purchases	How quickly does a prospective customer pay its bills?
Short-term creditors			
Working capital	Current assets – Current liabilities	Short-term debt-paying ability	Does this customer have sufficient cash or other liquid assets to cover its short-term obligations?
Current ratio	(Current assets)/(Current liabilities)	Short-term debt-paying ability without regard to the liquidity of current assets	Does this customer have sufficient cash or other liquid assets to cover its short-term obligations?
Quick ratio	Cash + Marketable securities + (Accounts receivable)/(Current liabilities)	Short-term debt-paying ability without having to rely on inventory sales	Does this customer have sufficient cash or other liquid assets to cover its short-term obligations?
Long-term creditors			
Debt-to-equity ratio	(Total debt)/(Total equity)	Amount of assets creditors provide for each dollar of assets the owners provide	Is the company's debt load excessive?
Times interest earned	Net income + (Interest + taxes)/(Interest expense)	Ability to pay fixed charges for interest from operating profits	Are earnings and cash flows sufficient to cover interest payments and some principal repayments?
Cash flow to liabilities	(Operating cash flow)/(Total liabilities)	Total debt coverage General debt-paying ability	Are earnings and cash flows sufficient to cover interest payments and some principal repayments?

ENTREPRENEURSHIP IN PRACTICE

IMPORTANT RATIOS FOR ENTREPRENEURS

TABLE 9.13: IMPORTANT RATIOS

RATIO NAME	HOW TO CALCULATE	WHAT IT MEANS IN DOLLARS AND CENTS
Balance sheet ratios		
Current	(Current assets)/(Current liabilities)	Measures solvency – the number of dollars in current assets for every $1 in current liabilities Example: A current ratio of 1.76 means that for every $1 of current liabilities, the firm has $1.76 in current assets with which to pay it
Quick	Cash + (Accounts receivable)/(Current liabilities)	Measures liquidity – the number of dollars in cash and accounts receivable for each $1 in current liabilities Example: A quick ratio of 1.14 means that for every $1 of current liabilities, the firm has $1.14 in cash and accounts receivable with which to pay it
Cash	(Cash)/(Current liabilities)	Measures liquidity more strictly – the number of dollars in cash for every $1 in current liabilities Example: A cash ratio of 0.17 means that for every $1 of current liabilities, the firm has $0.17 in cash with which to pay it
Debt-to-worth	(Total liabilities)/(Net worth)	Measures financial risk – the number of dollars of debt owed for every $1 in net worth Example: A debt-to-worth ratio of 1.05 means that for every $1 of net worth the owners have invested, the firm owes $1.05 of debt to its creditors
Income statement ratios		
Gross margin	(Gross margin)/(Sales)	Measures profitability at the gross profit level – the number of dollars of gross margin produced for every $1 of sales Example: A gross margin ratio of 34.4% means that for every $1 of sales, the firm produces 34.4c of gross margin
Net margin	(Net profit before tax)/(Sales)	Measures profitability at the net profit level – the number of dollars of net profit produced for every $1 of sales Example: A net margin ratio of 2.9% means that for every $1 of sales, the firm produces 2.9c of net margin
Overall efficiency ratios		
Sales-to-assets	(Sales)/(Total assets)	Measures the efficiency of total assets in generating sales – the number of dollars in sales produced for every $1 invested in total assets Example: A sales-to-assets ratio of 2.35 means that for every $1 invested in total assets, the firm generates $2.35 in sales
Return on assets	(Net profit before tax)/(Total assets)	Measures the efficiency of total assets in generating net profit – the number of dollars in net profit produced for every $1 invested in total assets Example: A return on assets ratio of 7.1% means that for every $1 invested in assets, the firm is generating 7.1c in net profit before tax
Return on investment	(Net profit before tax)/(Net worth)	Measures the efficiency of net worth in generating net profit – the number of dollars in net profit produced for every $1 invested in net worth Example: A return on investment ratio of 16.1% means that for every $1 invested in net worth, the firm is generating 16.1c in net profit before tax
Specific efficiency ratios		
Inventory turnover	(Cost of goods sold)/(Inventory)	Measures the rate at which inventory is being used on an annual basis Example: An inventory turnover ratio of 9.81 means that the average dollar volume of inventory is used up almost 10 times during the fiscal year

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Inventory turn-days	360/(Inventory turnover)	Converts the inventory turnover ratio into an average 'days inventory on hand' figure Example: An inventory turn-days ratio of 37 means that the firm keeps an average of 37 days of inventory on hand throughout the year
Accounts receivable turnover	(Sales)/(Accounts receivable)	Measures the rate at which accounts receivable are being collected on an annual basis Example: An accounts receivable turnover ratio of 8.00 means that the average dollar volume of accounts receivable is collected eight times during the year
Average collection period	360/(Accounts receivable turnover)	Converts the accounts receivable turnover ratio into the average number of days the firm must wait for its accounts receivable to be paid Example: An average collection period ratio of 45 means that it takes the firm 45 days on average to collect its receivables
Accounts payable turnover	(Cost of goods sold)/(Accounts payable)	Measures the rate at which accounts payable are being paid on an annual basis Example: An accounts payable turnover ratio of 12.04 means that the average dollar volume of accounts payable is paid about 12 times during the year
Average payment period	360/(Accounts payable turnover)	Converts the accounts payable turnover ratio into the average number of days a firm takes to pay its accounts payable Example: An accounts payable turnover ratio of 30 means that it takes the firm 30 days on average to pay its bills

Source: Andrea Biancalani On-line, 'Financial ratio analysis' [www.andreabiancalani.it/fin1.htm].

and ratios over time. In horizontal analysis, the trends are critical: Are the numbers increasing or decreasing? Are particular components of the company's financial position getting better or worse?[8]

DECISION SUPPORT SYSTEMS

A **decision support system (DSS)** is a computer-based software program that aids entrepreneurs and business managers in decision-making tasks. These programs are best typified by the 'what-if analysis' that is a function of spreadsheet software and will be used to help students gather information and examine business-planning decisions. Computer-based decision support system tools add a new dimension to the analysis of pro forma financial statements and break-even points.[9] Management information that was previously beyond the reach of the entrepreneur now can be readily synthesised to aid in evaluating the effects of various conditions on, for example, a business cash lifeline or in comparing alternative investments.

A decision support system can facilitate the financial planning process through the use of integrated pro forma financial statements and the generation of alternatives that can be quickly explored. This technique allows the entrepreneur to specify the desired minimum cash balance and determine the minimum level of sales to meet this requirement for all periods of the business plan or for the budget period. In addition, net income can be calculated at various points to see how it compares with the targeted profits. If a conflict does exist between the targeted net income and the generated minimum cash-balance profits, the manager can easily rerun the model, modifying some of the variables, such as borrowings, sales and expenses. Finally, the entrepreneur can use the decision support system to perform a sensitivity analysis for other levels of sales and expenses. Armed with this information, the individual can formulate a plan of action based on a more complete view of the financial characteristics and interactions of the business.[10]

SUMMARY

At a minimum, budding entrepreneurs must have an understanding of working capital, revenue, gross profit, expenses and profit margins.

Three principal financial statements are important to entrepreneurs: the income statement, the balance sheet and the cash-flow statement. The budgeting process facilitates financial statement preparation. Some key budget forecasts that entrepreneurs should prepare are the operating budget, the cash-flow budget and the capital budget. The operating budget typically has various kinds of forecasts, such as sales expense, production and operating forecasts. A cash-flow budget provides an overview of the in-flows and out-flows of cash during a specific period. Pro forma financial statements then are prepared as projections of the firm's financial position over a future period (pro forma income statement) or on a future date (pro forma balance sheet). The operating and cash-flow budgets often are used to prepare these pro forma statements. The capital budget is used to help entrepreneurs make investment decisions. The three most common methods of capital budgeting are the payback method, the net present value method and the internal rate of return method.

Another commonly used decision-making tool is break-even analysis, which tells how many units must be sold in order to break even at a particular selling price. It is possible to use this analysis even when fixed or variable costs can only be estimated. Ratio analysis can be a helpful analytical tool for entrepreneurs. Ratios are designed to show relationships between financial statement accounts.

The last part of the chapter examined decision support systems. Computer-based decision support system tools are adding a new dimension to the analysis of pro forma financial statements and break-even points and are helping entrepreneurs deal more effectively with financial decision making.

KEY TERMS AND CONCEPTS

assets
balance sheet
break-even analysis
capital budgeting
capital
cash flow
cash-flow budget
contribution margin approach
cost of goods sold (COGS)
current assets
current liabilities
decision support system (DSS)
depreciation
equity
expenses
financial ratios
financial statement
fixed cost
gross profit
hockey-stick growth
horizontal analysis
income statement
interest
internal rate of return (IRR) method
liabilities
linear regression
net present value (NPV) method
net profit
net worth
operating budget
payback method
pro forma statements
profit and loss statements
sales forecasts
variable cost
vertical analysis
working capital

REVIEW AND DISCUSSION QUESTIONS

1. What is the importance of financial information for entrepreneurs? Briefly describe the key components.
2. What are the benefits of the budgeting process?
3. How is the statistical forecasting technique of simple linear regression used in making a sales forecast?
4. Describe how an operating budget is constructed.
5. Describe how a cash-flow budget is constructed.
6. What are pro forma statements? How are they constructed? Be complete in your answer.

7. Describe how a capital budget is constructed.
8. One of the most popular capital-budgeting techniques is the payback method. How does this method work? Give an example.
9. Describe the net present value method. When would an entrepreneur use this method? Why? Make up an example similar to the Indian entrepreneur.
10. Describe the internal rate of return method. When would an entrepreneur use this method? Why?
11. When would an entrepreneur be interested in break-even analysis?
12. If an entrepreneur wants to use break-even analysis but has trouble assigning some costs as either fixed or variable, can break-even analysis still be used? Explain.
13. What is ratio analysis? How is horizontal analysis different from vertical analysis?
14. What is a decision support system? How can it be of value in helping entrepreneurs manage their financial resources?

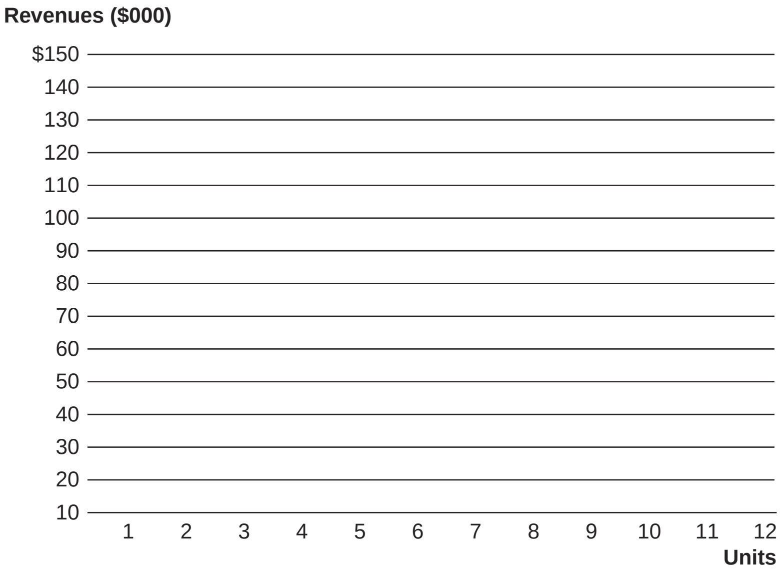
EXPERIENTIAL EXERCISE

THE PROJECT PROPOSAL

Bill Sergent has just received a request for a proposal from a large computer firm. The firm is looking for a supplier to provide it with high-tech components for a supercomputer being built for the Department of Defence. Bill's firm, which is only eight months old, was founded by a group of scientists and engineers whose primary expertise is in the area of computers and high technology. Bill is thinking about making a reply to the request for proposal, but first he wants to conduct a break-even analysis to determine how profitable the venture will be. Here is the information he will be using in his analysis:

- The computer firm wants 12 different components built and the purchase price will be $10 000 per component.
- The total cost of building the first component will be $20 000.
- The cost of building each of the 11 other components will be $8000, $6000, $5000, $4000, $5000, $6000, $8000, $10 000, $28 000, $40 000 and $40 000, respectively.
- Bill's company will not accept any proposal that will give it less than a 10 per cent return on sales.

On the basis of this information, complete the following break-even chart and then answer the two questions.



1. Should Bill bid on the contract? Why or why not?
2. If Bill has some room for negotiation with the computer firm, what would you recommend he do? Why?

CASE 9.1:
IT'S ALL GREEK TO HER

When Regina McDermott opened her car repair shop in Melbourne, she thought her 15 years of experience with cars was all she would need. To a degree she was right. Within six months her shop had more work than it could handle, thanks to her widening reputation. At the same time, however, Regina has found it necessary to spend more and more time dealing with financial planning.

Three weeks ago her accountant came to see her to discuss finance-related matters. One of these is the need for cash budgeting. 'I can work up a cash budget for you', he explained. 'However, I think you should understand what I'm doing so you will realise the importance of the cash budget and be able to visualise your cash in-flows and out-flows. I think you also need to make a decision regarding the new equipment you are planning to purchase. This machinery is state of the art, but, as we discussed last week, you can buy a number of different types of machinery. You are going to have to decide which is the best choice'.

Regina explained to her accountant that she was indifferent about which equipment to buy. 'All of this machinery is good. Perhaps I should purchase the cheapest'. At this point the accountant explained to her that she could use a number of ways to evaluate this type of decision. 'You can base your choice on the payback method – how long it takes to recover your investment in each of these pieces of equipment. You can base it on net present value by discounting future cash flows to the present. Or you can base it on internal rate of return, under which the cash flows are discounted at a rate that makes the net present value of the project equal to zero'.

Regina listened quietly and when the accountant was finished, she told him, 'Let me think about the various ways of evaluating my capital investment and I'll get back to you. Then, perhaps, you and I can work out the numbers together'. Her accountant said this sounded fine to him and he left. Regina began to wish she had taken more accounting courses while in college. As she explained to her husband, 'When the accountant begins to talk, it's all Greek to me'.

QUESTIONS

1. What is the purpose of a cash-flow budget? What does it reveal? Of what value would it be to Regina?
2. How does the payback method work? How does the net present value method work? How would you explain each of these methods to Regina?
3. How does the internal rate of return method work? How would you explain it to Regina?

CASE 9.2:
THE CONTRACT PROPOSAL

Dennis Darby owns a small manufacturing firm that produces electronic components for use in helicopters. Most of his business is a result of military and aircraft manufacturer contracts, although 10 per cent of revenues come from firms that own or rent helicopters. The latter are typically large companies or leasing/rental firms that work on a contractual basis for clients.

Dennis would like to increase his revenues from sales to private corporations that own their own helicopters. Specifically, he would like to do more business with oil companies that maintain helicopter fleets for ferrying people to and from oil rigs in the Timor Sea off Darwin and other offshore locations. Early this week, Dennis received a request from an oil company for 120 electronic components. He turned the order over to his chief estimator, who estimates that the fixed costs associated with producing these components will be $35 000, the unit variable cost will be $400 and the unit selling price will be $800.

Dennis will not accept any order on which the return on sales is less than 20 per cent. Additionally, the estimator has told him that a $1000 expense can be classified as either fixed or variable. Dennis intends to take this information and make a decision whether to accept the contract from the oil company. He has to make a decision within the next three days.

QUESTIONS

1. What is the break-even point for this project? Will the company make money if it manufactures the components? Show your calculations.
2. If the project will be profitable, will it provide Dennis with the desired 20 per cent return? Explain.
3. Of what value is break-even analysis to Dennis? Be complete in your answer.

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Ginny's Restaurant

Publication date: 8 March 2001
Revision date: 15 August 2001
Author(s): Mark Mitchell
Product number: 9-201-099

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Note on Low-Tech Marketing Math

Publication date: 17 December 1998
Author(s): Robert J. Dolan
Product number: 9-599-011

Describes basic calculations useful in marketing analysis, break-even analysis and price-volume relationships.

Signature Security: Providing Alarm Systems for the Countries Down Under

Publication date: 7 February 2000
Revision date: 31 March 2004
Author(s): William J. Coughlin, Walter Kuemmerle
Product number: 9-800-254

Signature Security, an entrepreneurial company, was created to roll up the electronic security industry in Australia and New Zealand. Twenty-six months after the original investment, some of the parties in the deal are reassessing their position.

ENDNOTES

1 James McNeill Stancill, 'Managing financial statements: Image and effect' *Harvard Business Review* (March/April 1981): 180.

2 For further in-depth exploration of this topic, see K.R. Allen, *Growing and Managing An Entrepreneurial Business*, (Boston: Houghton Mifflin Co, 1999); T. Burns, *Entrepreneurship.com*, (Chicago, IL: Dearborn Trade, 2001); E.C. Meyer and K.R. Allen, *Entrepreneurship and Small Business Management*, (Mission Hills, Calif: Glencoe, 1994); S. Rogers and R. Makonnen, *The Entrepreneur's Guide to Finance and Business Wealth Creation Techniques for Growing a Business*, (New York: McGraw-Hill, 2003); D.E. Vaughn, *Financial Planning for the Entrepreneur: Notes, Profiles, Cases* (Upper Saddle River, NJ: Prentice Hall, 1997); T. Zimmerer and N.M. Scarborough, *Essentials of Entrepreneurship and Small Business Management* 4th edn (Upper Saddle River, NJ: Pearson/Prentice Hall, 2005).

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6 Kenneth P. Sinclair and James A. Talbott, Jr, 'Using break-even analysis when cost behavior is unknown', *Management Accounting* (July 1986): 53. See also Billie M. Cunningham, Loren A. Nikolai and John D. Bazley, *Accounting: Information for Business Decisions* (Fort Worth, TX: The Dryden Press, 2000): 70–4.

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9 Roger L. Hayen, 'Applying decision support systems to small business financial planning', *Journal of Small Business Management* (July 1982): 35. See also Frederic J. Herbert and John H. Bradley, 'Expert systems development in small business: A managerial perspective', *Journal of Small Business Management* (July 1993): 23–34.

10 Hayen, 'Applying decision support systems to small business financial planning', 36.

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10

DEVELOPING AN EFFECTIVE BUSINESS PLAN

> The business plan as conceived and used by many entrepreneurs is passé. It has been corrupted to the point that it is over-emphasised by entrepreneurs and under-utilised by investors. This isn't to say that entrepreneurs should discontinue writing business plans and that investors don't care at all about written plans … Business plans are the equivalent of 'intellectual push-ups'. Nice exercise, but not necessarily relevant to anything in the real world.
>
> David E. Gumpert, best selling author on business planning.[1]

CHAPTER OBJECTIVES

1 To examine the critical factors that should be addressed in planning

2 To explore the planning pitfalls that plague many new ventures

3 To outline the importance of a business plan and describe the benefits derived from it

4 To set forth the viewpoints of those who read a business plan and describe the six steps followed in the reading process

5 To emphasise the importance of coordinating the business plan segments

6 To review key recommendations by venture capital experts for the development of a plan

7 To present a complete outline of an effective business plan and a discussion of each segment

8 To present some helpful hints for writing an effective business plan

9 To highlight points to remember in the presentation of a business plan

WHAT IS A BUSINESS PLAN?

We'll return to David Gumpert's challenging comments (see quote above) at the end of this chapter. Suffice it to say now that he means no business plan will help an entrepreneur who doesn't have sales, who doesn't have a website and who hasn't otherwise attracted investor attention.

Good planning is essential to the success of any undertaking. Planning entails the formulation of goals and directions for the future of a venture.[2] Several critical factors must be addressed when planning:

- realistic goals – these must be specific, measurable and set within time parameters
- commitment – the venture must be supported by all involved – family, partners, employees, team members
- milestones – subgoals must be set for continual and timely evaluation of progress
- flexibility – obstacles must be anticipated and alternative strategies must be formulated.

The comprehensive business plan, which should be the result of meetings and reflections on the direction of the new venture, is the major tool for determining the essential operation of a venture. It also is the primary document for managing the venture. One of the major benefits of this plan is that it helps the enterprise avoid common pitfalls that often undo all previous efforts. The following section describes these pitfalls.

A **business plan** is the written document that details the proposed venture. It must describe current status, expected needs and projected results of the new business.[3] Every aspect of the venture needs to be covered: the project, marketing, research and development, manufacturing, management, critical risks, financing and milestones or a timetable. A description of all of these facets of the proposed venture is necessary to demonstrate a clear picture of what that venture is, where it is projected to go and how the entrepreneur proposes it will get there. The business plan is the entrepreneur's roadmap for a successful enterprise.[4]

In some professional areas the business plan is referred to as a venture plan, a loan proposal, or an investment prospectus. Whatever the name, the business plan is the minimum document required by any financial source. The business plan allows the entrepreneur entrance into the investment process. Although it should be used as a working document once the venture is established, the major thrust of the business plan is to encapsulate the strategic development of the project in a comprehensive document for outside investors to read and understand.

The business plan describes to investors and financial sources all of the events that may affect the proposed venture. Details are needed for various projected actions of the venture, with associated revenues and costs outlined. It is vital to explicitly state the assumptions on which the plan is based. For example, increases/decreases in the market or upswings/downswings in the economy during the start-up period of the new venture should be stated.

The emphasis of the business plan always should be the final implementation of the venture. In other words, it's not just the writing of an effective plan that is important but also the translation of that plan into a successful enterprise.[5]

BENEFITS OF A BUSINESS PLAN

The entire business planning process forces the entrepreneur to analyse all aspects of the venture and to prepare an effective strategy to deal with the uncertainties that arise. Thus a business plan may help an entrepreneur avoid a project doomed to failure. As one researcher states:

> If your proposed venture is marginal at best, the business plan will show you why and may help you avoid paying the high tuition of business failure. It is far cheaper not to

ASIA–PACIFIC RESOURCES ON BUSINESS PLANNING

ENTREPRENEURSHIP
IN PRACTICE

- Australian Venture Capital Association Limited [www.avcal.com.au] > I Need Venture Capital > VC & How to get it > The business plan
- Business Town [www.business.gov.sg]. One of its resources is the Start-up eAdvisor, a website which tells you how to start a business in Singapore.
- Business.Gov.Au [www.business.gov.au] > How-to guides > Thinking of starting a business
- New Zealand Trade and Enterprise, Investment Ready Guide [www.escalator.co.nz]
- G. Senior and I. McBride, *Small Business Survival Tactics* (Christchurch, NZ: Enterprise Publications) [books@worksmart.co.nz]
- Graeme Ryan, *Business Planning Handbook* (Melbourne, Aust: Ryan Publishing) ISBN: 1 876498 00 5 [www.ryanpub.com.au/bph.htm]
- New Zealand Trade and Enterprise, *Planning for Success – a Do it Yourself Kit for Developing Your Own Business Plan*, 4th edn, 2005 ISBN 0-478-25445-8 [www.nzte.govt.nz/section/14189/12931.aspx]
- Peter Switzer and Maureen Jordan, *Small Business Start-up Guide: Secrets for Success* (Sydney, Aust: Allen & Unwin: 2002) ISBN 1865086444
- Small Business Counselling Service [www.sbcs.org.au] > Start-up Businesses > Business Plan Guide
- Women in Small Business Information Site [www.wisbis.qut.edu.au] > Contents > Search by Category > Starting A Business

> begin an ill-fated business than to learn by experience what your business plan could have taught you at a cost of several hours of concentrated work.[6]

It is important that entrepreneurs prepare their own business plan. If an entrepreneurial team is involved, then all of the key members should be part of writing the plan; in this case it is important that the lead entrepreneur understands the contribution of each team member. If consultants are sought to help prepare a business plan, the entrepreneur must remain the driving force behind the plan. Seeking the advice and assistance of outside professionals is always wise, but entrepreneurs need to understand every aspect of the business plan, since it is they who come under the scrutiny of financial sources. Thus the business plan stands as the entrepreneur's description and prediction for their venture and it must be defended by the entrepreneur – simply put, it is the entrepreneur's responsibility.[7]

Other benefits are derived from a business plan for both the entrepreneur and the financial sources that read it and evaluate the venture. Specifically for the entrepreneur, the following benefits are gained:

- The time, effort, research and discipline needed to put together a formal business plan force the entrepreneur to view the venture critically and objectively.
- The competitive, economic and financial analyses included in the business plan subject the entrepreneur to close scrutiny of their assumptions about the venture's success.
- Since all aspects of the business venture must be addressed in the plan, the entrepreneur develops and examines operating strategies and expected results for outside evaluators.
- The business plan quantifies objectives, providing measurable benchmarks for comparing forecasts with actual results.
- The completed business plan provides the entrepreneur with a communication tool for outside financial sources (for example, banks, business angels, venture capital fund

managers, equity investors, etc.) as well as an operational tool for guiding the venture towards success.[8]

The financial sources that read the plan derive the following benefits from the business plan:

- The business plan provides for financial sources the details of the market potential and plans for securing a share of that market.
- Through prospective financial statements, the business plan illustrates the venture's ability to service debt or provide an adequate return on equity.
- The plan identifies critical risks and crucial events with a discussion of contingency plans that provide opportunity for the venture's success.
- By providing a comprehensive overview of the entire operation, the business plan gives financial sources a clear, concise document that contains the necessary information for a thorough business and financial evaluation.
- For a financial source with no prior knowledge of the entrepreneur or the venture, the business plan provides a useful guide for assessing the individual entrepreneur's planning and managerial ability.[9]

PITFALLS TO AVOID IN PLANNING

A number of pitfalls in the business plan process should be avoided. The five pitfalls presented in this section represent the most common errors committed by entrepreneurs. To make these danger areas more easily recognisable, certain indicators or warning signs are presented. Each pitfall then has a possible solution introduced that will help entrepreneurs avoid the particular trap that limits a new venture's opportunity to succeed.

Pitfall 1: No realistic goals

Although this pitfall may sound self-explanatory, the following indicators demonstrate how common and well disguised it can be:

- lack of any attainable goals
- lack of a time frame to accomplish things
- lack of priorities
- lack of action steps.

One way to avoid this pitfall is to set up a timetable with specific steps to be accomplished during a specific period.

Pitfall 2: Failure to anticipate roadblocks

One of the most common pitfalls occurs when the entrepreneur is so immersed in their idea that objectivity goes out of the window. In other words, the person does not recognise the possible problems that may arise. Indicators are no recognition of future problems, no admission of possible flaws or weaknesses in the plan and no contingency or alternative plans. The best way to avoid this pitfall is to:

- list the possible obstacles that may arise
- list the alternatives that state what might have to be done to overcome the obstacles.

Pitfall 3: No commitment or dedication

Too many entrepreneurs appear to lack real commitment to their ventures. Although ventures may have started from a hobby or part-time endeavour, entrepreneurs must be careful to avoid the impression that they do not take their ventures seriously. Indicators are excessive procrastination, missed appointments, no desire to invest personal money and appearance of making a ‘fast buck’ from a hobby or a ‘whim’. The easiest way to avoid this pitfall is to act quickly and to be sure to follow up all professional appointments. Also, be ready and willing to demonstrate a financial commitment to the venture.

Pitfall 4: Lack of demonstrated experience (business or technical)

Since many investors weigh very heavily the entrepreneur’s actual experience in a venture, it is important that entrepreneurs demonstrate what background they possess. Because too many beginners attempt to promote ideas they really have no true knowledge of, they are doomed to fail simply because they are perceived as ignorant of the specifics in the proposed business. Indicators are no experience in business, no experience in the specific area of the venture, lack of understanding of the industry in which the venture fits and failure to convey a clear picture of how and why the venture will work and who will accept it. To avoid this pitfall, entrepreneurs need to give evidence of personal experience and background for this venture. If they lack specific knowledge or skills, they should obtain assistance from those who possess this knowledge or these skills. Demonstrating a team concept about those who will be helping out also may be useful.

Pitfall 5: No market niche (segment)

Many entrepreneurs propose an idea without establishing a **market niche** – who the potential customers will be. Just because the entrepreneur likes the product or service does not mean others will buy it. Numerous inventions at the US Patent Office never reached the marketplace because no customers were targeted to buy them – no market was ever established. Indicators are uncertainty about who will buy the basic idea(s) behind the venture, no proof of a need or desire for the good or product proposed and the assumption that customers or clients will purchase just because the entrepreneur thinks so. The best possible way to avoid this pitfall is to have a market segment specifically targeted and to demonstrate why and how the specific product or service will meet the needs or desires of this target group. (More specific information on market research was developed in chapter 8.)

The five pitfalls detailed here represent the most common points of failure entrepreneurs experience before their business plans ever get reviewed. In other words, these critical areas must be carefully addressed before developing a business plan. If these pitfalls can be avoided, then the entire business plan will be written more carefully and thus will be reviewed more thoroughly. This preparation helps entrepreneurs establish a solid foundation on which to develop an effective business plan.

DEVELOPING A WELL-CONCEIVED BUSINESS PLAN

Most investors agree that only a well-conceived and well-developed business plan can gather the necessary support that will eventually lead to financing. The business plan must describe the new venture with excitement and yet with complete accuracy.

Who reads the plan?

It is important to understand the audience for whom the business plan is written. Bankers, venture capital fund managers and business angels each have different criteria for assessment of the

ENTREPRENEURIAL EDGE

SCIENTISTS NEED BETTER BUSINESS PLANS

A huge capital venture firm is struggling to find winning business ideas that it can invest in from a cash pool soon to grow to $150m. BioPacificVentures (BPV) says the ideas are out there, but New Zealand and Australian scientists need to put more work into the pitching of their business plans.

Of 60 proposals to come across the company's table, 20 presentations were found wanting in detail. Another 15 'one-pager' submissions failed to even make the grade. Executive director Howard Moore said the venture capital group wanted to see detailed plans showing the strength of the management team behind the business idea. The 20 'below-par' proposals could still be revived with good business plans, he said. Scientists should obtain a business plan template and work hard to make it easier for venture capitalists such as BPV to assess its value, he said.

The fund is ready to begin investing mainly through an equity stake in life sciences – health, food and agriculture – in Australasia. Already $104m has been raised to make it the largest capital venture fund in New Zealand with another $50m expected by the end of the year. Investors in the 12-year fund include Nestlé, Wrightson, which has brought in $14m, ACC and entrepreneurs who have made their money and are looking to back other budding businesses.

Source: Tim Cronshaw, 'Firm struggles to find winning ideas', *Christchurch Press*, 4 June 2005.

proposal. Bankers stress the financial aspects of the proposal and give little emphasis to market, entrepreneur or other issues. Equity investors, venture capital fund managers and business angels emphasise market and finance issues. Business angels look at the entrepreneur and 'investor fit'. So entrepreneurs have customised their business plan accordingly.[10] Although numerous professionals may be involved with reading the business plan, such as venture capitalists, bankers, investors, potential large customers, lawyers, consultants and suppliers, entrepreneurs need to clearly understand three main viewpoints when preparing the plan.[11]

The first viewpoint is, of course, the entrepreneur's, since they are the ones developing the venture and clearly have the most in-depth knowledge of the technology or creativity involved. This is the most common viewpoint in business plans and it is essential. However, too many plans emphasise this viewpoint and neglect the viewpoints of potential customers and investors.

More important than high technology or creative flair is the marketability of a new venture. Referred to as 'market-driven', this type of enterprise convincingly demonstrates the benefits to users – the particular group of customers it is aiming for – and the existence of a substantial market. This is the second critical emphasis that an entrepreneur must incorporate into a business plan. Yet although the actual value of this information is considered high, too many entrepreneurs tend to de-emphasise in-depth marketing information in their business plans.[12] Establishing an actual market (determining who will buy the product or use the service) and documenting that the anticipated percentage of this market is appropriate for the venture's success are valuable components of the business plan.

The third viewpoint is related to the marketing emphasis just discussed. The investor's point of view is concentrated on the financial forecast. Sound financial projections are necessary if investors are to evaluate the worth of their investment. This is not to say an entrepreneur should fill the business plan with spreadsheets of figures. In fact, many venture capital firms employ a 'projection discount factor', which merely represents the belief of venture capitalists that successful new ventures usually reach approximately 50 per cent of their projected financial goals.[13] However, a three- to five-year financial projection is essential for investors to use in making their judgement of a venture's future success.

These three viewpoints have been presented in an order of decreasing significance to point out the emphasis needed in a well-conceived business plan. If they are addressed carefully in the plan, then the entrepreneur has prepared for what experts term the **five-minute reading**. The following six steps represent the typical business plan reading process many venture capitalists use (less than one minute is devoted to each step):

- **Step 1:** Determine the characteristics of the venture and its industry.
- **Step 2:** Determine the financial structure of the plan (amount of debt or equity investment required).
- **Step 3:** Read the latest balance sheet (to determine liquidity, net worth and debt/equity).
- **Step 4:** Determine the quality of entrepreneurs in the venture (sometimes the most important step).
- **Step 5:** Establish the unique feature in this venture (find out what is different).
- **Step 6:** Read the entire plan over lightly (this is when the entire package is paged through for a casual look at graphs, charts, exhibits and other plan components).[14]

These steps provide insight into how the average business plan is read. It appears somewhat unjust that so much of the entrepreneur's effort is put into a plan that is given only a five-minute reading. However, that's the nature of the process for many venture capitalists. Other financial or professional sources may devote more time to analysing the plan. But keep in mind that venture capitalists read through numerous business plans – thus, knowing the steps in their reading process is valuable for developing any plan. Related to this process of venture capitalists is a quote that links male entrepreneurs and venture capitalists: 'The men who manage men manage men who manage things, but the men who manage money manage the men who manage men'.[15]

Putting the package together

When presenting a business plan to potential investors, the entrepreneur must realise that the entire package is important. Presented next is a summary of key issues that the entrepreneur needs to watch for if the plan is going to be viewed successfully.

A business plan gives financiers their first impressions of a company and its principals. Potential investors expect the plan to look good, but not too good; to be the right length; to clearly and concisely explain early on all aspects of the company's business; and not to contain bad grammar and typographical or spelling errors.

Investors are looking for evidence that the principals treat their own property with care – and will likewise treat the investment carefully. In other words, form as well as content is important and investors know that good form reflects good content and vice versa.

Among the format issues we think most important are the following:[16]

- **Appearance:** The binding and printing must not be sloppy; neither should the presentation be too lavish. A stapled compilation of photocopied pages usually looks amateurish, while bookbinding with typeset pages may arouse concern about excessive and inappropriate spending. A plastic spiral binding holding together a pair of cover sheets of a single colour provides both a neat appearance and sufficient strength to withstand the handling of a number of people without damage.
- **Length:** A business plan should be no more than 50 pages long. The first draft will likely exceed that, but editing should produce a final version that fits within the 40-page ideal. Adherence to this length forces entrepreneurs to sharpen their ideas and results in a document likely to hold investors' attention.

Background details can be included in an additional volume. Entrepreneurs can make this material available to investors during the investigative period after the initial expression of interest.

- **The cover and title page:** The cover should bear the name of the company, its address and phone number and the month and year in which the plan is issued. Surprisingly, a large number of business plans are submitted to potential investors without return addresses or phone numbers. An interested investor wants to be able to contact a company easily and to request further information or express an interest, either in the company or in some aspect of the plan.

  Inside the front cover should be a well-designed title page on which the cover information is repeated and, in an upper or a lower corner, the legend 'Copy number' provided. Besides helping entrepreneurs keep track of plans in circulation, holding down the number of copies outstanding – usually to no more than 20 – has a psychological advantage. After all, no investor likes to think that the prospective investment is shop-worn.
- **The executive summary:** The two to three pages immediately following the title page should concisely explain the company's current status, its products or services, the benefits to customers, the financial forecasts, the venture's objectives in three to seven years, the amount of financing needed and how investors will benefit.

  This is a tall order for a two-page summary, but it will either sell investors on reading the rest of the plan or convince them to forget the whole thing.
- **The table of contents:** After the executive summary, include a well-designed table of contents. List each of the business plan's sections and mark the pages for each section.

An attractive appearance, an effective length, an executive summary, a table of contents, proper grammar, correct typing and a cover page – all are important factors when putting together a complete package. These points many times separate successful plans from unacceptable ones.

Guidelines to remember

The following points are a collection of recommendations by experts in venture capital and new-venture development.[17] These guidelines are presented as tips for successful business plan development. Entrepreneurs need to adhere to them in order to understand the importance of the various segments of a business plan they are creating, which will be discussed in the next section.

- **Keep the plan respectably short:** Readers of business plans are important people who refuse to waste time. Therefore entrepreneurs should explain the venture not only carefully and clearly but also concisely. (As indicated above, the plan should be an ideal 40 pages in length, and certainly no more than 50 pages, excluding the appendix.)
- **Organise and package the plan appropriately:** A table of contents, an executive summary, an appendix, exhibits, graphs, proper grammar, a logical arrangement of segments and overall neatness are elements critical to the effective presentation of a business plan.
- **Orient the plan towards the future:** Entrepreneurs should attempt to create an air of excitement in the plan by developing trends and forecasts that describe what the venture intends to do and what the opportunities are for the use of the product or service.
- **Avoid exaggeration:** Sales potentials, revenue estimates and the venture's potential growth should not be inflated. Many times a best-case, worst-case and probable-case

scenario should be developed for the plan. Documentation and research are vital to the plan's credibility. (See table 10.1 for business plan phrases.)

- **Highlight critical risks:** The critical-risks segment of the business plan is important in that it demonstrates the entrepreneur's ability to analyse potential problems and develop alternative courses of action.
- **Give evidence of an effective entrepreneurial team:** The management segment of the business plan should clearly identify the skills of each key person as well as demonstrate how all such persons can effectively work together as a team in managing the venture.
- **Do not over-diversify:** Focus the attention of the plan on one main opportunity for the venture. A new business should not attempt to create multiple markets or pursue multiple ventures until it has successfully developed one main strength.
- **Identify the target market:** Substantiate the marketability of the venture's product or service by identifying the particular customer niche being sought. This segment of the business plan is pivotal to the success of the other parts. Market research has to be included to demonstrate how this market segment has been identified.
- **Keep the plan written in the third person:** Rather than continually stating 'I', 'we', or 'us', the entrepreneur should phrase everything as 'they', or 'them'. In other words, avoid personalising the plan and keep the writing objective.
- **Capture the reader's interest:** Because of the numerous business plans submitted to investors and the small percentage of business plans funded, entrepreneurs need to capture the reader's interest right away by stating the uniqueness of the venture. Use the title page and executive summary as key tools for capturing the reader's attention and creating a desire to read more.

These guidelines are helpful for entrepreneurs preparing to write a business plan. The following section analyses the 10 major segments of a business plan.

ELEMENTS OF A BUSINESS PLAN

A detailed business plan usually has 10 sections. The ideal length of a plan is between 40 and 50 pages, although depending on the need for detail, the overall plan can range up to more than 100 pages (including appendix).[18] Figure 10.1 provides an outline of a typical plan. The remainder of this section describes the specific parts of the plan.

I: Executive summary

Many people who read business plans (bankers, venture capitalists, investors) like to see a summary of the plan that features its most important parts. Such a summary gives a brief overview of what is to follow, helps put all of the information into perspective and should be no longer than two to three pages. The summary should be written only after the entire business plan has been completed. In this way particular phrases or descriptions from each segment can be identified for inclusion in the summary. Since the summary is the first and sometimes the only, part of a plan read, it must present the quality of the entire report. The summary must be a clever snapshot of the complete plan.

The statements selected for a summary segment should briefly touch on the venture itself, the market opportunities, the financial needs and projections and any special research or technology associated with the venture. And this should be done in such a way that the evaluator or investor will choose to read on. If this information is not presented in a concise, competent manner, the reader may put aside the plan or simply conclude the project does not warrant funding.

TABLE 10.1: COMMON BUSINESS PLAN PHRASES: STATEMENT VERSUS REALITY

STATEMENT	REALITY
We conservatively project …	We read a book that said we had to be a $50 million company in five years and we reverse-engineered the numbers.
We took our best guess and divided by 2.	We accidentally divided by 0.5.
We project a 10 per cent margin.	We did not modify any of the assumptions in the business plan template that we downloaded from the Internet.
The project is 98 per cent complete.	To complete the remaining 2 per cent will take as long as it took to create the initial 98 per cent, but will cost twice as much.
Our business model is proven …	… if you take the evidence from the past week for the best of our 50 locations and extrapolate it for all the others.
We have a six-month lead.	We tried not to find out how many other people have a six-month lead.
We need only a 10 per cent market share.	So do the other 50 entrants getting funded.
Customers are clamouring for our product.	We have not yet asked them to pay for it. Also, all of our current customers are relatives.
We are the low-cost producer.	We have not produced anything yet, but we are confident that we will be able to.
We have no competition.	Only IBM, Microsoft, Netscape and Sun have announced plans to enter the business.
Our management team has a great deal of experience …	… consuming the product or service.
A select group of investors is considering the plan.	We mailed a copy of the plan to everyone in Pratt's Guide.
We seek a value-added investor.	We are looking for a passive, dumb-as-rocks investor.
If you invest on our terms, you will earn a 68 per cent internal rate of return.	If everything that could ever conceivably go right does go right, you might get your money back.

Source: Reprinted by permission of *Harvard Business Review*. Adapted from William A. Sahlman, 'How to write a great business plan', (July/August 1997): 106. Copyright © 1997 by the Harvard Business School Publishing Corporation; all rights reserved.

II: Business description

First, the name of the venture should be identified, with any special significance related (for example, family name, technical name). Second, the industry background should be presented in terms of current status and future trends. It is important to note any special industry developments that may affect the plan. If the company has an existing business or franchise, this is the appropriate place to discuss it. Third, the new venture should be thoroughly described along with its proposed potential. All key terms should be defined and made comprehensible. Functional specifications or descriptions should be provided. Drawings and photographs also may be included. Fourth, the potential advantages the new venture possesses over the competition should be discussed at length. This discussion may include patents, copyrights and trademarks, as well as special technological or market advantages.

III: Marketing

In the **marketing segment** of the plan the entrepreneur must convince investors that a market exists, that sales projections can be achieved and that the competition can be beaten.

FIGURE 10.1: **COMPLETE OUTLINE OF A BUSINESS PLAN**

Section I: Executive summary
Section II: Business description
  A General description of the business
  B Industry background
  C Goals and potential of the business and milestones (if any)
  D Uniqueness of product or service
Section III: Marketing
  A Research and analysis
    1 Target market (customers) identified
    2 Market size and trends
    3 Competition
    4 Estimated market share
  B Marketing plan
    1 Market strategy – sales and distribution
    2 Pricing
    3 Advertising and promotions
Section IV: Operations
  A Identify location
    1 Advantages
    2 Zoning
    3 Taxes
  B Proximity to supplies
  C Access to transportation
Section V: Management
  A Management team – key personnel
  B Legal structure – stock agreements, employment agreements, ownership
  C Board of directors, advisers, consultants
Section VI: Financial
  Financial forecast
    1 Profit and loss
    2 Cash flow
    3 Break-even analysis
    4 Cost controls
    5 Budgeting plans
Section VII: Critical risks
  A Potential problems
  B Obstacles and risks
  C Alternative courses of action
Section VIII: Harvest strategy
  A Transfer of assets
  B Continuity of business strategy
  C Identify successor
Section IX: Milestone schedule
  A Timing and objectives
  B Deadlines and milestones
  C Relationship of events
Section X: Appendix and/or bibliography

Source: Donald F. Kuratko, Ray V. Montagno and Frank J. Sabatine, *The Entrepreneurial Decision* (Muncie, IN: The Midwest Entrepreneurial Education Center, College of Business, Ball State University, 2002).

This part of the plan is often one of the most difficult to prepare. It is also one of the most critical because almost all subsequent sections of the plan depend on the sales estimates developed here. The projected sales levels, based on the market research and analysis, directly influence the size of the manufacturing operation, the marketing plan and the amount of debt and equity capital required.

Most entrepreneurs have difficulty preparing and presenting market research and analyses that will convince investors the venture's sales estimates are accurate and attainable. The following are aspects of marketing that should be addressed when developing a comprehensive exposition of the market.

The following (first) section of the marketing segment is applicable only if research and development is involved in the venture.

Research, design and development segment

The extent of any research, design and development in regard to cost, time and special testing should be covered in this segment. Investors need to know the status of the project in terms of prototypes, lab tests and scheduling delays.

In order to have a comprehensive section, the entrepreneur should have (or seek out) technical assistance in preparing a detailed discussion. Blueprints, sketches, drawings and models are often important.

It is equally important to identify the design or development work that still needs to be done and to discuss possible difficulties or risks that may delay or alter the project. In this regard, a developmental budget that shows the costs associated with labour, materials consulting, research, design and the like should be constructed and presented.

The next five subsets of the marketing segment are needed to detail the overall marketing plan, which should describe what is to be done, how it will be done and who will do it.

Market niche and market share

A market niche is a homogeneous group with common characteristics – that is, all the people who have a need for the newly proposed product or service. In describing this niche, the writer should address the bases of customer purchase decisions – price, quality, service, personal contacts, or some combination of these factors.

Next, a list of potential customers who have expressed interest in the product or service, together with an explanation for their interest, should be included. If it is an existing business, the current principal customers should be identified and the sales trend should be discussed. It is important to describe the overall potential of the market. Sales projections should be made for at least three years and the major factors affecting market growth (industry trends, socio-economic trends, governmental policy and population shifts) should be discussed. A review of previous market trends should be included and any differences between past and projected annual growth rates should be explained. The sources of all data and methods used to make projections should be indicated. Then, if any major customers are willing to make purchase commitments, they should be identified and the extent of those commitments should be indicated. On the basis of the product or service advantages, the market size and trends, the customers and the sales trends in prior years, the writer should estimate market share and sales in units and dollars for each of the next three years. The growth of the company's sales and its estimated market share should be related to the growth of the industry and the customer base.

Competitive analysis

The entrepreneur should make an attempt to assess the strengths and weaknesses of the competing products or services. Any sources used to evaluate the competition should be cited. This discussion should compare competing products or services on the basis of price, performance, service, warranties and other pertinent features. It should include a short discussion of the current advantages and disadvantages of competing products and services and why they are not meeting customer needs. Any knowledge of competitors' actions that could lead to new or improved products and an advantageous position also should be presented.

Finally, a review of competing companies should be included. Each competitor's share of the market, sales and distribution and production capabilities should be discussed. Attention should be focused on profitability and the profit trend of each competitor. Who is the pricing leader? Who is the quality leader? Who is gaining? Who is losing? Have any companies entered or dropped out of the market in recent years?

Marketing strategy

The general marketing philosophy and approach of the company should be outlined in the **marketing strategy**. The marketing strategy is a business's approach to marketing its products and services expressed in broad terms, which forms the basis for developing a marketing plan. Marketing research is the process of systematically gathering, analysing and interpreting data pertaining to the company's market, customers and competitors, with the goal of improving marketing decisions. Market research, the gathering and evaluation of data regarding consumers' preferences for products and services is a component of marketing research. The marketing philosophy and approach should be developed from market research and evaluation data and should include a discussion of:

- the kinds of customer groups to be targeted by the initial intensive selling effort
- the customer groups to be targeted for later selling efforts
- methods of identifying and contacting potential customers in these groups
- the features of the product or service (quality, price, delivery, warranty and so on) to be emphasised to generate sales
- any innovative or unusual marketing concepts that will enhance customer acceptance (for example, leasing where only sales were previously attempted).

This section also should indicate whether the product or service will initially be introduced nationally or regionally. Consideration also should be given to any seasonal trends and what can be done to promote contra-seasonal sales.

Pricing policy

The price must be 'right' in order to penetrate the market, maintain a market position and produce profits. In this discussion a number of pricing strategies should be examined and then one should be convincingly presented. This pricing policy should be compared with the policies of the major competitors. The gross profit margin between manufacturing and final sales costs should be discussed and consideration should be given as to whether this margin is large enough to allow for distribution, sales, warranty and service expenses; for amortisation of development and equipment costs; and for profit. Attention also should be given to justifying any price increases over competitive items on the basis of newness, quality, warranty, or service.

Advertising plan

For manufactured products, the preparation of product sheets and promotional literature, the plans for trade show participation, trade magazine advertisements, direct mailings and the use of

ENTREPRENEURSHIP IN PRACTICE

TIPS FOR THE ULTIMATE BUSINESS PLAN

To obtain financing for your business, you would rather:

1 jump out of an airplane
2 write a business plan.

More often than not, people will choose (1). As crazy as it sounds, potential entrepreneurs are frequently dismayed by the prospect of having to put together a plan and the accompanying financials. But when written well and as accurately as possible, business plans not only become key to obtaining financing, but also become the vehicle that drives the business throughout its start-up phase. A good plan enables the entrepreneur to target the right market, reduce risk and ultimately make the correct, informed decision.

WHY BUSINESS PLANS FAIL

>> The plan is constructed around strategies that are inaccurately defined.

>> The plan, while substantial, cannot be described clearly by management.

>> The plan lacks detailed information about job responsibilities and operating schedules.

>> The plan does not state goals and objectives lucidly and in professional terms.

>> The plan is incomplete.

BUSINESS PLAN DO'S AND DON'TS

>> Executive summary:
- Do: Get right to the point.
- Don't: Write more than a page and a half.

>> Management:
- Do: Play up your previous successes.
- Don't: Paper over the gaps in your team.

>> Marketing:
- Do: Send a product sample, if you can.
- Don't: Underprice your services because you failed to get good market data.

>> Financials:
- Do: Run cash-flow models at different growth rates.
- Don't: Inflate or understate your margins.

>> Overall:
- Do: Have a friend proofread your plan.
- Don't: Forget to use feedback.

Source: C. J. Prince, 'The ultimate business plan', *Success* (January 2000): 44–9.

advertising agencies, should be presented. For products and services in general, a discussion of the advertising and promotional campaign contemplated to introduce the product and the kind of sales aids to be provided to dealers should be included. Additionally, the schedule and cost of promotion and advertising should be presented and, if advertising will be a significant part of the expenses, an exhibit showing how and when these costs will be incurred should be included.

IV: Operations

This segment always should begin by describing the location of the new venture. The chosen site should be appropriate in terms of labour availability, wage rate, proximity to suppliers and customers and community support. In addition, local taxes and zoning requirements should be sorted out and the support of area banks for new ventures should be touched on.

Specific needs should be discussed in terms of the facilities required to handle the new venture (plant, warehouse storage and offices) and the equipment that needs to be acquired (special tooling, machinery, computers and vehicles).

Other factors that might be considered are the suppliers (number and proximity) and the transportation costs involved in shipping materials. Also, the labour supply, wage rates and needed skilled positions should be presented.

Finally, the cost data associated with any of the operation factors should be presented. The financial information used here can be applied later to the financial projections.

V: Management

This segment identifies the key personnel, their positions and responsibilities and the career experiences that qualify them for those particular roles. Complete résumés should be provided for each member of the management team. Also, this section is where the entrepreneur's role in the venture should be clearly outlined. Finally, any advisers, consultants, or members of the board should be identified and discussed.

The structure of payment and ownership (share agreements, consulting fees and so on) should be described clearly in this section. In summary, the discussion should be sufficient so that investors can understand each of the following critical factors that have been presented:

- organisational structure
- management team and critical personnel
- experience and technical capabilities of the personnel
- ownership structure and compensation agreements
- board of directors and outside consultants and advisers.

VI: Financial

The financial segment of a business plan must demonstrate the potential viability of the undertaking. In this part of the plan, three basic financial statements must be presented: the **pro forma balance sheet**, the **income statement** and the **cash-flow statement**.

The pro forma balance sheet

Pro forma means projected, as opposed to actual. The pro forma balance sheet projects what the financial condition of the venture will be at a particular point in time. Pro forma balance sheets should be prepared at start-up, semi-annually for the first years and at the end of each of the first three years. The balance sheet details the assets required to support the projected level of operations and shows how these assets are to be financed (liabilities and equity). Investors will want to look at the projected balance sheets to determine if debt/equity ratios, working capital, current ratios, inventory turnover and so on are within the acceptable limits required to justify the future financings projected for the venture.

The income statement

The income statement illustrates the projected operating results based on profit and loss. The sales forecast, which was developed in the marketing segment, is essential to this document. Once the sales forecast (earnings projection) is in place, production costs must be budgeted based on the level of activity needed to support the projected earnings. The materials, labour, service and manufacturing overhead (fixed and variable) must be considered, in addition to such expenses as distribution, storage, advertising, discounts and administrative and general expenses – salaries, legal and accounting, rent, utilities and telephone.

The cash-flow statement

In new-venture creation, the cash-flow statement may be the most important document since it sets forth the amount and timing of expected cash in-flows and out-flows. This section of the business plan should be carefully constructed.

Given a level of projected sales and capital expenditures over a specific period, the cash-flow forecast will highlight the need for and the timing of additional financing and will indicate peak requirements for working capital. Management must decide how this additional financing is to be obtained, on what terms and how it is to be repaid. The total amount of needed financing may be supplied from several sources – part by equity financing, part by bank loans and the balance by short-term lines of credit from banks. This information becomes part of the final cash-flow forecast.

A detailed cash flow, if understood properly, can direct the entrepreneur's attention to operating problems before serious cash crises arise.

In the financial segment it is important to mention any assumptions used for preparing the figures. Nothing should be taken for granted. Also, it should include how the statements were prepared (by a professional accountant or by the entrepreneur) and who will be in charge of managing the business's finances.

The final document that should be included in the financial segment is a break-even chart, which shows the level of sales (and production) needed to cover all costs. This includes costs that vary with the production level (manufacturing labour, materials, sales) and costs that do not change with production (rent, interest charges, executive salaries).

VII: Critical risks

In this segment potential risks such as the following should be identified: effect of unfavourable trends in the industry, design or manufacturing costs that have gone over estimates, difficulties of long lead times encountered when purchasing parts or materials and unplanned-for new competition.

In addition to these risks, it is wise to cover the what-ifs. For example, what if the competition cuts prices, the industry slumps, the market projections are wrong, the sales projections are not achieved, the patents do not come through, or the management team breaks up?

Finally, suggestions for alternative courses of action should be included. Certainly, delays, inaccurate projections and industry slumps all can happen and people reading the business plan will want to know the entrepreneur recognises these risks and has prepared for such critical events.

VIII: Harvest strategy

Every business plan should provide insights into the future harvest strategy. It is important for the entrepreneur to plan the orderly transition of the venture as it grows and develops. This section needs to deal with such issues as management succession and investor exit strategies. In addition, some thought should be given to change management – that is, the orderly transfer of the company assets if ownership of the business changes; continuity of the business strategy during the transition; and designation of key individuals to run the business if the current management team changes. With foresight, entrepreneurs can keep their dreams alive, ensure the security of their investors and usually strengthen their businesses in the process. For this reason, a written plan for succession of your business is essential.

IX: Milestone schedule

The **milestone schedule segment** provides investors with a timetable for the various activities to be accomplished. It is important to demonstrate that realistic time frames have been planned and that the interrelationship of events within these time boundaries is understood. Milestone scheduling is a step-by-step approach to illustrating accomplishments in a piecemeal fashion. These milestones can be established according to any appropriate time frame, such as quarterly, monthly, or weekly. It is important, however, to coordinate the time frame not only with such early activities as product design and development, sales projections, establishment of the management team, production and operations scheduling and market planning, but with other activities as well:

- incorporation of the venture
- completion of design and development
- completion of prototypes
- hiring of sales representatives
- product display at trade shows
- signing up distributors and dealers
- ordering production quantities of materials
- receipt of first orders
- first sales and first deliveries (dates of maximum interest because they relate directly to the venture's credibility and need for capital)
- payment of first accounts receivable (cash in).

These items are examples of the types of activities that should be included in the milestone schedule segment. The more detailed the schedule, the better the chance the entrepreneur can persuade potential investors that they have thought things out and that they are, therefore, a good risk.

X: Appendix and/or bibliography

The final segment is not mandatory, but it allows for additional documentation that is not appropriate in the main parts of the plan. Diagrams, blueprints, financial data, résumés of management team members and any bibliographical information that supports the other segments of the plan are all examples of material that can be included. It is up to the entrepreneur to decide which, if any, items to put into this segment. However, the material should be limited to relevant and supporting information.

Business plan: Recap of major segments

Figure 10.2 provides an important recap of the major segments of a business plan, using helpful hints as practical reminders for entrepreneurs. By reviewing this, entrepreneurs can gain a macro view of the planning process. Figure 10.3 is a personal checklist that gives entrepreneurs the opportunity to evaluate their business plan for each segment. The step-by-step evaluation is based on coverage of the particular segment, clarity of its presentation and completeness.

PRESENTATION OF THE BUSINESS PLAN

Once a business plan is prepared, the next major challenge is presenting the plan to either a single financial person or to a forum where financial investors have gathered. In any situation the oral presentation is a key step in selling the business plan to potential investors.

The presentation should be organised, well prepared, interesting and flexible. Entrepreneurs should develop an outline of the significant highlights that will capture the audience's interest. Although the outline should be followed, they also must feel free to add or remove certain bits of information as the presentation progresses – a memorised presentation lacks excitement, energy and interest.

FIGURE 10.2 HELPFUL HINTS FOR DEVELOPING THE BUSINESS PLAN

I Executive summary

- No more than three pages. This is the most crucial part of your plan because you must capture the reader's interest.
- What, how, why, where and so on must be summarised.
- Complete this part after you have a finished business plan.

II Business description segment

- The name of your business.
- A background of the industry with history of your company (if any) should be covered here.
- The potential of the new venture should be described clearly.
- Any uniqueness or distinctive features of this venture should be clearly described.

III Marketing segment

- Convince investors that sales projections and competition can be met.
- Use and disclose market studies.
- Identify target market, market position and market share.
- Evaluate all competition and specifically cover why and how you will be better than your competitors.
- Identify all market sources and assistance used for this segment.
- Demonstrate pricing strategy since your price must penetrate and maintain a market share to *produce profits*. Thus the lowest price is not necessarily the best price.
- Identify your advertising plans with cost estimates to validate proposed strategy.

IV Operations segment

- Describe the advantages of your location (zoning, tax laws and wage rates). List the production needs in terms of facilities (plant, storage, office space) and equipment (machinery, furnishings, supplies).
- Describe the access to transportation (for shipping and receiving).
- Indicate proximity to your suppliers.
- Mention the availability of labour in your location.
- Provide estimates of operation costs – be careful; too many entrepreneurs underestimate their costs.

V Management segment

- Supply résumés of all key people in the management of your venture.
- Carefully describe the legal structure of your venture (sole proprietorship, partnership, or corporation).
- Cover the added assistance (if any) of advisers, consultants and directors.
- Give information on how and how much everyone is to be compensated.

VI Financial segment

- Give actual estimated statements.
- Describe the needed sources for your funds and the uses you intend for the money.
- Develop and present a budget.
- Create stages of financing for purposes of allowing evaluation by investors at various points.

VII Critical-risks segment

- Discuss potential risks before investors point them out – for example:
  - price cutting by competitors
  - any potentially unfavourable industry-wide trends
  - design or manufacturing costs in excess of estimates
  - sales projections not achieved
  - product development schedule not met
  - difficulties or long lead times encountered in the procurement of parts or raw materials
  - greater than expected innovation and development costs to stay competitive.
- Provide some alternative courses of action.

VIII Harvest strategy segment

- Outline a plan for the orderly transfer of company assets (ownership).
- Describe the plan for transition of leadership.
- Mention the preparations (insurance, trusts and so on) needed for continuity of the business.

IX Milestone schedule segment

- Develop a timetable or chart to demonstrate when each phase of the venture is to be completed. This shows the relationship of events and provides a deadline for accomplishment.

X Appendix and/or bibliography

Source: Kuratko, Montagno and Sabatine, *The Entrepreneurial Decision*.

FIGURE 10.3 BUSINESS PLAN ASSESSMENT: COMPLETE EVALUATION OF EACH COMPONENT

The components

There are 10 components of a business plan. As you develop your plan, you should assess each component. Be honest in your assessment since the main purpose is to improve your business plan and increase your chances of success. For instance, if your goal is to obtain external financing, you will be asked to submit a complete business plan for your venture. The business plan will help a funding source to more adequately evaluate your business idea.

Assessment

Directions: The brief description of each component will help you write that section of your plan. After completing your plan, use the scale provided to assess each component.

5	4	3	2	1
Outstanding	**Very Good**	**Good**	**Fair**	**Poor**
(thorough and complete in all areas)	(most areas covered but could use improvement in detail)	(some areas covered in detail but other areas missing)	(a few areas covered but very little detail)	(no written parts)

The 10 components of a business plan

I Executive summary. This is the most important section because it has to convince the reader that the business will succeed. In no more than three pages, you should summarise the highlights of the rest of the plan. This means that the key elements of the following components should be mentioned.

The executive summary must be able to stand on its own. It is not simply an introduction to the rest of the business plan, but rather discusses who will purchase your product or service, what makes your business unique and how you plan to grow in the future. Because this section summarises the plan, it is often best to write it last.

	5	4	3	2	1
Rate this component:	**Outstanding**	**Very Good**	**Good**	**Fair**	**Poor**

II Description of the business. This section should provide background information about your industry, a history of your company, a general description of your product or service and your specific mission that you are trying to achieve. Your product or service should be described in terms of its unique qualities and value to the customer. Specific short-term and long-term objectives must be defined. You should clearly state what sales, market share and profitability objectives you want your business to achieve.

Key elements	**Have you covered this in the plan?**	**Is the answer clear? (yes or no)**	**Is the answer complete? (yes or no)**
a What type of business will you have?			
b What products or services will you sell?			
c Why does it promise to be successful?			
d What is the growth potential?			
e How is it unique?			

	5	4	3	2	1
Rate this component:	**Outstanding**	**Very Good**	**Good**	**Fair**	**Poor**

>>

III Marketing. There are two major parts to the marketing section. The first part is research and analysis. Here, you should explain who buys the product or service – in other words, identify your target market. Measure your market size and trends and estimate the market share you expect. Be sure to include support for your sales projections. For example, if your figures are based on published marketing research data, be sure to cite the source. Do your best to make realistic and credible projections. Describe your competitors in considerable detail, identifying their strengths and weaknesses. Finally, explain how you will be better than your competitors.

The second part is your marketing plan. This critical section should include your market strategy, sales and distribution, pricing, advertising, promotion and public awareness efforts. Demonstrate how your pricing strategy will result in a profit. Identify your advertising plans and include cost estimates to validate your proposed strategy.

Key elements	**Have you covered this in the plan?**	**Is the answer clear? (yes or no)**	**Is the answer complete? (yes or no)**
a Who will be your customers? (*target market*)			
b How big is the market? (*number of customers*)			
c Who will be your competitors?			
d How are their businesses prospering?			
e How will you promote sales?			
f What market share will you want?			
g Do you have a pricing strategy?			
h What advertising and promotional strategy will you use?			

Rate this component:

5	4	3	2	1
Outstanding	**Very Good**	**Good**	**Fair**	**Poor**

IV Operations. In this segment you describe the actual operations and outline their advantages. Zoning, taxes, access to transportation and proximity to supplies should all be considered in this section.

Key elements	**Have you covered this in the plan?**	**Is the answer clear? (yes or no)**	**Is the answer complete? (yes or no)**
a Have you identified a specific location?			
b Have you outlined the advantages of this location?			
c Any zoning regulations or tax considerations?			
d Will there be access to transportation?			
e Will your suppliers be conveniently located?			

Rate this component:

5	4	3	2	1
Outstanding	**Very Good**	**Good**	**Fair**	**Poor**

V Management. Start by describing the management team, their unique qualifications and your plans to compensate them (including salaries, employment agreements, stock purchase plans, levels of ownership and other considerations). Discuss how your organisation is structured; consider including a diagram illustrating who reports to whom. Also include a discussion of the potential contribution of the board of directors, advisers, or consultants. Finally, carefully describe the legal structure of your venture (sole proprietorship, partnership, or corporation).

Key elements	**Have you covered this in the plan?**	**Is the answer clear? (yes or no)**	**Is the answer complete? (yes or no)**
a Who will manage the business?			
b What qualifications do you have?			
c How many employees will you have?			
d What will they do?			
e How much will you pay your employees and what type of benefits will you offer them?			
f What consultants or specialists will you use?			
g What legal form of ownership will you have?			
h What regulations will affect your business?			

Rate this component:

5	**4**	**3**	**2**	**1**
Outstanding	**Very Good**	**Good**	**Fair**	**Poor**

VI Financial. Three key financial statements must be presented: a balance sheet, an income statement and a cash-flow statement. These statements typically cover a one-year period. Be sure you state any assumptions and projections made when calculating the figures.

Determine the stages where your business will require external financing and identify the expected financing sources (both debt and equity sources). Also, clearly show what return on investment these sources will achieve by investing in your business. The final item to include is a break-even analysis. This analysis should show what level of sales will be required to cover all costs.

If the work is done well, the financial statements should represent the actual financial achievements expected from your business plan. They also provide a standard by which to measure the actual results of operating your business. They are a very valuable tool to help you manage and control your business.

Key elements	**Have you covered this in the plan?**	**Is the answer clear? (yes or no)**	**Is the answer complete? (yes or no)**
a What is your total expected business income for the first year? Quarterly for the next two years? (*forecast*)			
b What is your expected monthly cash flow during the first year?			

Key elements	**Have you covered this in the plan?**	**Is the answer clear? (yes or no)**	**Is the answer complete? (yes or no)**
c Have you included a method of paying yourself?			
d What sales volume will you need to make a profit during the three years?			
e What will be the break-even point?			
f What are your projected assets, liabilities and net worth?			
g What are your total financial needs?			
h What are your funding sources?			

Rate this component:	**5**	**4**	**3**	**2**	**1**
	Outstanding	**Very Good**	**Good**	**Fair**	**Poor**

VII Critical risks. Discuss potential risks before they happen. Here are some examples: price cutting by competitors, potentially unfavourable industry-wide trends; design or manufacturing costs that could exceed estimates; sales projections that are not achieved. The idea is to recognise risks and identify alternative courses of action. Your main objective is to show that you can anticipate and control (to a reasonable degree) your risks.

Key elements	**Have you covered this in the plan?**	**Is the answer clear? (yes or no)**	**Is the answer complete? (yes or no)**
a What potential problems have you identified?			
b Have you calculated the risks?			
c What alternative courses of action exist?			

Rate this component:	**5**	**4**	**3**	**2**	**1**
	Outstanding	**Very Good**	**Good**	**Fair**	**Poor**

VIII Harvest strategy. Ensuring the survival of a venture is hard work. A founder's protective feelings for an idea built from scratch make it tough to grapple with issues such as management succession and harvest strategies. With foresight, however, an entrepreneur can keep the dream alive, ensure the security of his or her venture and usually strengthen the business in the process. Thus a written plan for succession of your business is essential.

Key elements	**Have you covered this in the plan?**	**Is the answer clear? (yes or no)**	**Is the answer complete? (yes or no)**
a Have you planned for the orderly transfer of the venture assets if ownership of the business is passed to this corporation?			
b Is there a continuity of business strategy for an orderly transition?			

Rate this component:	**5**	**4**	**3**	**2**	**1**
	Outstanding	**Very Good**	**Good**	**Fair**	**Poor**

IX Milestone schedule. This section is an important segment of the business plan because it requires you to determine what tasks you need to accomplish to achieve your objectives. Milestones and deadlines should be established and monitored on an ongoing basis. Each milestone is related to all others and together all of them provide a timely representation of how your objective is to be accomplished.

Key elements	**Have you covered this in the plan?**	**Is the answer clear? (yes or no)**	**Is the answer complete? (yes or no)**
a How have you set your objectives?			
b Have you set deadlines for each stage of your growth?			

Rate this component:	**5**	**4**	**3**	**2**	**1**
	Outstanding	**Very Good**	**Good**	**Fair**	**Poor**

X Appendix and/or bibliography. This section includes important background information that was not included in the other sections. It is where you would put such items as résumés of the management team, names of references and advisers, drawings, documents, licences, agreements and any materials that support the plan. You may also wish to add a bibliography of the sources from which you drew information.

Key elements	**Have you covered this in the plan?**	**Is the answer clear? (yes or no)**	**Is the answer complete? (yes or no)**
a Have you included any documents, drawings, agreements, or other materials needed to support the plan?			
b Are there any names of references, advisers, or technical sources you should include?			
c Are there any other supporting documents?			

Rate this component:	**5**	**4**	**3**	**2**	**1**
	Outstanding	**Very Good**	**Good**	**Fair**	**Poor**

Summary: Your plan
Directions: For each of the business plan sections that you assessed earlier, circle the assigned points on this review sheet and then total the circled points.

Components			**Points**		
I Executive summary	5	4	3	2	1
II Description of the business	5	4	3	2	1
III Marketing	5	4	3	2	1
IV Operations	5	4	3	2	1
V Management	5	4	3	2	1
VI Financial	5	4	3	2	1
VII Critical risks	5	4	3	2	1
VIII Succession planning	5	4	3	2	1
IX Milestone schedule	5	4	3	2	1
X Appendix and/or bibliography	5	4	3	2	1

Total points:
Scoring

50 — outstanding (the ideal business plan)
45–49 — very good
40–44 — good (the plan is sound with a few areas that need to be polished)
35–39 — above average (the plan has some good areas but needs improvement before presentation)
30–34 — average (some areas are covered in detail yet other areas show weakness)
20–29 — below average (most areas need greater detail and improvement)
Below 20 — poor (plan needs to be researched and documented much better)

Source: Donald F. Kuratko, Jeffrey S. Hornsby and Frank J. Sabatine, *The Breakthrough Experience* (Muncie, IN: The Midwest Entrepreneurial Education Center, Ball State University, 1999): 59–64.

Suggestions for preparation

The following steps in preparing an oral presentation are suggested for entrepreneurs:

- know the outline thoroughly
- use key words in the outline that help recall examples, visual aids, or other details
- rehearse the presentation in order to get the feel of its length
- be familiar with any equipment to be used in the presentation – such as an overhead projector, a slide projector, or a VCR
- the day before, practise the complete presentation using all visual aids and equipment
- the day of the presentation, arrive early in order to set up, test any equipment and organise notes and visual aids.[19]

What to expect

Entrepreneurs should realise that the audience reviewing their business plan is antagonistic. The venture capital sources pressure them in order to test their venture as well as the entrepreneurs. Thus, entrepreneurs must expect and prepare for a critical, sometimes sceptical, audience of financial sources. As an example, the following comments from Joseph R. Mancuso, president of the Center for Entrepreneurial Management, illustrate the reality of what entrepreneurs face:

> When you finally do hand over your plan, the venture source will glance at it briefly and begin his preliminary comments. No matter how good you think your plan is, he's not going to look at it and say, 'This is the greatest plan I've ever seen!' so don't go in looking for praise. It's highly likely that his remarks will be critical and even if they aren't, they'll seem that way. Don't panic. Even if it seems like an avalanche of objections, bear in mind that Digital Equipment Corporation (DEC) was turned down by everyone before American Research & Development (AR&D) in Boston decided to take a $70 000 chance on them. That might not seem like much now, but at the time it made all the difference. And Fred Adler didn't put $25 000 into Data General until all of the other established venture capitalists had turned down the deal. These are two of the best venture capital deals of all time and they almost didn't happen, so don't expect results in the first twenty minutes.[20]

Entrepreneurs must be prepared to handle the questions from the evaluators and learn from the criticism. They should never feel defeated but rather should make a commitment to improving the business plan for future review. Table 10.2 outlines some of the key questions that might be asked when a business plan is turned down. Entrepreneurs should use the answers to

TABLE 10.2: WHAT TO DO WHEN A VENTURE CAPITALIST TURNS YOU DOWN: TEN QUESTIONS

EVENT	QUESTIONS TO ASK
Confirm the decision	'That means you do not wish to participate at this time?'
Sell for the future	'Can we count you in for the second round of financing, after we've completed the first?'
Find out why you were rejected	'Why do you choose not to participate in this deal?' (Timing? Fit? All filled up?)
Ask for advice	'If you were in my position, how would you proceed?'
Ask for suggestions	'Can you suggest a source who invests in this kind of deal?'
Get the name	'Whom should I speak to when I'm there?'
Find out why	'Why do you suggest this firm and why do you think this is the best person to speak to there?'
Work on an introduction	'Who would be the best person to introduce me?'
Develop a reasonable excuse	'Can I tell him that your decision to turn us down was based on …?'
Know your referral	'What will you tell him when he calls?'

these questions to revise, rework and improve their business plan. The goal is not so much to succeed the first time as it is to succeed.

CONTRARIAN VIEWS ON BUSINESS PLANNING

Research evidence on the importance of business planning is mixed. Delmar and Shane believe that entrepreneurs who first completed business plans before talking to customers and beginning marketing or promotion had a lower termination rate.[21] Honig argues that despite the ubiquity of business planning education in entrepreneurship (including this book), there is little evidence that planning leads to success.[22] Breaking ranks with conventional wisdom, Harvard Business School professor William Sahlman says that business plans rank no higher than two – on a scale from one to 10 – as a predictor of a new venture's success. And David Gumpert's book *Burn Your Business Plan!* argues that writing a business plan unnecessarily wastes time and, in fact, could be counterproductive. Gumpert examines the minimal role of business plans for such entrepreneurs as Bill Gates and Michael Dell. He urges entrepreneurs instead to focus on key hands-on tasks that are more likely to impress professional investors – tasks such as preparing an effective oral presentation, writing a clear and compelling synopsis, developing a website that captures a business model and assembling hard-hitting financial projections.[23]

Gumpert suggests that rather than writing a 50-page business plan for the investor, a 12-slide presentation may be enough:

- What is the opportunity?
- What gives you special advantages in solving the problem?
- What makes you think that the people involved in your company are especially qualified to grow this business?
- What is the business model?
- What makes it scalable?
- How do you know you'll have customers?
- How do you connect to customers?
- What is the secret of your expected sales success?
- What have you learned from the competition?
- What are the risk factors?
- How will you make money?
- How will you use the funds you raise?

Maybe even the back of a napkin would suffice. Yes, there's a planning method for that too![24]

SUMMARY

This chapter provided a thorough examination of an effective business plan. The critical factors in planning and the pitfalls to be avoided were discussed. Indicators of these pitfalls and ways to avoid them were also presented.

Next, a business plan was defined and benefits for both entrepreneurs and financial sources were discussed. Developing a well-conceived plan was presented from the point of view of the audience for whom the plan is written. The typical six-step reading process of a business plan was presented to help entrepreneurs better understand how to put the business plan together. Ten guidelines in developing a business plan were provided, collated from the advice of experts in venture capital and new-business development.

The next section illustrated some of the major questions that must be answered in a complete and thorough business plan. The business plan was outlined with every major segment addressed and explained.

The chapter then presented some helpful hints for preparing a business plan, along with a self-analysis checklist for doing a careful critique of the plan before it is presented to investors.

The chapter concluded with a review of how to present a business plan to an audience of venture capital sources. Some basic presentation tips were listed, together with a discussion of what to expect from the plan evaluators.

Finally there was a discussion of contrarian views on business planning.

KEY TERMS AND CONCEPTS

business plan
cash-flow statement
five-minute reading
income statement
market niche
marketing segment
marketing strategy
milestone schedule segment
pro forma balance sheet

REVIEW AND DISCUSSION QUESTIONS

1 What are the critical factors to be considered when preparing a business plan?
2 Identify the benefits of a business plan:
  a for an entrepreneur
  b for financial sources.
3 Describe each of the five planning pitfalls entrepreneurs often encounter.
4 Identify an indicator of each pitfall named in question 2. What would you do about each?
5 What are the three major viewpoints to be considered when developing a business plan?
6 Describe the six-step process venture capitalists follow when reading a business plan.
7 What are the guidelines to be used for preparing a business plan?
8 Briefly describe each of the major segments to be covered in a business plan.
9 Why is the summary segment of a business plan written last? Why not first?
10 What are five elements included in the marketing segment of a business plan?
11 What are some critical factors covered in the management segment of a business plan?
12 What is the meaning of the term critical risks?
13 Describe each of the three financial statements that are mandatory for the financial segment of a business plan.
14 Why are milestones important to a business plan?
15 What do you think about the contrarian views on business planning?

EXPERIENTIAL EXERCISE

PUTTING TOGETHER A BUSINESS PLAN

The 10 major segments of a business plan are listed in the following left column. Identify the order in which each segment will appear in the plan by placing a 1 next to the first part and so on down to a 10 next to the last part.

Then match each of the 20 items or descriptions on the right with the segment in which it would appear. For example, if an item would appear in the first segment, put a 1 next to this description. Two items or descriptions are listed for each segment of the report. Answers are provided at the end of the chapter.

SEGMENTS OF THE REPORT

1 Financial segment
2 Marketing segment
3 Management segment
4 Summary
5 Operations segment
6 Business description segment
7 Critical-risks segment
8 Appendix and/or bibliography
9 Harvest strategy segment
10 Milestone schedule segment

CONTENTS OF THE SEGMENTS

a Describes the potential of the new venture
b Discusses the advantages of location
c Discusses price cutting by the competition
d Provides bibliographical information
e Most crucial part of the plan
f Describes any prototypes developed
g Analyses case if any sales projections are not attained
h Shows the relationship between events and deadlines for accomplishment
i Provides résumés of all key personnel
j Contains support material such as blueprints and diagrams
k Discusses pricing strategy
l Should be written after the business plan is completed
m Provides a budget
n Explains proximity to suppliers
o Sets forth timetables for completion of major phases of the venture
p Provides industry background
q Explains costs involved in testing
r Identifies target markets
s Describes legal structure of the venture
t Provides balance sheet and income statement

CASE 10.1:

GETTING IT RIGHT BY DOING IT WRONG

She had no business plan but 10 years later, she is one of New Zealand's most successful entrepreneurs. When Brigit Blair set up Linden Leaves 10 years ago, she broke the golden rule by setting up without a business plan. 'A five-year plan?' she laughs. 'We didn't have a five-week plan.'

A decade later, Linden Leaves' range of New Zealand-made body care products are sold from Auckland to London and many points in between. Christchurch-based Mrs Blair, 54, is well on the way to becoming a government business adviser's pin-up, the sort of entrepreneur the government's jobs ministry loves to champion.

'I launched without really knowing what I was getting into and without a business plan. I did everything wrong. For four years I exported only to Korea and Japan – probably the most difficult markets in the world. If I had really thought about it, I probably would never have taken the first step. Passion and a good deal of hard work go a long way, I guess.'

Source: Dave King, 'Getting it right by doing it wrong', *The Dominion Post* (Wellington), 1 July 2004.

QUESTIONS

1 Based on Brigit's experience, would you still recommend writing a business plan or would you just wing it?
2 What were secrets of her success without a business plan?

CASE 10.2:

IT'S JUST A MATTER OF TIME

Pedro Santini has been a computer analyst for five years. In his spare time he has developed a word processing software program that is more comprehensive and powerful than any on the market. Since he does not have a great deal of money, Pedro believes the first step in producing and marketing this product should be to get the necessary venture capital.

The software program has been written and trial-tested by Pedro and a handful of friends to whom he gave the material. Two of these friends are full-time typists who told him that the program is faster and easier to use than anything on the market. Pedro believes that these kinds of testimonials point out the profit potential of the product. However, he still needs to get financial support.

One of Pedro's friends has suggested a meeting with a venture capitalist. 'These guys have all sorts of money to lend for new ventures', the friend told Pedro. 'All you have to do is explain your ideas and

sell them on giving you the money. They are always looking to back a profitable idea and yours is certain to be one of the best they have seen in a long time'.

Pedro agrees with his friend but believes he should not discuss the matter with a venture capitalist until he has thought through answers to the various types of questions likely to be asked. In particular, Pedro believes he should be able to provide the venture capitalist with projected sales for the first three years and be able to explain the types of expenses that would be incurred. Once he has done this, Pedro feels he will be ready to talk to the individual. 'Right now', he told his friend, 'it's just a matter of time. I'd think that within seven to ten days I'll be ready to present my ideas and discuss financial needs'.

QUESTIONS

1 In addition to financial questions, what other questions is the venture capitalist likely to ask Pedro?
2 Would a business plan be of any value to Pedro? Why or why not?
3 How would you recommend Pedro get ready for his meeting with the venture capitalist? Be complete in your answer.

CASE 10.3: THE INCOMPLETE PLAN

When Joan Boothe drew up her business plan, she was certain it would help her get venture capital. Joan is in the throes of putting together a monthly magazine directed towards executive women in the workplace. The objective of the periodical is to provide information useful to women who are pursuing careers. The first issue is scheduled to go to press in 90 days. Some of the articles included in this issue are 'Managing your time for fun and profit', 'What you need to know about dressing for success' and 'Money management: Do it like the experts'. A section also is devoted to successful women at work. It is titled 'Women in the news'. Other features include a question-and-answer section that responds to letters and inquiries from readers (the first issue's questions were submitted by a group of women executives, each of whom had been asked to help get the column started by sending in a question); a stock market section that reviews industries or companies and points out the benefits and risks associated with investing in them; and a column on the state of the economy and the developments or trends expected over the next 12 months.

Joan's business plan consisted of six parts: a summary, a business description, a manufacturing segment, a management segment, a milestone schedule segment and an appendix. When it was returned to her with the rejection letter, the venture-capital firm wrote: 'Without a marketing segment, attention to critical risks and a financial segment, this plan is incomplete and cannot be favourably reviewed by us. If you would provide us with this additional information and submit the rewritten plan within the next 60 days, we will be happy to review the plan and give you our opinion within 10 working days'.

QUESTIONS

1 What should Joan put in the marketing segment? What types of information will she need?
2 For the critical-risks assessment segment, what key areas does Joan have to address? Discuss two of these.
3 For the financial segment, what suggestions would you make to Joan regarding the kinds of information to include? Be as specific as possible.

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Business Plans Available Some Thoughts on Business Plans

Publication date: 14 November 1996
Author(s): William A. Sahlman
Product number: 9-897-101

A framework for assessing new business opportunities and the business plans used to describe them is developed. Useful for aspiring entrepreneurs in MBA programs.

Note on Business Model Analysis for the Entrepreneur

Publication date: 22 January 2002
Author(s): Richard G. Hamermesh, Paul W. Marshall, Taz Pirmohamed
Product number: 9-802-048

A framework for assessing new business opportunities and the business plans used to describe them is developed. Useful for aspiring entrepreneurs in MBA programs.

ASIA RENAL CARE

Publication date: 3 January 2000
Author(s): Michael J. Roberts
Product number: 9-800-243

Presents a business plan for a start-up company focused on building a network of high-quality dialysis centres in the Asia–Pacific region. Includes a detailed financial forecast. An executable spreadsheet is available. Students have the opportunity to run various roll-out strategies and focus on different Asian countries.

ANSWERS

1	6
2	3
3	5
4	1
5	4
6	2
7	7
8	10
9	7
10	9
a	2
b	4
c	7
d	10
e	1
f	2
g	7
h	9
i	5
j	10
k	3
l	1
m	6
n	4
o	9
p	2
q	2
r	3
s	5
t	6

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16 This list is reprinted by permission of the *Harvard Business Review*. An exhibit from 'How to write a winning business plan', by Stanley R. Rich and David E. Gumpert, May/June 1985, 162. Copyright © 1985 by the President and Fellows of Harvard College; all rights reserved.

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ENTREPRENEURIAL CASE ANALYSIS

SHADOW GOURMET LTD

Elizabeth Ditzel, University of Otago

DEVELOPING THE ENTREPRENEURIAL PLAN

Shadow Gourmet Ltd is owned and operated by two entrepreneurial undergraduate students who work part-time growing, harvesting and selling *Pleurotus Pulmonaris* otherwise known as Oyster mushrooms. The *Pleurotus Pulmonaris* species of mushroom was chosen for two reasons – it has a distinctive but easily appealing favour and, compared to other mushrooms, it is comparatively easy to cultivate. The sight of mushrooms fruiting in pristine controlled conditions and the rapid maturation of the developing fruit bodies, combined with the severe lack of choice of edible mushrooms were the catalysts for the business venture. The business is located in Dunedin, a university city of approximately 100 000 people, 20 000 of whom are students attending a range of educational institutions.

BUSINESS SET UP Dave and Sam began their gourmet mushroom business on a budget of around $1000 in May 2004 and became an incorporated company in October 2004. They do everything from strategic planning to deliveries. They described the first six months of operation as being 'tedious and depressing' – the company was producing around 1 to 2 kilograms of mushrooms per week, of which at least half would end up being thrown out. Initial marketing strategies consisted it personal visits to restaurants and giving away free samples. However, this approach yielded only two customers and a weekly order of only 500 grams in total. However, this trial and error period allowed the company to experiment with growing techniques to sort out some of the production issues that could have been detrimental further down the track.

In February 2005 a breakthrough was made when Dave suggested using the local Otago Farmers' Market as a weekly outlet for sales. Expecting to sell around 1 of the 2 kilograms of mushrooms they had ready for sale between the market's trading hours of 8 am and 12 noon, they were ecstatic when they sold out of stock before 10 am. This rekindled their flagging spirits and steps were taken to upgrade the production facilities as quickly as possible in order to increase production. However, this led to a new dilemma – how to increase production capacity on a limited cash flow and with limited production space?

THE MUSHROOM PRODUCTION PROCESS Knowing the production process of this perishable but gourmet food is integral to understanding how the business operates and what its future might be. An overview is provided in figure A. Mushrooms are a species of fungus that grow in a medium called spawn produced in the following manner. Hydrated barley is placed in large (agee) quarter-pint capacity jars sealed with dome seals fitted with filter cotton wool and topped with a layer of tinfoil to allow air exchange with minimal risk of contamination. The jars are then placed in an autoclave and heated to 121°C at 15 psi of pressure for one hour to achieve sterilisation. The autoclave can hold 14 jars at a time. A master culture of fungus mycelium on agar is used to inoculate the barley grain after it has cooled. Once inoculated, the spawn jars are placed in an incubator at 28°C for 7 days. The incubators used by Dave and Sam are commercial (second-hand) laboratory grade and each one can hold 140 jars of spawn.

In the initial stages of operation the inoculation process was conducted in a makeshift laboratory in Sam's bedroom that extended out from the wall and folded away again. This 'laboratory' complies with heath and safety regulations in that it provides a clean area in which to work and therefore reduces the chance of contaminating the agar growing medium with other organisms. Over a period of about two weeks, the spawn jars become fully colonised. This is evident when the content of the jars changes from brown to a white colour indicating that the mycelium is growing.

Once the spawn jars are fully colonised they are moved to Dave's house (a larger flat with an outdoor shed and storage area for bales of straw) where the content is used to colonise the bulk production substrate of wheat straw. This is pasteurised (as opposed to sterilised) as straw does not need to

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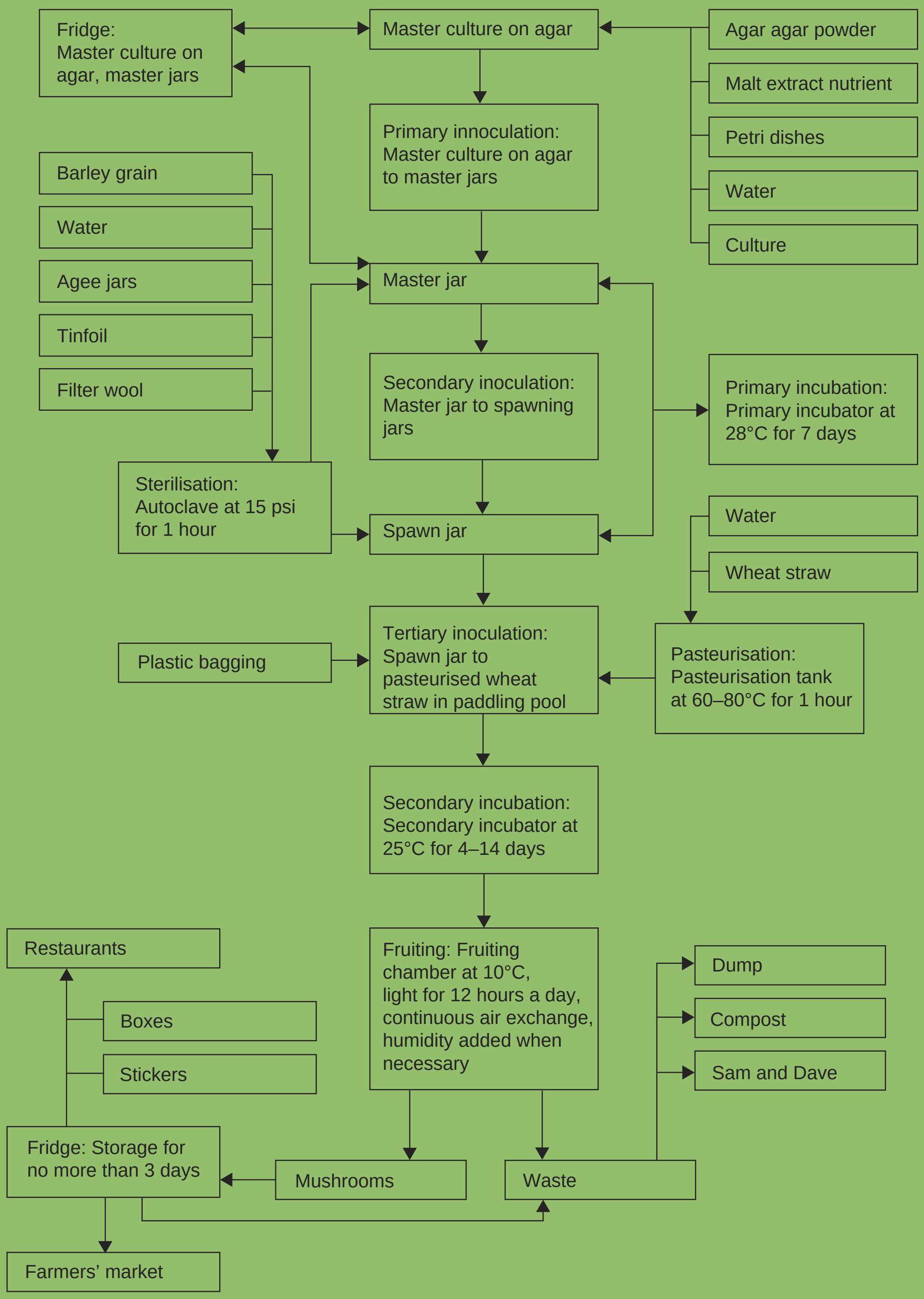
FIGURE A THE MUSHROOM GROWING PROCESS



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be sterilised to provide optimum growing conditions because of the virility of *Pleurotus Pulmonaris* combined with the low nitrogen content of the straw. The wheat straw is pasteurised in a large 250 litre stainless steel tank that was purpose built by a friend at a cost of $400. The tank is heated with a 2.3 kilowatt immersion heater and a 5.1 kilowatt gas ring and is insulated with Kevlar hot water cylinder insulation. It takes three hours to heat up to the required 65–68°C regardless of outside weather conditions.

The wheat straw is pasteurised by dunking batches of it into the water for one hour and then draining it. Once the straw has been pasteurised, it is placed in a children's plastic paddling pool and the two jars of spawn per bale of straw is mixed in by hand. This growing medium is packed into plastic tubing which is then heat-sealed to make bags of straw that measure about one-third of a metre in diameter by approximately a metre long. These bags are then tied, tagged with the date and have air holes punched in them to allow air exchange.

The mushroom growing bags are placed into a large secondary incubator that was purpose-built out of panels from a supermarket chiller (purchased at an auction) at a cost of $138. It is heated with a standard oil column heater with a thermostat, the door handle is constructed out of a complex system of levers designed to keep it well sealed. The secondary incubator holds 25 bags at a time and is kept at around 28°C with the bags taking around seven days to colonise.

Once the bags are fully colonised, they are put into the fruiting chamber – an outside construction that took Sam and Dave over a month to build. The floor contains over a metric tonne of concrete and it is insulated entirely with 5 centimetre thick polystyrene. The chamber holds up to 25 bags of growing medium.

This part of the production process is the most rewarding yet challenging as Oyster mushrooms produce a lot of carbon dioxide (CO_2) gas and require adequate ventilate to grow properly. They also need a small amount of light, a minimum level of heat (above 5°C) and a humidity greater than 80 per cent. The bags are placed in the fruiting chamber and the plastic sides are slit. After approximately 12 days exposure to light, air and humidity, the bags form primordial mushrooms. Plastic is then carefully peeled back from the bags to allow the primordia (the immature mushrooms) to develop into mature edible mushrooms after a further five days on average. The mushrooms are then harvested and placed in a refrigerator for up to five days.

ENVIRONMENTAL ASSESSMENT

Dave and Sam usually sell around 5 kilograms or more of mushrooms that retail at $40 per kilogram – meaning that their turnover is at least $200 per week. Restaurants place orders by phone during the week and these are filled either the same or next day. All other mushrooms are sold at the Otago Farmer's Market on a Saturday morning. In the early days of their business, nearly all of this money was used to purchase raw materials, such as straw and jars and simply survive. Their biggest current monthly fixed costs now are power and gas cylinder refills and their personal time cost in attending to the various stages of the production process.

Demand for the mushrooms increased during 2005 and in response to this Dave and Sam doubled their primary incubator capacity, tripled their pasteurising and secondary incubator capacity and were able to easily double their output. However, there is now a 'bottle-neck' in the production process in that the fruiting chamber is full and can hold no more.

Because of the particular requirements of the business it is hard to find the right kind of business 'space' to operate in but recently vacant premises that suit their purpose has been found. Dave and Sam are now facing an important business decision. While they estimate that the local market demand could be between 20 and 30 kilograms per week, on the basis of their financial status, renting any space costing over $7500 a year (the proposed annual rental price for a building they are considering) is risky.

Currently only one other company sells Oyster mushrooms in Dunedin. This company is based in Auckland and air freights produce into the city. At the beginning of 2006, in response to the fact this competitor had begun selling Oyster mushrooms in two of the local supermarkets, Sam and Dave dropped their Otago Farmer's Market retail price from $4.00 to $3.50 per 100 grams.

Dave and Sam are entrepreneurial students who have a passion for Oyster mushrooms. They enjoy mixing their everyday business with their continuing education and are keen to remain 'hands-on' managers, yet at the same time they wish to develop and expand their business. They have survived the critical 'start-up' phase and their business is now in its third year of successful but modest operation. Recently they enlisted the help of a local business 'start-up' incubator to help them prepare a business plan for their future.

DISCUSSION QUESTIONS

1. What should be in an effective business plan for Shadow Gourmet?
2. What environmental factors do you think will have the greatest impact on the future of Shadow Gourmet?
3. What should Sam and Dave do about marketing and distributing their mushrooms to both the local and wider communities?
4. What financial preparation is required for their future success?

The author acknowledges the guidance and permission of
David Wilson and Sam Guerrin, co-owners of Shadow Gourmet Ltd,
Dunedin, in writing this case study

PART FOUR: INITIATING ENTREPRENEURIAL VENTURES

CHAPTER

11

OPPORTUNITY ASSESSMENT, FEASIBILITY ANALYSIS AND COMMERCIALISATION

> Fellow-soldiers, to avoid all mistakes in the conduct of great enterprises is beyond man's powers; but when a mistake has once been made, to use his reverses as lessons for the future is the part of a brave and sensible man.
>
> Roman Commander Marcus Minucius Rufus, defeated by Hannibal in 217 BC

CHAPTER OBJECTIVES

1 To explain the challenges that face new venture start-ups when they assess opportunities, evaluate their feasibility and commercialise new products and services

2 To review common pitfalls in taking new venture ideas to the marketplace

3 To present critical factors involved in new venture development

4 To examine why new ventures fail

5 To study factors that underlie venture success

6 To analyse the evaluation process, especially profile analysis and feasibility analysis

7 To learn the basic principles of commercialisation and new product development

INTRODUCTION

In this chapter we are interested in opportunity assessment, evaluation and **commercialisation** for high growth entrepreneurs. High growth success depends on three key factors:

- characteristics of the entrepreneur – personal reasons for start-up
- the environment around the entrepreneur – risks, market size, resources availability
- the nature of the venture itself – differing scalability, growth potential and performance.[1]

This complexity often makes assessment, evaluation and ultimate commercialisation of new ventures very tricky to analyse in advance. But it is 'do-able' and this chapter reveals some of the tried and tested ways to make sure an opportunity ends up as a commercialised product in the marketplace (see figure 11.1).

An entrepreneur is someone who takes advantage of a profit opportunity. Entrepreneurs depend on a broad range of sources of ideas, networks and relationships to draw knowledge about future markets and technologies. They are highly opportunistic and need to move quickly to realise the opportunity before it is lost. The problem is that opportunities differ across markets and technologies. Therefore, the budding entrepreneur must understand how to assess new ideas and opportunities, how to evaluate their business viability and how to commercialise the resulting products and service into the marketplace.

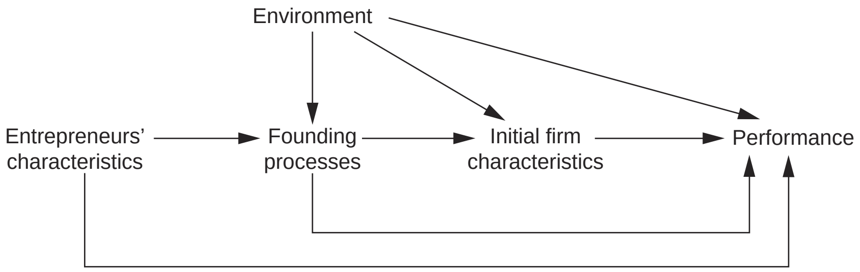
HOW TO ASSESS AN OPPORTUNITY

Ideas are 'a dime a dozen', they say in the US. That means ideas are very common and easy to find. They are everywhere. You see them standing at a bus stop, you think of them in the shower. 'Viable' opportunities are not easily found. Rarer still are highly viable commercial opportunities.

What is an **opportunity**? An opportunity comes more often from the creative process and from intuition than from scientific analysis. An opportunity is something that an entrepreneur recognises as solving a real problem or adding value for people. The best business opportunities may well be the ones that solve the problems of everyday life. If the idea solves a problem or adds value, then it becomes an opportunity.[2]

We are learning more about opportunity recognition through research. We know that people find opportunities more often in industries with which they are familiar.[3] There seems also to be a correlation between 'weak ties' (networks outside of friends and family) and the number of ideas that an entrepreneur recognises.[4] Some researchers see it both as a planned activity and as a serendipitous phenomenon.[5]

FIGURE 11.1 THE ELEMENTS AFFECTING NEW VENTURE PERFORMANCE



Source: Arnold C. Cooper, 'Challenges in predicting new firm performance', *Journal of Business Venturing* (May 1993): 243. Reprinted with permission.

What is the difference between a 'mere' idea and a viable opportunity? To tell that difference, the entrepreneur actually needs vertical and lateral thinking:

- **Lateral thinking** is problem-solving that approaches problems indirectly at diverse angles (some say 'out of the box') instead of concentrating on one approach.[6]
- **Vertical thinking** is analytical and sequential and it uses fixed categories and labels.

The entrepreneur needs cross-functional expertise in both types of thinking so that no new idea will be wasted. The wider the net, the greater the catch. True opportunity spotters identify opportunities laterally (through intuition and gut feeling) but they analyse them vertically (through science and commercialisation processes).

So, how to spot those special (highly profitable and viable) opportunities? There are certain tried and tested techniques:[7]

- Choose a suitable, exploitable market. Do not go after the software operating system market unless you can beat Microsoft. Similarly, the search engine market may well be occupied. Mainstream markets are difficult for entrepreneurs to break into.
- Choose niche markets that cater for specialist needs. Body Shop started up by appealing to environmentally aware cosmetics customers. Patagonia adopted an 'organic cotton only' policy before others were thinking about sustainability.
- Open new markets. The smartest entrepreneurs see emerging trends early and manoeuvre themselves into the cash flow. David Hall says 'I have a rule of thumb: Find any market growing at 25% a year or more and you can be sure there are many new niche markets continuously being created'.
- Steer clear of over-crowded marketplaces. Look for pickings elsewhere. Become a big fish in a small pond.
- The reverse is also true. Small fish in a really big pond have the opportunity to capture market share.
- Offer a unique product or service. Though infrequent, the entrepreneur may discover some technical breakthrough protected by a patent.

Peter Drucker once came up with the sources of opportunities shown in table 11.2.

TABLE 11.1: **THE DIFFERENCE BETWEEN VERTICAL AND LATERAL THINKING STYLES**

VERTICAL THINKING	LATERAL THINKING
Looking for the right approach	Looking for as many approaches as possible
Rightness	Richness
Proceeds if there is a direction	Proceeds to generate direction
Is analytical	Is provocative
Is sequential	Can make jumps
One must be correct at every step	One does not have to be correct at every step
Uses negative to block off certain pathways	There is no negative
Excludes what is irrelevant	Welcomes chance intrusions
Fixed categories/labels	Labels may change
Explores most likely paths	Explores least likely paths
Is a finite process	Is a 'probabilistic' process

Source: 'Vertical thinking vs. lateral thinking' [www.revision-notes.co.uk/revision/961.html].

ENTREPRENEURIAL EDGE

JIM'S MOWERS

A great example of niche spotting and opportunity exploitation is Jim's Mowers, based in Melbourne, Australia. Jim Penman noticed two social trends: Seventy per cent of Australian women of childbearing age are in the workforce; and the average work week is 45 hours. Australians are busy people, he reasoned and they spend billions a year outsourcing home services – everything from lawn mowing to childcare – simply because they are too preoccupied with their working lives. So Jim decided to move into that niche. Jim was a 'necessity entrepreneur' who started 'with $24 and an urgent need to pay the rent' in 1982. He now owns the largest lawn mowing franchise in the world with around 2200 franchisees in Australia, New Zealand and Canada. Jim's brand now adorns 30 different business systems, from antennas and appliance repairs to wardrobes and window cleaning. The distinctive 'Jim's' brand and customer management systems made famous in lawn mowing have been cleverly leveraged into other home services applications in a way and to an extent that is unique in the world.

Source: '2003 hall of fame inaugural inductees' [www.franchise.org.au/content/?id=213]. For more information on the Jim's Group visit the website at [www.jims.net].

TABLE 11.2: **SOURCES OF ENTREPRENEURIAL OPPORTUNITIES**

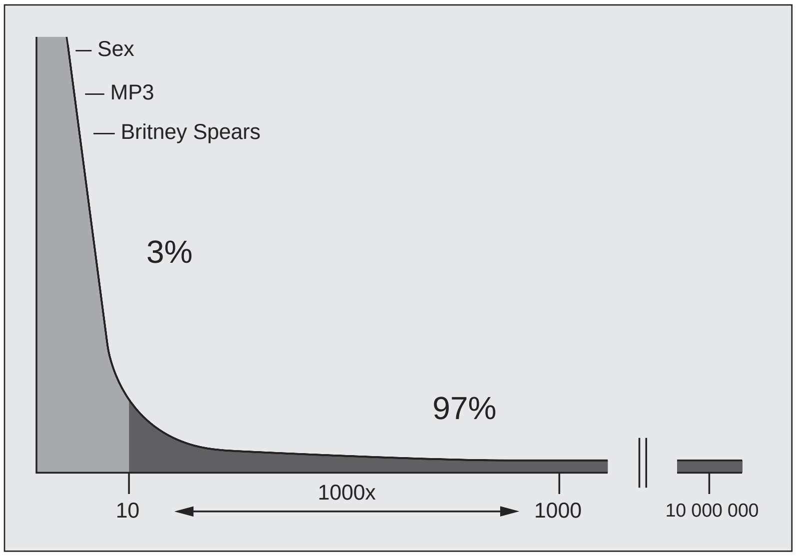
INTERNAL SOURCES OF OPPORTUNITIES	EXTERNAL SOURCES OF OPPORTUNITIES
The unexpected – the unexpected success, the unexpected failure, the unexpected outside event	Demographic changes caused by things like wars, migrations, medical developments
The incongruity – between reality as it actually is and reality as it is assumed to be or as it 'ought to be'	Changes in perception and fashion brought about by changes in the economy
Innovation based on process need; any inadequacy in a business process that is taken for granted	Changes in awareness caused by new knowledge
Changes in industry structure or market structure that catch everyone unawares	'Why?' and 'What If?' questions: Why do we always do things this way? What if we do it differently? Why should we limit ourselves to getting better in what we are doing? What if we change things radically? Why should I look at this risk as a problem? What if I try to convert risks into opportunities? Why don't we challenge our big competitor's market leadership position? What if we create a new market segment? Why should we look at cross-cultural differences as a problem? What if we try to leverage the power of our diversity?

Source: Peter F. Drucker, *Innovation and Entrepreneurship: Practice and Principles* (New York: Harper & Row, 1985).

In the information age, opportunities may have a different character. Joe Krause, the founder of Excite search engine, talks about how to spot opportunities on the net. Have a look at an average day of searches. The 97 per cent part of the graph (figure 11.2) represents the 97 per cent of searches conducted on Excite.

> The most popular searches (things like sex, MP3s and the bare midriff female singer du jour) were vastly more popular than the 1000th most popular search. For example, 'sex' was on the order of 100 000 times more popular than the 1000th most popular search (whatever that was). Said another way, there were a handful of extraordinarily common queries and millions of far less popular queries.

FIGURE 11.2 **EXCITE QUERY DISTRIBUTION**



Source: 'The long tail of software. Millions of markets of dozens' [bnoopy.typepad.com/bnoopy/2005/03/the_long_tail_o.html].

> In fact, the frequency of the average query was 1.2 searches per day for the entire world! That means if you wrote each of the millions and millions of search engine queries on a slip of paper, put them all in a fish bowl and grabbed one at random, there was a high likelihood that this query was asked only once during the day. The most interesting statistic, however, was that the top ten searches were thousands of times more popular than the average search, yet these top ten searches represented only 3% of our total volume. 97% of our traffic came from the 'long tail' – queries asked once a day.[8]

This is where the smart entrepreneur comes in. The big companies go after those dozens of markets of millions of people, but the smart entrepreneur turns it on its head and goes after the millions of markets of dozens. These are called 'long-tail markets' because they exist way out to the right on this graph. Google, eBay, Amazon, Rhapsody, Netflix, iTunes. What do they all have in common? They all work the 'long tail' and they're all radically changing the dynamics of their more traditional businesses. What's the next big trend? As this book goes to press, the word is 'podcasting'.

PITFALLS IN SELECTING NEW IDEAS AND OPPORTUNITIES

The first thing in choosing an opportunity is to analyse the pitfalls. Here are six of the most important pitfalls commonly encountered in the process of selecting an opportunity.

- **Lack of objective evaluation:** Many entrepreneurs lack objectivity. Engineers and technically trained people are particularly prone to falling in love with an idea for a product or service. They seem unaware of the need for the scrutiny they would give to a design or project in the ordinary course of their professional work. The way to avoid this pitfall is to subject all ideas to rigorous study and investigation by outsiders.
- **No real insight into the market:** Many entrepreneurs do not realise the importance of developing a marketing approach in laying the foundation for a new venture. They show a

managerial short-sightedness.[9] In addition, they do not understand the life cycle that must be considered when introducing a new product or service. No product is instantaneously profitable, nor does its success endure indefinitely. Entrepreneurs must not only forecast the life cycle of the new product, but also recognise that introducing the product at the right time is important to its success. Timing is critical. Action taken too soon or too late will often result in failure.

- **Inadequate understanding of technical requirements:** The development of a new product often involves new techniques. Failure to anticipate the technical difficulties with developing or producing a product can sink a new venture. Entrepreneurs cannot be too thorough when studying the project before initiating it. Encountering unexpected technical difficulties frequently poses time-consuming and costly problems.
- **Poor financial understanding:** A common difficulty with the development of a new product is an overly optimistic estimate of the funds required to carry the project to completion. Sometimes entrepreneurs are ignorant of costs, or are victims of inadequate research and planning. Quite often, they tend to underestimate development costs by wide margins. It is not unusual for estimates to be less than half of what is eventually required.
- **Lack of venture uniqueness:** A new venture should be unique. **Uniqueness** is the special characteristics and design concepts that should draw the customer to the venture and should provide performance or service superior to competitive offerings. The best way to ensure customer awareness of differences between the company's product and competitors' products is through product differentiation. Pricing becomes less of a problem when the customer sees the product as superior to its competitors. A product that is unique in a significant way can gain the advantage of differentiation.
- **Ignorance of legal issues:** Business is subject to many legal requirements. One is the need to make the workplace safe for employees. A second is to provide reliable and safe products and services. A third is the necessity for patents, trademarks and copyrights to protect one's inventions and products. When these legal issues are overlooked, major problems can result (see Entrepreneurship in practice: World-class failures).

ASSESSING NEW VENTURE OPPORTUNITIES

You cannot evaluate what you do not measure. The old adage 'that which gets measured gets done' is no less true of the opportunity evaluation. One way is to have a checklist that provides data to weigh up the value proposition as well as to forewarn of problems and to illuminate alternatives. In most cases, however, such a questionnaire approach is too general. The assessment must be tailor-made for the specific venture.

A new venture goes through three specific phases: pre-start-up, start-up and post-start-up. The pre-start-up phase begins with an idea for the venture and ends when the doors are opened for business. The start-up phase commences with the initiation of sales activity and the delivery of products and services and ends when the business is firmly established and beyond short-term threats to survival. The post-start-up phase lasts until the venture is terminated or the surviving organisational entity is no longer controlled by an entrepreneur.

During the pre-start-up and start-up phases, five factors are critical:

- the relative uniqueness of the venture
- the relative investment size at start-up
- the expected **growth of sales** and/or profits as the venture moves through its start-up phase
- the availability of products during the pre-start-up and start-up phases
- the availability of customers during the pre-start-up and start-up phases.

WORLD-CLASS FAILURES

ENTREPRENEURSHIP
IN PRACTICE

Here are some great failures in entrepreneurial history. Which pitfall do you think doomed these once attractive opportunities?

- **Leyland P76:** The Leyland P76 was a large car produced by Leyland Australia. It was nicknamed the 'cheese wedge' because of its shape, with a large boot able to hold a 44-gallon drum. Beset by strikes, power cuts and steel shortages, Leyland were unable to meet demand, although assembly continued in New Zealand.
- **Yugo:** This Serbian car was sold in the United States from 1986 to 1990. Dubbed 'the latest in Serbo-Croatian technology', the Yugo suffered from 'You go. I stay' reliability.
- **Boo.com:** Online clothing and accessories store. After blowing through hundreds of millions of dollars of venture capital on a poorly planned business model, it became the poster-child for mismanaged dot-coms.
- **eToys Inc:** This short-lived Internet retailer assumed that selling online was a different business, when it was really just a different distribution channel.
- **Pets.com:** An online pet food store that focused more on its brand name than profitability.
- **New Coke:** Coca-Cola company changed the formula and taste of its flagship product in 1985. It was a marketing and public relations debacle and the company had to backtrack and return to the older formula.
- **Segway:** The Segway human transporter is intended to revolutionise commuting transport. It is slowly finding acceptance in very specific applications in an uninformed world market.
- **Polaroid's Polavision:** Edwin Land used Polaroid's wet-chemistry technology to develop an instant movie camera. But videotape technology was far better.
- **R.J. Reynolds' Premier:** This cigarette didn't burn or emit smoke, but it simply didn't taste good.

Sources: 'Flops', *Business Week* (16 August 1993): 80; and Wikipedia, Licensed under the GNU Free Documentation Licence from the Wikipedia article 'List of commercial failures'.

Uniqueness

A new venture's range of uniqueness can be considerable, extending from fairly routine to highly non-routine. What separates the routine from the non-routine venture is the amount of innovation required during pre-start-up. This distinction is based on the need for new process technology to produce services or products and on the need to service new market segments. Venture uniqueness is further characterised by the length of time a non-routine venture will remain non-routine. For instance, will new products, new technology and new markets be required on a continuing basis? Or will the venture be able to 'settle down' after the start-up period and use existing products, technologies and markets?

Investment

The capital investment required to start a new venture can vary considerably. In some industries less than $50 000 may be required, whereas in other industries millions of dollars are necessary. Moreover, in some industries only large-scale start-ups are feasible. For example, in the publishing industry one can start a small venture that can remain small or grow into a larger venture. By contrast, an entrepreneur attempting to break into the airline industry will need a considerable upfront investment.

Another finance-related critical issue is the extent and timing of funds needed to move through the venture process. To determine the amount of needed investment, entrepreneurs must answer questions such as these:

TABLE 11.3: A NEW VENTURE IDEA CHECKLIST

BASIC FEASIBILITY OF THE VENTURE	• Can the product or service work? • Is it legal?
COMPETITIVE ADVANTAGES OF THE VENTURE	• What specific competitive advantages will the product or service offer? • What are the competitive advantages of the companies already in business? • How are the competitors likely to respond? • How will the initial competitive advantage be maintained?
BUYER DECISIONS IN THE VENTURE	• Who are the customers likely to be? • How much will each customer buy and how many customers are there? • Where are these customers located and how will they be serviced?
MARKETING OF THE GOODS AND SERVICES	• How much will be spent on advertising and selling? • What share of market will the company capture? By when? • Who will perform the selling functions? • How will prices be set? How will they compare with the competition's prices? • How important is location and how will it be determined? • What distribution channels will be used – wholesale, retail, agents and direct mail? • What are the sales targets? By when should they be met? • Can any orders be obtained before starting the business? How many? For what total amount?
PRODUCTION OF THE GOODS AND SERVICES	• Will the company make or buy what it sells? Or will it use a combination of these two strategies? • Are sources of supplies available at reasonable prices? • How long will delivery take? • Have adequate lease arrangements for premises been made? • Will the needed equipment be available on time? • Do any special problems with plant setup, clearances, or insurance exist? How will they be resolved? • How will quality be controlled? • How will returns and servicing be handled? • How will pilferage, waste, spoilage and scrap be controlled?
STAFFING DECISIONS IN THE VENTURE	• How will competence in each area of the business be ensured? • Who will have to be hired? By when? How will they be found and recruited? • Will a banker, lawyer, accountant, or other advisers be needed? • How will replacements be obtained if key people leave? • Will special benefit plans have to be arranged?
CONTROL OF THE VENTURE	• What records will be needed? When? • Will any special controls be required? What are they? Who will be responsible for them?
FINANCING THE VENTURE	• How much will be needed for development of the product or service? • How much will be needed for setting up operations? • How much will be needed for working capital? • Where will the money come from? What if more is needed? • Which assumptions in the financial forecasts are most uncertain? • What will be the return on equity, or sales and how does it compare with the rest of the industry? • When and how will investors get their money back? • What will be needed from the bank and what is the bank's response?

Source: Karl H. Vesper, *New Venture Strategies*, copyright © 1990, 172. Adapted by permission of Prentice-Hall, Inc., Englewood Cliffs, New Jersey.

- Will industry growth be sufficient to maintain break-even sales to cover a high fixed-cost structure during the start-up period?
- Do the principal entrepreneurs have access to substantial financial reserves to protect a large initial investment?
- Do the entrepreneurs have the appropriate contacts to take advantage of various environmental opportunities?
- Do the entrepreneurs have both industry and entrepreneurial track records that justify the financial risk of a large-scale start-up?[10]

Sales growth

The growth of sales through the start-up phase is another critical factor. Key questions are:

- What is the growth pattern anticipated for new-venture sales and profits?
- Are sales and profits expected to grow slowly or level off shortly after start-up?
- Are large profits expected at some point with only small or moderate sales growth? Or are both high sales growth and high profit growth likely? Or will initial profits be limited with eventual high profit growth over a multi-year period?

In answering these questions, it is important to remember that most ventures fit into one of the three following classifications.

A **lifestyle venture** appears to have independence, autonomy and control as their primary driving forces. Neither large sales nor profits are deemed important beyond providing a sufficient and comfortable living for the entrepreneur.

In a **small profitable venture**, financial considerations play a major role. Additionally, autonomy and control are important in the sense that the entrepreneur does not want venture sales (and employment) to become so large that they must relinquish equity or an ownership position and thus give up control over cash flow and profits, which, it is hoped, will be substantial.

In a **high-growth venture**, significant sales and profit growth are expected to the extent that it may be possible to attract venture capital money and funds raised through public or private placements.[11]

Product availability

Essential to the success of any venture is **product availability**, the availability of a saleable good or service, at the time the venture opens its doors. Some ventures have problems in this regard because the product or service is still in development and needs further modification or testing. Other ventures find that because they bring their product to market too soon, it must be recalled for further work. A typical example is the software firm that rushes the development of its product and is then besieged by customers who find 'bugs' in the program. Lack of product availability in finished form can affect the company's image and its bottom line.

Customer availability

If the product is available before the venture is started, the likelihood of venture success is considerably better than otherwise. Similarly, venture risk is affected by **customer availability** for start-up. At one end of the risk continuum is the situation where customers are willing to pay cash for products or services before delivery. At the other end of the continuum is the enterprise that gets started without knowing exactly who will buy its product. A critical consideration is how long it will take to determine who the customers are and what their buying habits are. As Ronstadt notes:

> The decision to ignore the market is an extremely risky one. There are, after all, two fundamental criteria for entrepreneurial success. The first is having a customer who is willing to pay you a profitable price for a product or a service. The second is that you must actually produce and deliver the product or service. The farther a venture removes itself from certainty about these two rules, the greater the risk and the greater the time required to offset this risk as the venture moves through the pre-start-up and start-up periods.[12]

WHY NEW VENTURES FAIL

Start-ups are high-risk, high-mortality ventures. According to Massey University research, 25 per cent of New Zealand companies founded in 1997 had failed by 2004.[13] Research in Australia finds a five-year failure rate of 39 per cent.[14] So it is important to recognise the warning signals that tell us a business is about to tip over the edge. According to Australian accountants, up to 90 per cent of small businesses make the same financial mistakes leading to high failure rates.[15] Here are the top 10 blunders:

- **Insufficient capital:** Most small and medium enterprises (SMEs) are undercapitalised, with no buffer for quieter times or unexpected expenses. This problem is compounded when they do not have arrangements in place with their banks.
- **No business plan:** Statistics show that the top businesses are likely to have a business plan in place. As the majority of SMEs do not have a business plan, they tend to lose focus and are too easily distracted from the right strategic course for the business. It also means they do not have a yardstick by which to measure their business performance.
- **No managerial focus:** Many people who establish small businesses fall into the trap of believing that because they are good at what the business does they will be good at running that type of business. Their time is so taken up with what they are doing they never have time to effectively manage the business.
- **Inadequate records:** Too often, the paperwork is forgotten; this can lead to trouble with the tax office or other government agencies and also make it difficult for the business manager to measure the firm’s performance.
- **Lack of profit focus:** Many businesses do not plan for profits or adequate profits, focusing simply on survival. This leaves them with no funds in reserve and no way to fund growth. Good businesses know how much profit they need to be making and organise their business around that figure.
- **Cash flow:** Management of SMEs often get into trouble because they run out of cash. They do not differentiate between profits and cash flow and they do not understand the cycles that occur in their business cash flows. Cash flow management requires strong discipline and control over debtors and stock.
- **Inadequate systems:** Many SMEs do not have operating systems in place and are overly dependent on the owners’ personal abilities. A lack of systems can cause differential standards and an inability to provide consistency within the business.
- **Failure to plan for taxation:** A business has to manage, fund and plan for a wide range of tax responsibilities. Failing to manage these can severely damage a business.
- **Inadequate resource management:** Business has a whole range of resources to manage – time, people, plant and equipment, cash, etc. It is necessary to know how to balance each and combine resources effectively.

MALCOLM BRICKLIN KEEPS ON TRYING

ENTREPRENEURIAL EDGE

As an entrepreneur, Malcolm Bricklin, 65, is best known for his bold failures. He began importing Subaru cars to the US in 1968 but left in 1972 before Subaru's sales ignited. His attempt at manufacturing his own car – the gorgeous, gull-winged Bricklin – failed before even 3000 were built. And then he brought the notoriously gimpy Yugo to the US in the 1980s. Undaunted, he declared in 2002 that his new company, Zastrava Motor Works, would import a different car from the former Yugoslavia. Luckily for him, it never happened. Now Bricklin tells *FSB* that his Manhattan-based company, today called Visionary Vehicles, plans to start hawking five models from China's Chery Automobile Co. for 30 per cent less than the price of comparable vehicles.

Ian Mount interviews Malcolm Bricklin:

Mount: What happened to Zastrava?

Bricklin: When we formed Zastrava, we went to see a factory in Serbia and realized that the cost to update it would make it impossible. NATO had fired five missiles into it during the war, so it was challenged, to say the least.

Mount: Why will the Chery succeed where the Bricklin and Yugo crapped out?

Bricklin: In the Bricklin case I had to build a factory, so I went to a place that would give me money – Canada – not to a place that was good at building cars. In Canada at that time, you could work for three months and go on the dole (unemployment benefit) for a year, so every three months we were getting about 80% turnover. With the Yugo, we took a car that was a 20-year-old Fiat and made 528 changes in 14 months and colour was about the only option we offered. To sell 50 000 of those cars a year for three years was impressive. Then the country imploded.

Mount: Did you learn anything from all this?

Bricklin: Don't do business with a factory that can't do as good a job as we can in the US. The one in Yugoslavia was built in the 1950s. The difference this time is that we're doing business with a factory that is state of the art. And it's in a country I hope won't blow up.

Source: Ian Mount, 'Wild ride', *FSB: Fortune Small Business* 15(2) (March 2005): 24.

- **Break-even point:** One of the most critical pieces of information for any business is to know and understand the break-even point, to allow for effective pricing and costing decisions. Too often, businesses get into trouble because they trade under their break-even point.

Research in Singapore finds that there are six **critical factors** that are internal to the firm and that they are things entrepreneurs can do something about. These include: high operating expenses, lack of capital, short-sighted view of the future, lack of control over cash, lack of knowledge of the company's product(s) and inappropriate marketing strategy. The most important external variable is high taxes but external factors are way behind the internal ones. The researcher comments that:

> many people from certain quarters in Singapore, such as officials and members of the chambers of commerce or even the SMA, have the tendency to blame the economic environment (high inflation and high interest rates), labour environment (high labour cost and tight labour market), competitive environment and regulatory environment for the problems faced by SMEs. The first step in helping SMEs may be the recognition that these uncontrollable factors, though relevant, may not be the most important factors and thus, these organisations should stop focusing solely on these factors.[16]

FEASIBILITY ANALYSIS OF NEW VENTURE OPPORTUNITIES Once an idea has cleared the assessment hurdles, it is ready for evaluation. Here we are talking about a feasibility analysis of the new product or service idea. Entrepreneurs must put their ideas through this analysis in order to discover if the proposals contain any fatal flaws. This gives a 'go' or 'no-go' gate in deciding whether to proceed. Feasibility analysis is one of the most important skills an entrepreneur can acquire. It forces entrepreneurs to do serious research and to think critically about their business concept. All of the techniques below make up what we call feasibility analysis.

Critical questions analysis

Many important feasibility-related questions should be asked. Following are 10 sets of preliminary questions that can be used to evaluate an idea:

- Is it a new product/service idea? Is it proprietary? Can it be patented or copyrighted? Is it unique enough to get a significant head start on the competition? Or can it be easily copied?
- Has a prototype been tested by independent testers who try to blow up the system or rip the product to shreds? What are its weak points? Will it stand up? What level of research and development should it receive over the next five years? If it is a service, has it been tested on guinea pig customers? Will they pay their hard-earned money for it?
- Has it been taken to trade shows? If so, what reactions did it receive? Were any sales made? Has it been taken to distributors? Have they placed any orders?
- Is the product or service easily understood by customers, bankers, venture capitalists, accountants, lawyers and insurance agents?
- What is the overall market? What are the market segments? Can the product penetrate these segments? Can any special niches be exploited?
- Has market research been conducted? Who else is in the market? How big is the market? How fast is it growing? What are the trends? What is the projected life cycle of the product or service? What degree of penetration can be achieved? Are there any testimonials from customers and purchasing agents? What type of advertising and promotion plan will be used?
- What distribution and sales methods will be used – independent sales representatives, the company sales force, direct mail, door-to-door sales, supermarkets, service stations and company-owned stores? How will the product be transported, for example: company-owned trucks, common carriers, postal service or air freight?
- How will the product be made? How much will it cost? For example, will it be produced in-house or by others? Will production be by continuous process or other method? What is the present capacity of company facilities? What is the break-even point?
- Will the business concept be developed and licensed to others or developed and sold away?
- Can the company get – or has it already lined up – the necessary skills to operate the business venture? Who will be the workers? Are they dependable and competent? How much capital will be needed now? How much more in the future? Have major stages in financing been developed?[17]

Financial failure analysis

It is time to get serious about the financials. Indeed, early financial data can often predict the failure of newly founded ventures. One important study saw that financial failure was characterised by too much initial indebtedness and too little revenue financing. As shown by table 11.4, the risk of failure can be reduced by using less debt as initial financing and by generating enough revenue in the initial stages.

Further, the study recognised the risk associated with the initial size of the venture being developed. Specific applications of the model included the following:

- Role of profitability and cash flows. The entrepreneur and manager should ensure that the products are able to yield positive profitability and cash flows in the first years.
- Role of debt. The entrepreneur and manager should ensure that enough stockholders' capital is in the initial balance sheet to buffer future losses.
- Combination of both. The entrepreneur and manager should not start a business if the share of stockholders' capital in the initial balance sheet is low and if negative cash flows in the first years are probable.
- Role of initial size. The entrepreneur and manager should understand that the more probable the negative cash flows and the larger the debt share in the initial balance sheet, the smaller the initial size of the business should be.

TABLE 11.4: **THE FAILURE PROCESS OF A NEWLY FOUNDED FIRM**

1	Extremely high indebtedness and small size	
2	Velocity of capital too slow; growth too fast, poor profitability (as compared to the budget), or some combination of these	
3	Unexpected lack of revenue financing	
4	Poor static liquidity and debt service ability	
A	Profitability	
1	Return on investment ratio defined on end-of-the-year basis	Net profit + Interest expenses × 100 = Total capital at the end of the year
B	Liquidity	
Dynamic		
2	Cash flow to net sales	= Net profit + Depreciations × 100 ÷ Net sales
	Static	
3	Quick ratio	= Financial assets ÷ Current debt
C	Solidity	
Static		
4	Stockholders' capital to total capital	= Total capital – Debt capital × 100 ÷ Total capital
Dynamic		
5	Cash flow to total debt	= Net profit + Depreciations × 100 ÷ Total debt
D	Other factors	
Growth or dynamic size		
6	Rate of annual growth in net sales	Net sales in year t × 100 = Net sales in year $t - 1$
Size		
7	Logarithmic net sales	= In (Net sales)
Velocity of capital		
8	Net sales to total capital	Net sales = Total capital at the end of the year

Source: Erkki K. Laitinen, 'Prediction of failure of a newly founded firm', *Journal of Business Venturing* (July 1992): 326–8. Reprinted with permission.

- Role of velocity of capital. The entrepreneur and manager should not budget for fast velocity of capital in the initial years if the risk of negative cash flows is high. More sales in comparison to capital means more negative cash flows and poorer profitability.
- Role of control. The entrepreneur and manager should monitor financial ratios from the first year, especially the cash-flow-to-total-debt ratio. Risky combinations of ratios (Z-scores) – especially negative cash flows, a low stockholders' capital-to-total-capital ratio and a high velocity of capital – should be monitored and compared with industrial standards. The entrepreneur should try to identify the reasons for poor ratios and pay special attention to keeping profitability at the planned level (with control ratios).[18]

Profile analysis

A single strategic variable seldom shapes the ultimate success or failure of a new venture. In most situations, a combination of variables influences the outcome. Thus, it is important to identify and investigate these variables before the new idea is put into practice. The results of such a **profile analysis** enable the entrepreneur to judge the business's potential.

The internal profile analysis in the Experiential exercise at the end of this chapter is one method of determining the resources available to a new venture. This checklist approach allows entrepreneurs to identify major strengths and weaknesses in the financial, marketing, organisational and human resource factors needed for the venture to progress successfully. In this manner, entrepreneurs can prepare for possible weaknesses that may inhibit the growth of their venture. More important, many of the reasons cited for venture failure earlier in this chapter can be avoided through a careful profile analysis.

Feasibility criteria approach

Another method, the **feasibility criteria approach**, provides a means of analysing the internal strengths and weaknesses that exist in a new venture by focusing on the marketing and industry potential. A criteria selection list which highlights factors critical to new venture feasibility has been developed. Entrepreneurs can gain insights into the viability of their venture using this list of questions:

- Is it proprietary? The product does not have to be patented, but it should be sufficiently proprietary to permit a long head start against competitors and a period of extraordinary profits early in the venture to offset start-up costs.
- Are the initial production costs realistic? Most estimates are too low. A careful, detailed analysis should be made so no large, unexpected expenses arise.
- Are the initial marketing costs realistic? This answer requires the venture to identify target markets, market channels and promotional strategy.
- Does the product have potential for very high margins? This is almost a necessity for a fledgling company. Gross margins are one thing the financial community understands. Without them, funding can be difficult.
- Is the time required to get to market and to reach the break-even point realistic? In most cases, the faster the better. In all cases, the venture plan will be tied to this answer and an error here can spell trouble later on.
- Is the potential market large? In determining the potential market, entrepreneurs must look three to five years into the future because some markets take this long to emerge. The mobile telephone, for example, had an annual demand of approximately 400 000 units in 1982. However, by the late 1990s this market was estimated to grow by at least 45 per cent annually.
- Is the product the first of a growing family? If it is, the venture is more attractive to investors. If they do not realise a large return on the first product, they might on the second, third, or fourth.

- Does an initial customer exist? It is certainly impressive to financial backers when a venture can list its first 10 customers by name. This pent-up demand also means the first quarter's results are likely to be good and the focus of attention can be directed to later quarters.
- Are the development costs and calendar times realistic? Preferably, they are zero. A ready-to-go product gives the venture a big advantage over competitors. If costs exist, they should be complete, detailed and tied to a month-by-month schedule.
- Is this a growing industry? This is not absolutely essential if the profits and company growth are there, but it means less room for mistakes. In a growing industry, good companies do even better.
- Can the product and the need for it be understood by the financial community? If the financiers can grasp the concept and its value, the chances for funding will increase. For example, a portable heart-monitoring system for post-coronary monitoring is a product many will understand. Undoubtedly, some of those hearing the presentation will have already had coronaries or heart problems of some sort.[19]

If the new venture meets fewer than six of these acceptance criteria questions, it typically lacks feasibility for funding. If the new venture meets seven or more of the acceptance criteria, it may stand a good chance of being funded.

Comprehensive feasibility approach

A more comprehensive and systematic feasibility analysis, the **comprehensive feasibility approach**, incorporates external factors in addition to those in the feasibility criteria approach questions. Figure 11.3 presents a breakdown of the factors involved in a comprehensive feasibility study of a new venture – technical, market, financial, organisational and competitive. A more detailed feasibility analysis guide is provided in table 11.5, which identifies the specific activities involved in each feasibility area.

Although all five of the areas presented in figure 11.3 are important, two merit special attention: technical and market.

Technical feasibility

The evaluation of a new venture idea should start with identifying the **technical feasibility**. This analysis includes an assessment of the technical requirements for producing a product or service that will satisfy the expectations of potential customers. The most important of these are:

- functional design of the product and attractiveness in appearance
- flexibility, permitting ready modification of the external features of the product to meet customer demands or technological and competitive changes

FIGURE 11.3 KEY AREAS FOR ASSESSING THE FEASIBILITY OF A NEW VENTURE

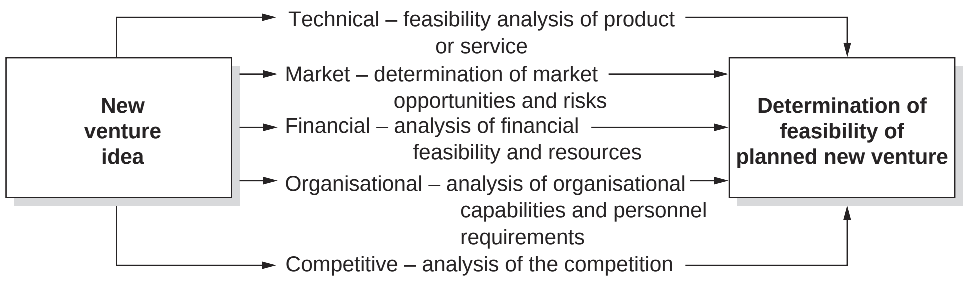


TABLE 11.5: **SPECIFIC ACTIVITIES OF FEASIBILITY ANALYSES**

TECHNICAL FEASIBILITY ANALYSIS	MARKET FEASIBILITY ANALYSIS	FINANCIAL FEASIBILITY ANALYSIS	ANALYSIS OF ORGANISATIONAL CAPABILITIES	COMPETITIVE ANALYSIS
Crucial technical specifications	Market potential	Required financial resources for:	Personnel requirements	Existing competitors
Design	Identification of potential customers and their dominant characteristics (e.g. age, income level, buying habits)	fixed assets	Required skill levels and other personal characteristics of potential employees	Size, financial resources, market entrenchment
Durability	Potential market share (as affected by competitive situation)	current assets	Managerial requirements	Potential reaction of competitors to newcomer by means of price cutting, aggressive advertising, introduction of new products and other actions
Reliability	Potential sales volume	necessary working capital	Determination of individual responsibilities	Potential new competitors
Product safety	Sales price projections	Available financial resources	Determination of required organisational relationships	
Standardisation	Market testing	Required borrowing	Potential organisational development	
Engineering requirements	Selection of test	Potential sources for funds	Competitive analysis	
Machines	Actual market test	Cost of borrowing		
Tools	Analysis of market	Repayment conditions		
Instruments	Marketing planning issues	Operation cost analysis		
Work flow	Preferred channels of distribution, impact of promotional efforts, required distribution points (warehouses), packaging considerations, price differentiation	Fixed costs		
Product development		Variable costs		
Blueprints		Projected cash flow		
Models		Projected profitability		
Prototypes				
Product testing				
Lab testing				
Field testing				
Plant location				
Desirable characteristics of plant site (proximity to suppliers, customers), environmental regulations				

Source: Hans Schollhammer and Arthur H. Kuriloff, *Entrepreneurship and Small Business Management* (New York: John Wiley & Sons, 1979), 56. Copyright © 1979 by John Wiley & Sons, Inc. Reprinted by permission of John Wiley & Sons, Inc.

- durability of the materials from which the product is made
- reliability, ensuring performance as expected under normal operating conditions
- product safety, posing no potential dangers under normal operating conditions
- reasonable utility – an acceptable rate of obsolescence
- ease and low cost of maintenance
- standardisation through elimination of unnecessary variety among potentially interchangeable parts
- ease of processing or manufacture
- ease in handling and use.[20]

The results of this investigation provide a basis for deciding whether a new venture is feasible from a technical viewpoint.

Marketability

Assembling and analysing relevant information about the **marketability** of a new venture are vital for judging its potential success. Three major areas in this type of analysis are:

- investigating the full market potential and identifying customers (or users) for the goods or service
- analysing the extent to which the enterprise might exploit this potential market
- using market analysis to determine the opportunities and risks associated with the venture.

To address these areas, a variety of informational sources must be found and used. For a market feasibility analysis, general sources would include:

- general economic trends – various economic indicators such as new orders, housing starts, inventories and consumer spending
- market data – customers, customer demand patterns (for example, seasonal variations in demand, governmental regulations affecting demand)
- pricing data – range of prices for the same, complementary and substitute products; base prices; and discount structures
- competitive data – major competitors and their competitive strength.

More attention is given to marketing issues in chapter 8. At this point, it is important to note the value of marketing research in the overall assessment and evaluation of a new venture.[21]

Thus, as demonstrated by table 11.5, the comprehensive feasibility analysis approach is closely related to the preparation of a thorough business plan (covered in detail in chapter 10). The approach clearly illustrates the need to evaluate each segment of the venture before initiating the business or presenting it to capital sources.

Figure 11.4 provides a list of key feasibility areas to assess a new venture. It behoves the entrepreneur to have considered each of these before a ‘go’/‘no-go’ decision is made.

COMMERCIALISING NEW VENTURE OPPORTUNITIES

The assessment process and the feasibility analysis that we have been discussing are basically the first hurdles of a complex procedure called commercialisation. Having assessed and evaluated a new venture opportunity, the next step is to develop it for the marketplace. Commercialisation is the sequence of actions necessary to achieve market entry and general market competitiveness of new services, processes and products. Commercialisation has been the subject of serious study and elaboration for more than 20 years.[22]

FIGURE 11.4 KEY FEASIBILITY AREAS TO ASSESS NEW VENTURES

Marketing and sales

- Market research and evaluation: Ability to design and conduct market research studies and to analyse and interpret study results; familiarity with questionnaire design and sampling techniques
- Strategic sales: Experience in developing marketing strategies and establishing sales forces and then planning appropriate sales, advertising and promotional programs and setting up an effective network distributor or sales representative organisation
- Sales management and merchandising: Ability to organise, supervise, motivate and provide merchandising support to a direct sales force; ability to analyse territory and account sales potential and to manage a sales force to obtain target market share
- Direct selling: Experience in identifying, meeting and developing new customers; demonstrated success in closing sales
- Service: Ability to perceive service needs of particular products; experience in determining service and spare parts requirements, handling customer complaints and managing a service organisation
- Distribution management: Ability to organise and manage product flow from manufacturing through distribution channels to the ultimate customer, including familiarity with shipping costs, scheduling techniques, carriers and other factors
- Overall marketing skills: Give yourself a combined rating reflecting your skill level across all of the marketing areas

Operations

- Manufacturing management: Knowledge of the product processes, machines, workforce and space required to produce the product; experience in managing production to produce products within time, cost and quality constraints
- Inventory control: Familiarity with techniques of controlling in-process and finished-goods inventories of materials
- Quality control: Ability to set up inspection systems and standards for effective quality control of incoming, in-process and finished materials
- Purchasing: Ability to identify appropriate supply sources, negotiate supplier contracts and manage incoming flow of material into inventory; familiarity with economical order quantities and discount advantage
- Overall operations skills: Give yourself a combined rating reflecting your skill level across all of the operations areas

Research, development and engineering

- Direction and management of applied research: Ability to distinguish and keep a prudent balance between long-range projects at the frontiers of your technology, which attract the most creative individuals and shorter-range research in support of current product development activity
- Management of development: Ability to plan and direct work of development engineers and to use time and cost budgets so perfectionists do not ruin you but product performance, appearance and production engineering needs can still be met
- Management of engineering: Ability to plan and direct engineers in the final design of a new product for manufacture and in the engineering and testing of the production process to manufacture that new product
- Technical know-how: Ability to contribute personally to research, development and engineering because of up-to-date, in-depth knowledge of the technologies in which your company is involved
- Overall research, development and engineering skills: Give yourself a combined rating reflecting your skill level across the previous areas

Financial management

- Raising capital: Ability to decide how best to acquire funds for start-up and growth; ability to forecast the need for funds and to prepare budgets; familiarity with sources and vehicles of short-term and long-term financing
- Money management: Ability to design, install, maintain and use financial controls; familiarity with accounting and control systems needed to manage money; ability to set up a project cost-control system, analyse overhead/contribution/absorption, prepare profit-and-loss and balance sheets and manage a bookkeeper
- Specific skills: Cash-flow analysis; break-even analysis; contribution analysis; budgeting and profit-planning techniques; profit and loss, balance sheet and present value analysis of return on investment and payback
- Overall financial skills: Give yourself a combined rating reflecting your skill level across all of the financial areas

General management and administration

- Problem solving: Ability to anticipate potential problems and plan to avoid them; ability to gather facts about problems, analyse them for real causes and plan effective action to solve the problems;

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thoroughness in dealing with the details of particular problems and in follow-through

- Communications: Ability to communicate effectively and clearly, both in speech and in writing, to the media, the public, customers, peers and subordinates
- Planning: Ability to set realistic and attainable goals, identify obstacles to achieving the goals and develop detailed action plans to achieve those goals; ability to schedule own time systematically
- Decision making: Ability to make decisions on your best analysis of incomplete data
- Project management: Skill in organising project teams, setting project goals, defining project tasks and monitoring task completion in the face of problems and cost/quality constraints
- Negotiating: Ability to work effectively in a negotiating situation; ability to quickly balance value given and value received
- Personnel administration: Ability to set up payroll, hiring, compensation and training functions
- Overall administrative skills: Give yourself a combined rating reflecting your skill level across all of the administrative areas

Personnel management

- Leadership: Ability to understand the relationships among tasks, the leader and the followers; ability to lead in situations where appropriate; willingness to manage actively, supervise and control activities of others through directions, suggestions, inspiration and other techniques
- Listening: Ability to listen and understand without interrupting or mentally preparing your own rebuttal at the expense of hearing the message
- Helping: Ability to ask for and provide help and to determine situations where assistance is warranted
- Criticism: Ability to provide performance and interpersonal criticism to others that they find useful; ability to receive feedback from others without becoming defensive or argumentative
- Conflict resolution: Ability to confront differences openly and to deal with them until resolution is obtained
- Teamwork: Ability to work well with others in pursuing common goals
- Selecting and developing subordinates: Ability to select and delegate responsibility to subordinates and to coach them in the development of their managerial capabilities
- Climate building: Ability to create, by the way you manage, a climate and spirit conducive to high performance; ability to press for higher performance while rewarding work well done
- Overall interpersonal skills: Give yourself a combined rating reflecting your skills across all of the personnel management areas

Legal and tax aspects

- Corporate law: Familiarity with legal issues relating to stock issues, incorporation, distribution agreements, leases and so on
- Contract law: Familiarity with contract procedures and requirements (governmental and commercial), including default, warranty and incentive provisions; fee structures; overhead, general and administrative expenses allowable; and so forth
- Patent law: Experience with preparation and revision of patent applications; ability to recognise a strong patent; familiarity with claim requirements
- Tax law: Familiarity with general state and federal reporting requirements for businesses and with special provisions concerning corporations, tax shelters, fringe benefits and other issues
- Overall legal and tax skills: Give yourself a combined rating reflecting your skill level across all of the legal and tax areas

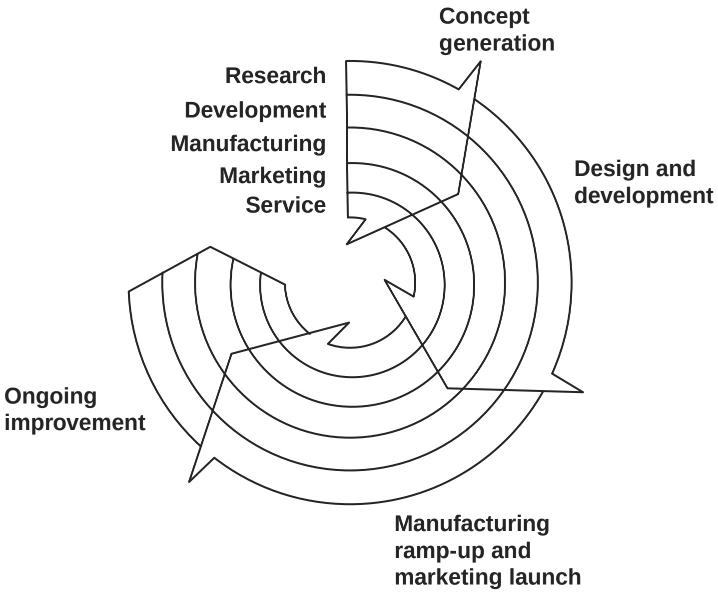
Source: Greg R. Smith, SciVentures Investments Pty Ltd 2001. Prepared for AIC [www.sciventures.com.au/upload/document/IIR_talk_111102.pdf].

Nevens and his team at Harvard University outlined the best practice model shown in figure 11.6.[23] They see it as a series of overlapping and concurrent phases that involve many business functions simultaneously. The process begins when a business has assessed and determined feasible a novel product or service. The process continues through design, development, manufacturing ramp-up and marketing and includes as well later efforts to improve the product.

Other models have seen commercialisation as a linear process with stages and gates (hurdles) through which the new product or service has to pass from one phase to another. See chapter 5 for a description of the stage-gate process of innovation, which emulates the commercialisation process.

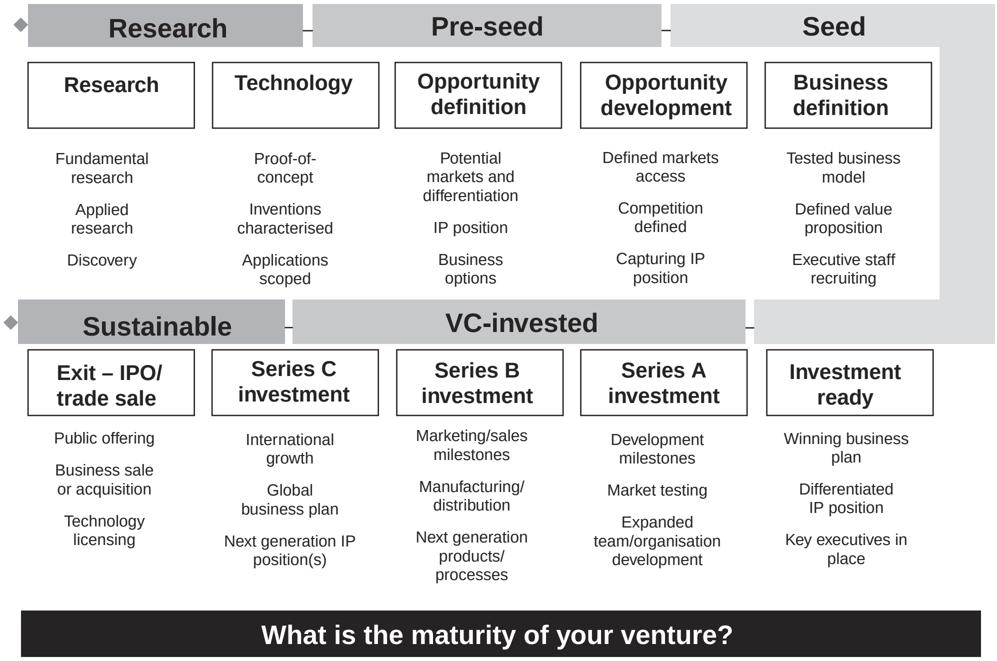
One excellent Australian model shows the pathway from ‘mind to market’. Figure 11.6 shows the various stages that an idea will need to move through in order to reach commercial success.

FIGURE 11.5: THE COMMERCIALISATION PROCESS



Source: *Pratt's Guide to Venture Capital Sources* (Wellesley, MA: Venture Economics, 1999).

FIGURE 11.6 COMMERCIALISATION PROGRESSION MODEL



Research		Pre-seed		Seed
Research	**Technology**	**Opportunity definition**	**Opportunity development**	**Business definition**
Fundamental research Applied research Discovery	Proof-of-concept Inventions characterised Applications scoped	Potential markets and differentiation IP position Business options	Defined markets access Competition defined Capturing IP position	Tested business model Defined value proposition Executive staff recruiting

Sustainable	VC-invested			
Exit – IPO/ trade sale	**Series C investment**	**Series B investment**	**Series A investment**	**Investment ready**
Public offering Business sale or acquisition Technology licensing	International growth Global business plan Next generation IP position(s)	Marketing/sales milestones Manufacturing/ distribution Next generation products/ processes	Development milestones Market testing Expanded team/organisation development	Winning business plan Differentiated IP position Key executives in place

What is the maturity of your venture?

Source: T. Michael Nevens, Gregory Summe and Bro Uttal, 'Commercialising technology: What the best companies do', *Harvard Business Review on Entrepreneurship* (Harvard Business School, 1990), 175–204.

The steps follow the progression of start-up companies through pre-seed, seed and venture or other investment capital funding. These steps are:

- **Research phase:** Much of this is conducted in universities, research institutes and corporate labs. The ideas and concepts emerging from the discovery process may yield possible commercialisable products.
- **Technology phase:** Ideas make a transition from the research lab to the 'proof of concept' stage. Possible new, unanticipated applications are scoped out. Attention is paid to protecting the intellectual property through patents or copyrights.
- **Opportunity definition phase:** 'Pre-seed' activities begin in earnest. The key here is understanding how the idea will work in the marketplace. Fatal flaws must be identified. Competitor and marketplace analysis help determine the business options.
- **Opportunity development phase:** Deeper understanding is gained about market access. A positioning strategy vis-à-vis competitors is elaborated. Thought is given to how to capture or legally monopolise the market through the product's intellectual property (IP) position. The concept moves now into the 'seed' stage where an angel investor might become interested.
- **Business definition phase:** A team now progresses the seed stage to develop business models and define the value proposition. Staffing requirements need to match the skills requirements.
- **Investment-ready phase:** The executive team prepares a full business plan that describes the cash generation engine and market opportunities in detail. Staff recruitment is completed. The team takes business's case on a road show into the capital markets.
- **Series A investments:** Series A investors typically obtain a percentage of the equity based on the business's valuation, market prospects and IP value. Series A investors demand milestones for phased funding. The executive team together with the board and investors make decision points on 'go'/'no-go' decisions and test the product with customers.
- **Series B investments:** Based on the success of the A phase, series B investors will demand a further equity percentage based on the same factors as in the A series.
- **Series C investments:** Further rounds help sustain the business's growing profitability. During this phase there may be considerable dilution of equity share interests held by the founders. At this stage, many Australian and New Zealand companies migrate their operations and intellectual property to the United States or Europe.
- **Exit – initial public offering (IPO) or trade sale:** Investors and founders may wish to capture the value of the company and on-sell it or take it public. A hot company may well be acquired by a larger competitor. Other businesses grow to their limits and ultimately are sold at market rates. The most successful companies may offer shares to the public through the stock exchange to raise additional capital in order to grow and expand.

SUMMARY

Both high growth and lifestyle entrepreneurs must make decisions about the feasibility and commercial value of new ventures. The techniques in this chapter are more suited to the high growth entrepreneur.

The complexity of factors involved in new venture start-up (as shown in figure 11.1) makes it difficult to clearly assess and evaluate each one. In addition, the difficulty of obtaining reliable data on failed firms adds to this dilemma. Improvements are being made, however, and new venture assessment is becoming a stronger process.

Opportunity assessment means determining whether an idea has commercialisable value. The entrepreneur needs both vertical and lateral thinking to make this judgement. There are a number of tried and tested methods for assessing whether a 'mere' idea can become a 'viable' opportunity. In the age of the Internet, opportunity assessment may have an entirely different character. Here we are more interested in finding 'millions of markets of dozens' rather than 'dozens of markets of millions'.

A number of pitfalls may occur in the selection of a new venture: lack of an objective evaluation of the venture, lack of insight into the market, inadequate understanding of technical requirements, poor financial understanding, lack of venture uniqueness and failure to be aware of legal issues.

Assessment is more rigorous than evaluation. When assessing a new venture, an entrepreneur needs to consider several critical factors: the uniqueness of the good or service, the amount of capital investment required to start the venture, the growth of sales and the availability of the product.

Some major reasons new ventures fail are inadequate knowledge of the market, faulty product performance, ineffective marketing and sales effort, inadequate awareness of competitive pressures, rapid product obsolescence, poor timing and undercapitalisation. In drawing together these and other reasons, recent research reveals three major categories of causes for failure: product/market problems, financial difficulties and managerial problems. In addition, entrepreneurs face internal and external problems.

Feasibility analysis leads the entrepreneur through a series of critical decision points. The feasibility of the entrepreneur's product or service can be assessed by asking the right questions, by making a profile analysis of the venture and by carrying out a comprehensive feasibility study.

Assuming that a 'mere' idea has been identified as a 'viable' opportunity and that it has survived the rigours of feasibility analysis, the final step to bringing it to the marketplace is the commercialisation process. Commercialisation takes a new product or service through a 'stage-gate' series of hurdles (see chapter 5). In this chapter we describe those hurdles as a series of phases from the research phase all the way to the exit phase. Each of these steps requires people with different skills.

KEY TERMS AND CONCEPTS

commercialisation
comprehensive feasibility approach
critical factors
customer availability
feasibility criteria approach
growth of sales
high-growth venture
lateral thinking
lifestyle venture
marketability
opportunity
product availability
profile analysis
small profitable venture
technical feasibility
uniqueness
vertical thinking

REVIEW AND DISCUSSION QUESTIONS

1. Why are we more interested in high growth entrepreneurs than in lifestyle entrepreneurs?
2. Describe some of the key factors involved in new venture performance (use figure 11.1).
3. What are the two types of thinking that an entrepreneur needs to assess an opportunity? Give your own examples.
4. What are some techniques to support highly profitable business opportunities?
5. What does Drucker mean by internal and external sources of opportunities?
6. Many entrepreneurs lack objectivity and have no real insight into the market. Why are these characteristics considered pitfalls of selecting new ventures?
7. Many entrepreneurs have a poor understanding of the finances associated with their new venture and/or have a venture that lacks uniqueness. Why are these characteristics considered pitfalls of selecting new ventures?
8. What are the overall categories in a new venture idea checklist?
9. What are the top reasons for ventures failing?
10. What are ways to evaluate new venture opportunities?

11 Explain how a feasibility criteria approach works.
12 Explain how a comprehensive feasibility approach works.
13 Explain how assessment, evaluation and commercialisation go together.
14 What is the progression of the commercialisation process?

EXPERIENTIAL EXERCISE

INTERNAL PROFILE ANALYSIS

Choose any emerging company with which you are familiar. If you are not familiar with any, consult magazines such as the American ones (*Entrepreneur*, *Forbes*, *Fortune* and *Business Week*), Asia–Pacific ones (*Australian Financial Review*, *Business Review Weekly*, *Her Business*, *National Business Review*, *Unlimited*), or international magazines (*Economist*, *Far Eastern Economic Review*, *Financial Times*, *AsiaWeek*, *Asian Wall Street Journal*). Gather information on one firm. Then complete the following internal profile analysis by placing a check mark (√) in the appropriate column.

INTERNAL RESOURCE	STRONG WEAKNESS	SLIGHT WEAKNESS	NEUTRAL	SLIGHT STRENGTH	STRONG STRENGTH
Financial					
Overall performance					
Ability to raise capital					
Working capital					
Position					
Marketing					
Market performance					
Knowledge of markets					
Product					
Advertising and promotion					
Price					
Distribution					
Organisational and technical					
Location					
Production					
Facilities					
Access to suppliers					
Inventory control					
Quality control					
Organisational structure					
Rules, policies and procedures					
Company image					
Human					
Number of employees					
Relevancy of skills					
Morale					
Compensation package					

- Based on your analysis, what three recommendations would you make to the company's management?

CASE 11.1:

FROM WOOL TO FLU REMEDY

The unusual tale of how wool research led to the influenza drug Relenza is a classic illustration of how Australia's strength in rural research underpins the nation's growth in biotechnology. But it is also a story that highlights some of the pitfalls to avoid when commercialising research.

Within 50 years of European settlement in 1788, sheep were grazing in every colony of Australia. The annual wool clip was more than two million kilograms and wool had become the nation's main export. But in the 1950s, the wool industry was threatened by the development of nylon, a reliable synthetic fibre with predictable properties. In response, the Commonwealth Scientific and Industrial Research Organisation

(CSIRO), Australia's largest science organisation, launched a counterattack involving research into every aspect of wool – from breeding sheep for finer wool to understanding the physical and chemical properties of individual fibres.

To investigate protein structure, the researchers turned to X-ray crystallography – invented by Anglo–Australian Nobel laureates William and Lawrence Bragg. The impact was profound. It improved dyeing and stopped wool from yellowing and shrinking in the wash. But a downturn in the wool industry in the 1970s encouraged protein chemists at the CSIRO to shift their focus away from wool and link up with their colleagues in medical research.

Targeting flu

In the 1950s, medical researchers at the Walter and Eliza Hall Institute in Melbourne discovered that the influenza virus carries enzymes known as neuraminidases, which help it to enter cells. Inhibiting neuraminidase enzymes became a strategy for treating influenza.

Peter Colman, a researcher at the CSIRO Division of Protein Chemistry, collaborated with colleagues, Jose Varghese and Graeme Laver at the Australian National University in Canberra to identify the three-dimensional structure of neuraminidase and observe what changes occurred when the influenza virus mutated into a new strain. In 1983, they published their first crude image of the protein (*Nature* 303, 35–40; 1983).

The work attracted the attention of international drug company Glaxo Wellcome, but a year of negotiation led nowhere. It was too difficult to persuade the company to invest in a small team on the other side of the world.

A local start-up company called Biota came to the rescue and, with government support, the work continued. In the mid-1980s, working with synchrotrons around the world, Colman and Varghese made the long-awaited breakthrough. 'It was slow, difficult work, but it showed us that one part of a coat protein didn't change in the flu strains. There was a cleft in the neuraminidase protein – a potential target for a drug', says Colman.

The researchers eventually designed a synthetic molecule that could plug this cleft and disrupt the virus's life cycle. This synthesised molecule became the basis for the drug Relenza, commercialised by Biota in 1999 with GlaxoSmithKline.

But it took longer than anticipated to get the drug through the US Food and Drug Administration's approval process and some clinicians have raised concerns about Relenza's performance. Biota's shares collapsed in value following the company's failure to deliver a long heralded royalty income.

Since then, Biota has survived and learned, as has the wider industry. Colman is now at the Walter and Eliza Hall Institute looking at the structure of the proteins responsible for cell death with a view to developing new anticancer drugs. And Varghese continues at the CSIRO, using synchrotron X-ray diffraction to determine the structure of proteins involved in a range of conditions including diabetes, inflammation diseases and certain cancers.

Woolly end

And what of wool? The past half-century of research has helped keep the industry in business, despite synthetic fibres. The latest innovation is a product called Optim. 'We found we could transform wool by stretching and setting the fibres to create a new fibre with a silk-like touch, distinctive sheen and subtle lustre, which retains the best properties of wool', David Phillips from the CSIRO's Division of Textile Fibre Technology.

'We needed to know exactly what was happening at the molecular level, so we used synchrotron X-ray diffraction at the Photon Factory in Japan. The analysis confirmed that we had succeeded in changing the protein structure of the wool to a structure similar to silk', says Phillips.

Source: Charles Beckley, 'From wool to flu remedy', *Nature* 429 (6 April 2004): 5–10.

QUESTIONS

1 What were some of the pitfalls of commercialising the influenza drug Relenza?
2 What are the new directions for wool?

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ENTREPRENEURSHIP GOES GLOBAL: RESMED'S GAMBLE

Publication date: 26 April 2004
Revision date: 7 June 2004
Author(s): Christopher A. Bartlett Andrew N. McLean, Meg Wozny
Product number: 9-304-051

On the basis of its innovative medical device for treating sleep apnoea, CEO Peter Farrell has made Australian-born ResMed a successful global company. But the company is struggling to implement a strategy to expand the device from its focused core market to a much broader market for sufferers of stroke and congestive heart failure – an approach that involves an entirely different business model to sell modified products through new channels.

DARWIN AND THE DEMON: INNOVATING WITHIN ESTABLISHED ENTERPRISES

Publication date: 1 July 2004
Author(s): Geoffrey A. Moore
Product number: R0407F

As commercial processes commoditise in a developed economy, they are outsourced or transferred offshore, leaving onshore companies with unrelenting, Darwinian pressure to come up with the next wave of innovation. But 'innovation' is a broad term. There are many types, from the ballyhooed disruptive innovation to more mundane forms such as process and experiential, which might involve, respectively, doing such things as streamlining the supply chain and delighting customers with small product modifications. Many executives find it hard to decide which kind to focus on. The best way to choose is to consider the phases of a market's life span.

ACTIVISION: THE 'KELLY SLATER'S PRO SURFER' PROJECT

Publication date: 19 July 2004
Revision date: 18 July 2005
Author(s): Alan MacCormack, Kerry Herman, Enrico D'Angelo
Product number: 9-605-020

Mike Ward, the producer in charge of developing the Kelly Slater's Pro Surfer game for Activision, must decide whether to launch the game in time for the 2002 Christmas season. Complicating his decision are the lukewarm response from consumers to TV test spots of the game and the need to fund a multimillion dollar marketing campaign. Also describes Activision's approach to game development, which was based on a green-light process adopted by the firm in 2000 to better control new game development.

COMMERCIALISATION AT THE GARVAN INSTITUTE FOR MEDICAL RESEARCH (A)

Publication date: 2 November 2005
Revision date: 10 January 2006
Author(s): Lee Fleming, Michael Vitale, Jonathan West
Product number: 9-606-051

A large and successful not-for-profit medical research institute must decide strategy to commercialise its discoveries. In the process, it must balance multiple conflicting demands from its stakeholders.

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- venture

12

LEGAL STRUCTURES FOR NEW VENTURES

> Ridwan always wanted to start his own business. So last January the Indonesian quit his job as a nurse, sold his car and took his savings out of the bank. Five months later, he is the owner of a health spa in Jakarta. Almost. He still hasn't received an inspection from the municipal authorities, mandatory for the business to operate legally. Nor has he gotten his operational permit. This is not unusual. It takes 151 days to start a business in Jakarta.
>
> World Bank[1]

CHAPTER OBJECTIVES

1. To examine the legal forms of organisation – sole proprietorship, partnership, incorporated companies and franchising
2. To illustrate the advantages and disadvantages of each of these legal forms
3. To compare the characteristics of unincorporated, incorporated and other forms of business legal structure
4. To examine the comparative forms of business legal structure around the world
5. To define the classifications of companies
6. To examine the franchise structure, benefits and drawbacks

EASE OF STARTING A BUSINESS

According to the World Bank, on average, it takes a business in a rich nation six procedures, 8 per cent of annual per capita income and 27 days to get started. In a poor or lower-middle-income economy, the same process takes 11 procedures, 122 per cent of annual per capita income and 59 days. In more than a dozen poor countries, registering a new business takes more than 100 days.[2] New Zealand, United States, Singapore, Australia and Hong Kong are among the easiest countries in the world to start a business. So imagine poor Ridwan in the opening quote. He lives in Indonesia, where it actually takes more than 101 per cent of per capita annual income and 151 days to start a business.

In this chapter, we are concerned with legal structures that affect the launch of a new business venture. We will emphasise Australian and other Commonwealth structures and compare them to typical US forms.

EVALUATING LEGAL STRUCTURES

Choosing the appropriate legal structure is a complex issue because of the inherent tax consequences and liabilities of the owner(s) and because the structure selected will determine what capital-formation options are available. Before deciding how to organise an operation, prospective entrepreneurs need to identify the legal structure that will best suit the demands of the venture. The necessity for this derives from changing tax laws, liability situations, availability of capital, need to set up a foreign operation and the complexity of business formation. Here are some of the important factors that must be taken into consideration when selecting a business structure:

- **Asset protection:** The business structure will determine the extent to which personal assets (such as the family home) are at risk against business failure.
- **Limited liability:** This refers to the important commercial characteristic where the business participants' personal liability for the business debts is limited to a specified amount.
- **Distribution flexibility:** Some business structures enable payment of different types of income such as trading profits, capital gains and franked dividends to different participants.
- **Financing:** As the business grows, it may be necessary to raise more funds by way of borrowing or equity. Consider the ease with which future financing can be raised while selecting the business structure.

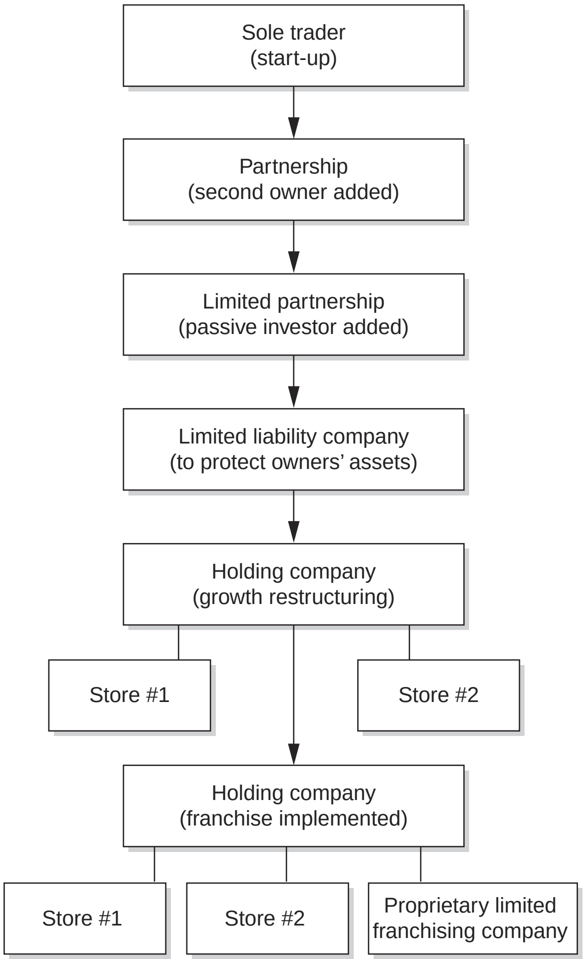
TABLE 12.1: EASE OF STARTING A BUSINESS

COUNTRY	COST (% OF ANNUAL INCOME PER CAPITA)	NO. PROCEDURES	TIME (DAYS)
New Zealand	0.2	2	12
United States	0.5	5	5
Singapore	1.1	6	6
Australia	1.9	2	2
Hong Kong	3.4	5	11
Taiwan	6.0	8	48
Thailand	6.1	8	33
Japan	10.7	11	31
China	13.6	13	48
Korea	15.2	12	22
Philippines	20.3	11	48
Malaysia	20.9	9	30
Vietnam	50.6	11	50
Indonesia	101.7	12	151

- **Taxation:** This is a complex issue that goes well beyond merely selecting the structure that is taxed at the lowest rate.
- **Business environment:** This includes stringency of the regulatory approval systems and technological risks.
- **Personal relationships:** Increasingly, couples are sharing ownership, management and responsibility. Sometimes called co-preneurs, they share trust, commitment, loyalty and work–life balance – or not!

Figure 12.1 shows how a firm's legal structure could evolve as it grows over time. Starting out as a sole trader, eventually a second owner is added and the firm becomes a partnership. Later on, a passive investor brings capital but not decision making (or liability) to the enterprise and

FIGURE 12.1 HOW THE LEGAL STRUCTURE CAN EVOLVE



Source: Adapted from: A.J. Sherman, 'Selecting the best legal structure for growth', *Raising Capital* (Kiplinger Books, 2003).

BUSINESS STRUCTURES UP CLOSE AND PERSONAL

ENTREPRENEURIAL EDGE

When it comes to corporate structure, Deborah Williams has pretty much seen it all. Hard as it may be to believe, her company, Black Cat Computer Wholesale, in Amherst, New York, has gone through three different corporate forms in its first five years of operation. Williams admits that choosing the right form for her $7-million company 'has been a nightmare, mainly because we grew so quickly that it was tough to figure out just what structure made sense for us. I'm an entrepreneur, not an accountant or an expert in corporate structure', she says. 'I relied on the advice of accountants who really weren't qualified to advise a fast-growing company.'

Marcelo Giglio is lucky. Very lucky. Sued eight times, Giglio's home, car and cash were at stake every time. And each time the real estate agent got to keep his assets by winning or settling the lawsuits. After the last experience two years ago, Giglio, who was having nightmares about his problems, found a way to separate his business from his personal life and assets. The solution: incorporation. 'I had all my assets under my name and if there was ever a problem I would lose everything and I was very worried, my home, my income property and cars', said Giglio, who was born in Argentina. 'Now, if there is a problem it is with the corporation. There is a level of protection that is very useful.'

For entrepreneurs with fertile business imaginations, the question often arises: What's the best way to set up and manage more than one business venture? Then other questions follow: Does it make sense to mimic large corporations by setting up subsidiaries? Or are there advantages to keeping the businesses separate? For Fran Greene, an entrepreneur who has founded two companies in Orlando-Cakes Across America and Sun State Electronics, the advantages of keeping her businesses separate far outweigh the costs. But making that judgement takes some time and analysis. 'If you just looked at strictly business issues, you could probably toss a coin and go either way', she says. 'My companies are in different industries, but they've got similarities because sales orders come in by telephone. Then again, Cakes' customers are consumers and Sun State handles mainly government business, which is about as different as you can get'. But, Greene emphasises, there are other factors to consider besides strictly business ones. 'As the founder of two growing businesses, I'm very conscious of their futures and of wanting my children to participate in those futures. Since I have six children, who range in age from 28 to 35, I hope that I'll eventually be able to have each one of them take over a different company that I've founded'. There are other pluses, such as liability protection. 'By keeping my companies separate, I protect each of them against the effects of any problem that might crop up in the other business line'.

'Back in 1993, I incorporated my company, mainly in the interest of liability protection', says Tim McCorry, chief executive of the McCorry Group, a $2-million manufacturer of sports fitness products in Pennsylvania. Back then, McCorry says, 'I knew I wanted to get out of the starting gate clean, grow my business and one day bring in investors. But I didn't know about such things as how many shares of stock the company should have or how much they should be worth'. For McCorry, that meant initially authorising and issuing a grand total of 100 shares, all of which went to him. Their par value was based on his initial investment of $30 000. 'When our new investment round is completed, the company will be recapitalised with many more shares authorised and a smaller portion of them being issued to me – but they'll be much more valuable'.

Sources: Jill Andresky Fraser, 'Perfect form', *Inc.* 19(18) (December 1997): 155; Elizabeth Aguilera, 'Minority proprietors can protect assets through incorporation', *Orange Country Register* (9 April 2001); Jill Andresky Fraser, 'Keeping your businesses separate', *Inc.* 18(5) (April 1996): 115; Jill Andresky Fraser, 'Private company stock', *Inc.* 22(6) (May 2000): 171.

so it changes into a limited partnership. As the assets grow and as the risks increase, it becomes necessary to protect the assets (such as home and car) of the owners and so the structure evolves into a limited company. Later, the owners feel the need to create a holding company structure. The holding company is not actively involved in business operations but owns enough shares in other companies so as to have control over their operation. Finally, success drives them to not only open and own stores, but to set up a franchising arm as a proprietary limited company.

REGULATORY BODIES

Every country has a regulatory regime – composed of legislation and a regulatory authority – that dictates how businesses are started, operated and wound up. These government bodies oversee the **incorporation** of companies and the regulation of businesses. The majority of their transactions are now done online using an electronic filing system that covers incorporation of companies. Table 12.2 presents the principals **regulatory bodies**, the main legislation and good starting points for entrepreneurs.

We now look at the types of legal structures that businesses use to run their affairs. In the Asia–Pacific, there are a variety of common legal business structures. They include unincorporated forms such as the **sole tradership** and **partnerships**; **incorporated companies**; and other forms of business such as **trading trusts**, cooperatives and **non-profit organisations**. Because each form has specific advantages and disadvantages, it is impossible to recommend one form over the other. The entrepreneur's specific situation, concerns and desires will dictate this choice.

INCORPORATED COMPANIES

New ventures initially can be categorised as incorporated or **unincorporated businesses**. In fact, legally the term 'company' should only be applied to an incorporated business and not an unincorporated business. What is the difference between a company and a **corporation**? The public perception is confusing. Most people think that a company is a locally owned and operated business (such as a convenience store), while a corporation is a very large business (such as Woolworths). In legal terms, this is totally misleading.

In the US, a corporation is a legal entity (distinct from a natural person) that often has similar rights in law to those of a natural person. In Australia, New Zealand and Singapore, as well as in the United Kingdom and Ireland, this is known as an incorporated company. They both have limited liability and their shareholders are not normally responsible for the company's debts beyond the amount they paid for their shares. Accordingly, while the terminology differs, the concept of a company or corporation is largely the same.

Inc. is used to indicate that an entity is a corporation, namely an incorporated company where personal assets of the shareholders are protected. In the United States, corporations are often identified by the term 'Incorporated' added after the business name, such as 'Texas Instruments, Incorporated'. Curiously, in Australia, an Inc. is an incorporated association, that is, a non-profit entity, also with limited liability for its members.

TABLE 12.2: REGULATORY BODIES FOR COMPANY FORMATION

COUNTRY	MAIN REGULATORY AGENCY	REGULATOR'S WEBSITE	MAIN LEGISLATION	LEGISLATION SITE	GOOD STARTING POINT FOR ENTREPRENEURS
Australia†	Australian Securities & Investments Commission (ASIC)	www.asic.gov.au	Corporations Act	www.comlaw.gov.au	www.business.gov.au
New Zealand	New Zealand Companies Office	www.companies.govt.nz	Companies Act	www.legislation.govt.nz	www.biz.org.nz
Singapore	Accounting and Corporate Regulatory Authority (ACRA)	www.acra.gov.sg	Companies Act	statutes.agc.gov.sg	www.business.gov.sg
United States†	Securities & Exchange Commission (SEC)	www.sec.gov	Securities Act	thomas.loc.gov	www.sba.gov

† In Australia and the United States, the regulation of business is managed by state and territory governments. ASIC's and SEC's roles are limited to the regulation of companies and certain other investment activities.

Incorporation is the birth of a company; it means giving legal form to a company. The Certificate of Incorporation is basically a birth certificate. Just like infants themselves, incorporated businesses become separate legal entities in their own right and are recognised therefore as separate from their owners.

Around the world, there is a variety of terms used for the different types of incorporated small businesses and table 12.3 details some of these.

TABLE 12.3: BUSINESS STRUCTURES AROUND THE WORLD

ABBREVIATION	WHAT IS IT?	WHERE USED
AG	**Aktiengesellschaft**	Germany, Austria, Switzerland
	Stock corporation equivalent to a PLC or an Inc.	
GmbH	Company with limited liability	Germany, Austria, Switzerland
	Similar to LLC	
Inc.	An incorporated association; that is, a non-profit entity	Australia
	A corporation or incorporated company	United States
LLC	Limited liability company	Worldwide (not used in Australia)
	Similar to a corporation combined with a limited liability partnership	
ILP	Incorporated limited partnership	Australia (Vic., Qld, NSW)
	Similar to LLC but with more flexible investment vehicles – minimum level of investment $20 million	
LLP	Limited liability partnership	Worldwide
	Each partner is fully liable for the debts of the partnership, not including acts of professional negligence or malpractice	
Ltd	Private company with liability limited by shares (not traded publicly)	Commonwealth countries (other than Australia)
	A public company	Australia
	Liability limited by shares or guarantee (not-for-profit companies only)	
	Shares may be traded publicly but will not always be	
NV	Dutch for a public limited liability company (translation of Société Anonyme) and equivalent of PLC by shares	Belgium and Netherlands
NL	Mining company not entitled to call on the unpaid issue price of shares	Australia
	No liability for shareholders, as distinct from limited liability	
PLC	**Public limited company**	Commonwealth countries (other than Australia)
	Liability limited by shares which are traded publicly	
Pty Ltd	Proprietary Limited	Australia
	A private company with liability limited by shares (not traded publicly)	
S.A.	**Sociedad Anónima**	Spain
	Equivalent of PLC	
	Société Anonyme	France
	Equivalent of PLC	
SpA	Societā per Azioni	Italy
	Equivalent of PLC	

Limited liability companies

For almost all business purposes around the world, two forms – the private company and the public company – are the most frequent legal structures. In Australia, these different types of companies are denoted by the abbreviations Pty Ltd (proprietary limited) and Ltd (limited), respectively. The essential difference is that the private company cannot legally offer its shares to the public.

Private company

In English law and in other countries with similar laws, the assets available to the creditors in the event of bankruptcy are limited to the assets of the company. Consequently, if the company goes bankrupt, creditors cannot seize the private assets of the directors, such as home, car and savings. In theory, individual directors do not go bankrupt and they can start up in business immediately afterwards. In practice, however, directors are personally liable if they knowingly allow the company to trade when there is no reasonable expectation that it can pay its debts. A private company's shares cannot be offered to the general public, whereas a public company's shares can be offered to the public. This is the major distinguishing feature between a private company and a public company. Most businesses are private companies.[3]

Under the governing Australian Corporations Act, a proprietary company must either be limited (shareholders are protected when it comes to company debts) or unlimited (shareholders face unlimited liability). A private company in Australia is referred to as a **proprietary limited company (Pty Ltd)**. A Pty Ltd company has at least one director and one shareholder and these may or may not be the same person. A Pty Ltd is the opposite of a public company. For example, a Pty Ltd cannot invite the public to invest or deposit money with it, whereas a public company can raise capital by offering shares to the public by issuing a prospectus.

- Advantages:
  - liabilities of the shareholders are limited to their subscribed share capital and any debts that are personally guaranteed
  - the company is a separate legal entity, which may enter into agreements, can be sued, can sue others
  - retained profits are taxed at the company income tax rate
  - ease in attaining ownership in the company by acquiring shares
  - ease of ownership change
  - additional capital is more available to this type of legal structure
  - shares are transferable and the authority of shareholders can be controlled through the type of shares issued
  - continuity of the company's existence – not dependent on the owners.
- Disadvantages:
  - set up, administrative and operating costs are high
  - increased statutory requirements for taxation and corporation law
  - revenue and capital losses must be retained by the company – these cannot offset the owners' incomes.[4]

Public company

In Australia, a public company is indicated by the word 'Limited' or the abbreviation 'Ltd' at the end of the company's name, for example BHP Billiton Limited. 'PLC' indicates that a company is a public company in many other Commonwealth jurisdictions. A public company is a type of limited company whose shares may be offered for sale to the public. The abbreviation Ltd or PLC status is roughly equivalent to a US corporation. It is not compulsory for a public company to ‘float’. However, many do float and their shares are usually traded on the stock exchange. For this reason and to retain confidence in the stock exchange, the requirements placed on public companies are far more rigorous than those for private companies, particularly in relation to the amount of financial information they are required to publish in their financial reports. Mainly due to their ability to raise capital, the public company carries with it certain advantages; but these qualities can also be a source of disadvantage. The following offers a summary of the key advantages and disadvantages of the PLC.

- Advantages:
  - essentially those of a private company, plus
  - increased potential for raising finance by share issues to the public or through other financial investors.
- Disadvantages:
  - most expensive set-up cost of all forms of business organisation considered
  - if shares are traded publicly, more open to hostile takeover bids
  - tighter levels of regulation
  - public ownership by minority shareholders does not provide them (as owners) with any real control of the business.

How does one own shares in a limited company?

The owners of a limited company – whether private or public – are referred to as shareholders. An individual can become a part owner of the business by purchasing shares in that business. When the profits of the business are distributed to shareholders, they are distributed in the form of a dividend, the value of which is decided on not by the owners, but by the directors of the business (who may indeed be the same persons as the owners). Dependent on the type of share owned, the holder will have certain voting rights for each share they possess. There are essentially two types of shares commonly sold in companies.

The ordinary share

These are the most common type of share, hence the name. These ordinary shares provide the shareholder with full ownership rights in the business, including voting rights. The percentage of total shares owned by an individual, or group, determines the level of control they have over the company. The dividend on ordinary shares is not guaranteed and directors may decide that it is in the best interests of the company not to pay a dividend on ordinary shares in a particular year.

The preference share

The defining characteristic of the preference (or preferred) share is that a dividend is normally guaranteed at a fixed level, regardless of the performance of the business. If the business cannot pay that dividend in a particular period, it will normally be accrued to the next financial period. Preference shareholders are also paid their dividend before, or in preference to, ordinary shareholders. However, as a trade-off for having a preferred right to dividends, preference shareholders will have limited voting rights in comparison to ordinary shareholders.

Alongside the ability to sell shares to the general public, another difference between the private company and the public company is the level of regulation surrounding their incorporation and subsequent operation. As one might expect, regulations surrounding public companies are more rigorous. However, for the purposes of this section we will consider those requirements shared by both forms of company.

Quasi-incorporated businesses

Limited partnerships are used in situations (for example, passive investor) where capital investment comes without responsibility for management and without liability for losses beyond the initial investment. Such an organisation allows the right to share in the profits with limited liability for the losses. The advantage of the limited liability partnership is that it allows an investor to invest in a partnership without being liable beyond the extent of their financial investment, provided certain conditions are met. Limited partners may not:

- draw out or receive back any part of their contribution to the partnership during its lifetime
- take part in the management of the business or have power to bind the firm.

We have referred to these entities as quasi-incorporated as they share some similarities with both incorporated and unincorporated business structures. However, strictly speaking limited liability partnerships are unincorporated while limited partnerships are incorporated.

Limited liability partnership

In a **limited liability partnership (LLP)** structure, the liability of a partner contributing capital can be limited to the amount of financial contribution, provided that person does not take part in the management of the business. LLPs are particularly common in oil and gas exploration, in motion-picture ventures and in venture capital investments. A general partner in a limited partnership has **unlimited liability** and therefore is personally liable for the debts of the firm. However, a limited partner can be an investor whose liability is limited to the size of the investment they make and who can only be involved in the firm's management in certain prescribed circumstances. The standard features of limited partnerships include flow-through tax status, limited liability for passive investment partners and separate legal personality.

Incorporated limited partnership

An **incorporated limited partnership (ILP)** is a form of a limited partnership and is a relatively recent development in Australia, although the US equivalent (confusingly entitled a limited liability company or LLC) has been in existence for some time. The ILP has been developed in response to calls by venture capital and private equity investors for more flexible investment vehicles. An incorporated limited partnership is a partnership with the capacity and powers of an individual as well as the powers of a company. It can have up to 20 general partners and an unlimited number of limited partners. As with all limited partnerships, the limited partners are not entitled to participate in management and general partners have unlimited liability.

At this stage, the ILP has only been introduced in Victoria, Queensland and New South Wales.

- Advantages of an ILP:
  - limited liability for limited partners
  - **flow-through taxation** – that is, each partner of the ILP is taxed based on their pro rata portion of the ILP's taxable income

  - the partners can also have the benefit of any losses incurred by the ILP to offset against other taxable income which they may have.
- Disadvantages of an ILP:
  - only able to be used for limited investment purposes
  - short life span of between five and 15 years
  - must have minimum investment funds of $20 000 000 – means that substantial investment is required before ILP structure can be implemented.

UNINCORPORATED BUSINESSES

There are two very frequent forms of doing business that are called unincorporated, that is, not organised and maintained as a legal corporation.

Sole tradership

A sole trader (also known as a sole proprietor) is a business that is owned and operated by one person. The enterprise has no existence apart from its owner. This individual has a right to all of the profits and bears all of the liability for the debts and obligations of the business. The individual also has unlimited liability, which means their business and personal assets stand behind the operation. If the company cannot meet its financial obligations, the owner can be forced to sell the family car, house and whatever assets that would satisfy the amounts owing to the creditors.

To establish a sole tradership, a person merely needs to obtain the permissions or licences that are necessary in the field to begin operations. One must also normally apply for registration of your business name with the relevant state or territory department. Because of its ease of formation, the sole tradership is the most widely used legal form of organisation.[5]

- Advantages of sole traderships:
  - ease of formation – it is an inexpensive business structure to establish and maintain and it has the least government reporting requirements
  - losses reduce personal taxes – in both Australia and New Zealand, losses from the business can be offset against any other income or future earnings
  - less formality and fewer restrictions are associated with establishing a sole tradership than with any other legal form
  - sole ownership of profits – the proprietor is not required to share profits with anyone
  - decision making and control vested in one owner – no co-owners or partners must be consulted in the running of the operation
  - flexibility – management is able to respond quickly to business needs in the form of day-to-day management decisions as governed by various laws and good sense
  - relative freedom from governmental control – very little governmental interference occurs in the operation, although there may be considerable ‘compliance costs’
  - freedom from corporate business taxes – proprietors are taxed as individual taxpayers and not as businesses
  - easy to wind it up – it is easy to close the company and stop trading.
- Disadvantages of sole traderships:
  - there are few tax concessions – if the business is successful, the personal tax rate in Australia and New Zealand may be higher than the company rate

- unlimited liability – the individual proprietor is personally responsible for all business debts and this liability extends to all of the proprietor's assets
- lack of continuity – the enterprise may be crippled or terminated if the owner becomes ill or dies
- lack of personal freedom – it may not be possible to take holidays, as there is nobody else with the expertise to run your business while you are away; the same problems arise with sickness or accidents
- less available capital – ordinarily, proprietorships have less available capital than other types of business organisations, such as partnerships and corporations
- relative difficulty obtaining long-term financing – because the enterprise rests exclusively on one person, it often has difficulty raising long-term capital
- relatively limited viewpoint and experience – the operation depends on one person and this individual's ability, training and expertise will limit its direction and scope.

Partnerships

Partnerships emerge in various ways. A sole trader may reach a stage where further growth requires the taking-on of a partner. Alternatively, two or more people may decide to combine their skills and resources to start a business in partnership with each other.

In a partnership, a group of people contribute their time, talents and money towards the business. In return, they share the responsibilities and profits. A partnership can be created by oral or written agreement, but a written agreement is preferable. In the absence of a formal partnership agreement, the law will assume that each partner has an equal share in the business. If, for example, one partner is contributing more money or time, the partnership agreement will normally provide that they have a greater share in the business. By clearly spelling out in the partnership agreement what has been agreed upon, the likelihood of disputes is reduced.

Before entering a partnership, you should remember that many people who have been close friends for years have found it impossible to work together as business partners. Being close friends with your business partner can keep you from challenging them or offering constructive criticism.

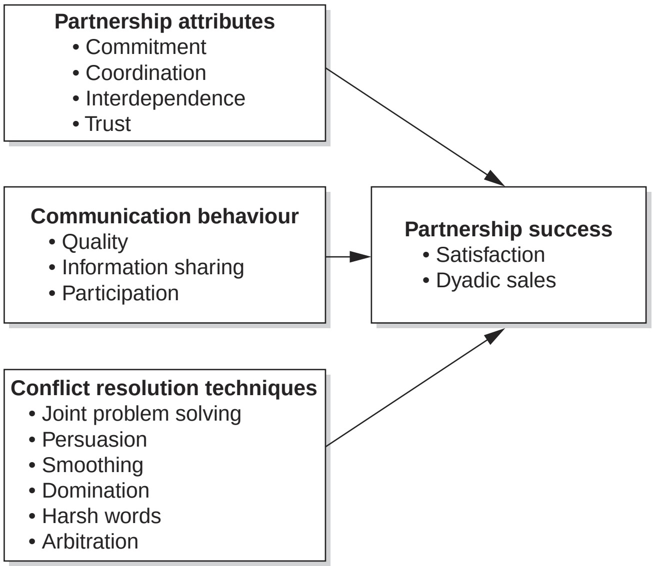
The desire and decision to form partnerships appear to be fairly well understood. However, very little information exists regarding the processes required to develop and nurture the partnership beyond the initial decision to establish the relationship. Given both the costs and risks associated with a failed partnership, insight into the factors affecting partnership success is quite useful.

One research study attempted to shed light on these issues and to offer an improved understanding of the form and substance of the interaction between or among partners. The study suggested that trust, the willingness to coordinate activities and the ability to convey a sense of commitment to the relationship are key. Critical also are the communications strategies the trading parties use (see figure 12.2 for an illustration of the key factors).

Joint participation enables all parties to understand better the strategic choices facing them. The researchers found that trust, commitment, communication quality, joint planning and joint problem resolution all serve to better align partners' expectations, goals and objectives. The challenge lies in developing a management philosophy or corporate culture under which independent trading parties can relinquish some control, while also engaging in planning and organising that takes into account the needs of all parties.[6]

The partnership agreement should outline the financial, managerial and material contributions into the business and delineate the roles of the partners in the business relationship.

FIGURE 12.2 **FACTORS ASSOCIATED WITH PARTNERSHIP SUCCESS**



Source: Jakki Mohr and Robert Spekman, 'Characteristics of partnership success: Partnership attributes, communication behavior and conflict resolution techniques', *Strategic Management Journal* 15 (1994): 137

It will serve as the guideline for your working relationship with your partner. The following are some subjects often covered in a partnership agreement:

- the purpose of the partnership business
- the terms of the partnership
- the financial contributions made by each partner for start-up and during the lifetime of the business
- the distribution of profits and losses
- the withdrawal of contributed assets or capital by a partner
- the management powers and work responsibilities of each partner
- the provisions for admitting new partners
- the provisions for expelling a partner
- the provisions for continuing the business in the event of a partner's death, illness, disability, or desire to leave
- the provision for determining the value of a departing partner's interest and method of payment of that interest
- the methods of setting disputes through mediation or arbitration
- the duration of the agreement and the terms of dissolution of the business.[7]

In addition to the written articles, entrepreneurs must consider different types of partnership arrangements. Depending on the needs of the enterprise, one or more of these may be used. It is important to remember that in a typical partnership arrangement at least one partner must be a general partner who is responsible for the debts of the enterprise and who has unlimited liability.[8]

- Advantages of partnerships:
  - ease of formation – legal formalities and expenses are few compared with those needed to create a more complex enterprise, such as a corporation

  - direct rewards – partners are motivated to put forth their best efforts by direct sharing of the profits
  - flexibility – in a partnership, it is often possible to obtain more capital and a better range of skills than in a sole proprietorship
  - responsiveness – a partnership often is able to respond quickly to business needs in the form of day-to-day decisions
  - relative freedom from governmental control and regulation – very little governmental interference occurs in the operation of a partnership
  - confidentiality – partnerships do not have to disclose profits to the public.
- Disadvantages of partnerships:
  - few tax concessions – most partnerships pay taxes as individuals and the personal tax rate in Australia and New Zealand may be higher than the company rate
  - unlimited liability of at least one partner – although some partners can have limited liability (as in limited partnerships), at least one must be a general partner who assumes unlimited liability
  - lack of continuity – if any partner dies or simply withdraws from the business, the partnership arrangement ceases (however, operation of the business can continue based on the right of survivorship and the possible creation of a new partnership by the remaining members or by the addition of new members)
  - relative difficulty obtaining large sums of capital – most partnerships have problems raising capital, especially when long-term financing is involved; usually the collective wealth of the partners dictates the amount of total capital the partnership can raise, especially when first starting out
  - bound by the acts of just one partner – a general partner can commit the enterprise to contracts and obligations that may prove disastrous to the enterprise in general and to the other partners in particular
  - difficulty in exit strategy – if the partnership is dissolved or altered, difficulties may be experienced in obtaining an acceptable valuation or in raising capital to purchase a retiring partner's share
  - difficulty of disposing of partnership interest – buying a partner out may be difficult unless specifically arranged for in the written agreement.

It is important to correctly draw up the partnership agreement from the beginning. Uncertainty and ambiguity may come back to haunt a venture. Let us say that Alice, Bette and Cathy work as partners without an explicit agreement. The three women lease a factory as tenants in common and produce widgets. Each receives one-third of the profits. Later, Alice signs a contract for some plant and equipment to produce the Mark II widget. However, their business falters and Alice has to go back on the contract. Then, for totally unrelated reasons, Alice is declared bankrupt and the supplier sues for breach of contract. The court determines that Alice, Bette and Cathy were in fact partners. Alice is found to have bound the partnership to the equipment contract. As Alice has gone bankrupt, Bette and Cathy are ordered to pay all of the supplier's damages and costs.[9]

OTHER BUSINESS FORMS

Trading trust

A common alternative business form in Australia and New Zealand is the trading trust. It is very much like a family trust, except that it is able to operate as a business with the added advantage of being able to pay money (profits) to the beneficiaries without them having to work in the business (unlike a company). This is attractive to people running a company who have non-working children over 16, as profit may be distributed to these children who will usually be taxed at a lower marginal rate due to having less income from other sources. It is also aimed at protecting the personal assets of professionals. A trading trust can ring-fence assets and insulate professional life from personal life when, for example, a doctor or dentist is facing malpractice or medical misadventure claims. A trust will generally be taxed on a ‘flow-through’ basis similar to a partnership, although there are some exceptions for publicly traded trusts in Australia and for certain trading trusts in New Zealand.

Cooperative society

A **cooperative society** is a business structure that has corporate status. The main difference between cooperatives and companies is dividend distribution. Under a company structure, there is a profit motive that returns dividends to the members of the company. A cooperative, in contrast, operates on a service motive that provides services to its members and any return of capital is limited. Unlike a company, all members of a cooperative have only one vote, irrespective of their shareholding. In other ways, it is run in a similar fashion to a company. A board of directors is elected which controls the management of the business of the cooperative.[10]

Charitable trust

A familiar form of non-profit corporation (or ‘not-for-profit’) is the religious, charitable, or educational organisation. Its purpose is not to make a profit, but it is permitted to do so if the profit is left within the trust.

STARTING A BUSINESS IN A FOREIGN COUNTRY

New Zealand

Foreigners are eligible for residence in New Zealand under the Entrepreneur Visa Category if they have successfully established and are self-employed or working in a business that is benefiting New Zealand. Benefiting New Zealand includes introducing new or existing technology, management or technical skills; introducing new, or enhancing existing products or services; creating new or expanding existing export markets; creating employment for others; revitalising an existing business. They must have established, purchased, or made a substantial investment of at least 25 per cent in a business operating in New Zealand.

Australia

Many foreign companies operate in Australia through a locally established subsidiary company, which have the benefit of limited liability and separate legal status. A company can be either public or a proprietary company limited by shares. A foreign company intending to expand in Australia is obliged to register with the Australian Securities and Investments Commission (ASIC) as a foreign company. At least one of the directors of the company or the company secretary must reside in Australia. For public companies, at least two of the company directors must reside in Australia.

TABLE 12.4: COMPARISON OF THE MAJOR FORMS OF BUSINESS

	INCORPORATED COMPANIES				
CHARACTERISTIC	PRIVATE LIMITED COMPANY	PUBLIC LIMITED COMPANY (LTD OR PLC)	PROPRIETARY LIMITED COMPANY (PTY LTD)	LIMITED PARTNERSHIP (LTD)	INCORPORATED LIMITED PARTNERSHIP (ILP)
Description	Private company with liability limited by shares (not traded publicly)	A public limited company, liability limited by shares which are traded publicly	Used in Australia Unlike a PLC, a Pty Ltd cannot invite the public to invest	Created by agreement to carry on a business for a profit At least one party must be a general partner and the others limited partners A limited partnership must be registered Certificate of registration issued	Similar to corporation and limited partnership ILP must be registered Certificate of registration issued Separate legal entity to partners Must have a written agreement in place at all times
Liability	Liabilities of the shareholders are limited to their subscribed share capital and any debts personally guaranteed	Limited liability of shareholders – shareholders are not liable for the debts of the corporation		Unlimited liability of all general partners Limited partners are liable only to the extent of capital contributions	Same as for limited partnership
Duration	Continuity of the company's existence – not dependent on the owners	Continuity of the company's existence – not dependent on the owners		By agreement or by termination of the last general partner or last limited partner	By agreement and by notice of regulator in certain situations
Transferability of interest	Shares can be transferred	Where shares are publicly traded, more open to hostile takeover bids	Shares can be transferred	Interest can be assigned (same as general partnership), but registration must be amended	All or part of interest of limited liability partner can be transferred with consent of general partners
Management	Shareholders elect directors who set policy and appoint officers	Shareholders elect directors who set policy and appoint officers	Shareholders elect directors who set policy and appoint officers	General partners have equal voice or by agreement Limited partners may not retain limited liability if they actively participate in management	Same as limited partnership

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Taxation	**Double taxation** in some jurisdictions (e.g. USA) as company pays income tax on net profits and shareholders pay income tax on disbursed dividends Some jurisdictions, such as Australia, allow dividend imputation which allows a credit to the shareholder for tax paid by the company	Double taxation in some jurisdictions (e.g. USA) as company pays income tax on net profits and shareholders pay income tax on disbursed dividends Some jurisdictions, such as Australia, allow dividend imputation which allows a credit to the shareholder for tax paid by the company		Generally taxed as a partnership	Same as general partnership
Fees, licences, reports	All required	All required		Application fee and various fees for changing registration details	Application fee
Possible sources of finance	Dependent on the size of the private limited company, suppliers, banks, factoring, leasing and hire purchase companies, government grants and loans, venture capital institutions, private share issues	Suppliers, banks, factoring, leasing and hire purchase companies, government grants and loans, venture capital institutions, public share issues via the stock exchange		Partners' savings, banks, suppliers, government grants and loans, hire purchase and leasing companies Difficult to obtain large sums of capital	Banks, wholesale investors, venture capital institutions, other private equity funds
	UNINCORPORATED COMPANIES		OTHER FORMS		
CHARACTERISTIC	SOLE TRADERSHIP	PARTNERSHIP	TRADING TRUST	CHARITABLE TRUST	COOPERATIVE SOCIETY
Description	Used around the world, created at will by owner Also called a sole proprietorship	Used around the world, created by agreement of the parties who wish to pool their time, talents and money	Similar to a family trust Can pay beneficiaries without them working for the trust Limited to Australia and New Zealand	An incorporated association (i.e. a non-profit entity)	Near universal availability Made up of members whose role is defined by constitution
Liability	Unlimited liability Owner is personally responsible for all debts	Unlimited liability (except for limited partners in a limited partnership)	Ring-fences assets from liability Good for professionals such as doctors	Limited liability provided decision-makers act prudently, within objects, legally and not for personal gain	Limited liability provided decision-makers act prudently, within objects, legally and not for personal gain

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	UNINCORPORATED COMPANIES		OTHER FORMS		
CHARACTERISTIC	SOLE TRADERSHIP	PARTNERSHIP	TRADING TRUST	CHARITABLE TRUST	COOPERATIVE SOCIETY
Duration	Determined by owner; automatically dissolved on owner's death Easy to wind up	Terminated by agreement of the partners, by the death of one or more of the partners, by withdrawal of a partner, by bankruptcy and so forth	Terminated by agreement	Terminated by trustees	Terminated by agreement of the General Meeting of Members
Transferability of interest	Interest can be transferred, but individual's trader status then ends	Although partnership interest can be assigned, assignee does not have full rights of a partner	Depends on form of trust	Assets can be passed on to an organisation with similar tax status	Assets can be passed on to an organisation with similar tax status
Management	Completely at owner's discretion No co-owners or partners need be consulted	Each general partner has a direct and equal voice in management unless expressly agreed otherwise in the partnership agreement	Usually managed as a family business, with all the problems of that form	By trustees although trust deed can allow for appointment and removal of trustees by membership	By members at a General Meeting and/or by committees
Taxation	Owner pays personal taxes on business income Losses reduce personal taxes No corporate tax	Each partner pays pro rata share of income taxes on net profits, whether or not they are distributed	Income distributed by a trading trust is taxed at the tax rate of the beneficiary	Must be charitable	Charitable status possible, dependent on objects Can also operate under a range of other exemptions
Fees, licences, reports	None	None	None	Change of rules, name and office Also change of trustees (where land is owned by trust)	Annual accounts, change of rules, name and office must be reported
Possible sources of finance	Owners' savings, banks, suppliers, government grants and loans No venture capital	Partners' savings, banks, suppliers, government grants and loans, hire purchase and leasing companies Difficult to obtain large sums of capital	Family savings Difficult to obtain outside financing	Donations, re-invested income	Donations, re-invested income

Singapore

A properly structured Singapore International Business Company (IBC) is not treated as an 'Offshore Company' but rather as a legitimate corporate vehicle domiciled in a regulated trading jurisdiction. The first S$100 000 (US$60 000) of local corporate profits earned in Singapore are tax free, while international profits earned outside Singapore are also not subject to tax, provided certain conditions are met. Singapore has formed double taxation treaties with 33 countries. Singapore requires that at least one director is resident in Singapore.

Thailand

There are three major forms of partnership in Thailand:

- an unregistered ordinary partnership
- a registered ordinary partnership
- a limited partnership.

Each form of partnership has different levels of liability for partners and different tax consequences for the partners and partnership. The most popular form among foreign investors is the private limited company, which requires a minimum of seven promoters and must file a memorandum of association, convene a statutory meeting, register the company and obtain a company income tax identity card. Thailand also offers the possibility of establishing a representative or regional office for those companies engaged in non-revenue generating activities (for example, market research, quality control, support services).[11]

United States

Forming a company in the US does not require large amounts of money. When compared to most other Western countries, the fees and restrictions are fairly low. Many US non-residents are forming companies in the United States, some of which are operating within the country, others of which are operating entirely outside. In general, there are no citizenship or residency requirements to forming a company in the US. The corporation is, however, required to have a registered agent in the state of incorporation and in any state in which it is qualified or registered to conduct intrastate business.

In the US, the strict liability laws often require business people to incorporate in order to limit their personal liability. Incorporation and starting a business in the US may also carry visa advantages. However, it is important to understand that forming a company itself does not guarantee you a visa.

The majority of US non-residents without a strong reason to form a business in any given jurisdiction choose the states of Delaware or Nevada because of their business-friendly environment and easy compliance requirements. Delaware is well known as a corporate haven and many major corporations are chartered in Delaware. More than half a million business entities have their legal home in Delaware, including more than 50 per cent of all US publicly traded companies and 58 per cent of the *Fortune* 500. Delaware charges no income tax on corporations not operating within the state. However, in this respect Delaware is no different from other states: none of the US states charges income tax on out-of-state income.

The legal structure options that are available in the US are to form a US corporation; a partnership; or a limited liability company (LLC). Costs (filing fees) are generally under US$500 and legal fees should not exceed an additional US$1000. Annual filing fees and taxes vary from state to state. In California, the minimum annual franchise tax is US$800 and additional filing fees are about US$20 per year. Registered agent service companies charge about US$200 per year.

A corporation is generally taxable in its own right, without regard to the tax status of its owners. The Subchapter S variation, where a corporation is treated as a partnership for tax purposes, is generally not available if any shareholder is not a citizen/resident of the US. Partnerships are not taxed separately from their owners. Instead, they are ‘pass-through’ entities for tax purposes, with partnership profits and losses being allocated to the partners regardless of whether cash is distributed by the partnership. One of the benefits of being a partnership for taxation purposes is that if the partnership has losses, the partners can offset those losses against personal income from other sources and thereby reduce their income tax liability.

FRANCHISE CONTRACTS

The final form of business legal structure that we will examine in this chapter is franchising. Actually, a **franchise** is not a legal form per se; it could be any one of the structures we have discussed. However, we include it here because it is a consideration as entrepreneurs launch new ventures.

Franchise entrepreneurs have been the subject of considerable research.[12] Franchising has come of age in New Zealand and Australia. New Zealand’s franchise industry is worth about $10 billion with 300 systems and 4000 outlets.[13] According to the Franchising Australia 2004 report, there were about 850 franchise systems in Australia with more than 500 000 people employed. The majority of franchising takes place in the retail non-food industry (30 per cent of franchisors and 18 per cent of franchise units). Next, the property and business services sector accounts for 24 per cent of franchisors and some 21 per cent of franchise units. Most franchise systems operate from specific commercial sites (69 per cent), but some are home-based (24 per cent) or mobile operations (25 per cent), including combinations of these. Almost one-third of franchisors use master franchising arrangements in their domestic operations.[14]

A franchise is any arrangement in which the owner of a trademark, trade name, or copyright has licensed others to use it in selling goods or services. A franchisee (a purchaser of a franchise) is generally legally independent but economically dependent on the integrated business system of the franchisor (the seller of the franchise). In other words, a franchisee can operate as an independent businessperson but still realise the advantages of a regional or national organisation.[15]

Advantages of franchising

Several advantages are associated with franchising.

Training and guidance

Perhaps the greatest advantage of buying a franchise, as compared to starting a new business or buying an existing one, is that the franchisor will usually provide both training and guidance to the franchisee. As a result, the likelihood of success is much greater for national franchisees who have received this assistance than for small-business owners in general. For example, it has been reported that the ratio of failure for small enterprises in general to franchised businesses may be as high as four or five to one.

Brand-name appeal

An individual who buys a well-known national franchise, especially a big-name one, has a good chance to succeed. The franchisor’s name is a drawing card for the establishment. People are often more aware of the product or service offered by a national franchise and prefer it to those offered by lesser-known outlets.

A proven track record

Another benefit of buying a franchise is that the franchisor has already proved the operation can be successful. Of course, if someone is the first individual to buy a franchise, this is not the case. However, if the organisation has been around for five to 10 years and has 50 or more units, it should not be difficult to see how successful the operations have been. If all of the units are still in operation and the owners report they are doing well financially, one can be certain the franchisor has proved that the layout and location of the store, the pricing policy, the quality of the goods or service and the overall management system are successful.

Financial assistance

Another reason a franchise can be a good investment is that the franchisor may be able to help the new owner secure the financial assistance needed to run the operation. In fact, some franchisors have personally helped the franchisee get started by lending money and not requiring any repayment until the operation is running smoothly. In short, buying a franchise is often an ideal way to ensure assistance from the financial community.

Disadvantages of franchising

The prospective franchisee must weigh the advantages of franchising against the accompanying disadvantages.

Franchise fees

In business, no one gets something for nothing. The larger and more successful the franchisor, the greater the franchise fee. For a franchise from a national chain, it is not uncommon to be faced with a fee of $5000 to $100 000. Smaller franchisors or those who have not had great success charge less. Nevertheless, entrepreneurs deciding whether or not to take the franchise route into small business should weigh the fee against the return they could get putting the money into another type of business. Also, remember that this fee covers only the benefits discussed in the previous section. The prospective franchisee also must pay for building the unit and stocking it, although the franchisor may provide assistance in securing a bank loan.

Additionally, a fee is usually tied to gross sales. Typically, the franchise buyer pays an initial franchise fee, spends their own money to build a store, buy the equipment and inventory and then pay a continuing royalty based on sales, usually between 5 and 12 per cent. Most franchisors require buyers to have 25 to 50 per cent of the initial costs in cash. The rest can be borrowed, in some cases, from the franchising organisation itself.

Franchisor control

When one works in a large corporation, the company controls the employee's activities. If an individual has a personal business, they control their own activities. A franchise operator is somewhere between these extremes. The franchisor generally exercises a fair amount of control over the operation in order to achieve a degree of uniformity. If entrepreneurs do not follow franchisor directions, they may not have their franchise licence renewed when the contract expires.

Unfulfilled promises

In some cases, especially among less-known franchisors, the franchisees have not received all they were promised.[16] For example, many franchisees have found themselves with trade names that have no drawing power. In addition, many franchisees have found that the promised assistance from the franchisor has not been forthcoming. For example, instead of being able to purchase supplies more cheaply through the franchisor, many operators have found themselves paying exorbitant prices for supplies. If franchisees complain, they risk having their agreement with the franchisor terminated or not renewed.

Franchise law

In New Zealand, there is no specific franchising legislation. Franchise relationships are governed by normal commercial law. Australia has gone down a different road. The Australian Franchising Code of Conduct ensures that franchisees are informed of all relevant facts when starting their business and that they can access a fast and relatively inexpensive way to resolve any disputes. Franchisors are required to disclose specific facts to franchisees and to follow set procedures in their dealings with franchisees. If a dispute arises, either party can require the other to attend mediation. Potential franchisees must sign a statement that they have been given independent advice or that they were told to seek such advice and choose not to do so. The Code's disclosure obligations require franchisors to supply prospective franchisees, or those seeking to renew or extend an existing franchise, with a specifically prescribed disclosure document and a copy of the Code. Excluded from the Code are foreign franchisors with only one franchise operating within Australia. The Australian Competition and Consumer Commission (ACCC) administers the Code and enforces it through sanctions. Disputes are dealt with by a mediation adviser appointed by the Commonwealth Minister for Workplace Relations and Small Business.[17]

Legal structure of a franchise

What business legal structure should a franchise have? There is no right or wrong answer to this question. A franchise can be any of the forms discussed in this chapter. The differences relate to tax treatment and liability. Franchise entrepreneurs should take care to protect their personal assets from business liability in relation to contracts executed, for example, lease contracts and supplier contracts. For this reason, many new franchisees are more interested in the corporate form for its tax differences than for its potential liability protection. The advantage they see is the potential that corporate income will be subject to tax rates lower than personal income. There are also possible benefits related to increased options for retirement accounts and different treatment of certain income tax deductions.

FINAL THOUGHTS

As mentioned earlier, an entrepreneur always should seek professional legal advice in order to avoid misunderstanding, mistakes and, of course, added expenses. The average entrepreneur encounters many diverse problems and stumbling blocks in venture formation. Since they do not have a thorough knowledge of law, accounting, real estate, taxes and governmental regulations, an understanding of certain basic concepts in these areas is imperative.

The material in this chapter is a good start towards understanding the legal forms of organisations. It can provide entrepreneurs with guidelines for seeking further and more specific advice on the legal form that appears most applicable to their situation. The following key questions can be helpful for placing legal forms of business in perspective:

- What is the size of the risk? What is the amount of the investor's liability for debts and taxes?
- What would the continuity (life) of the firm be if something happened to the principal(s)?
- What legal structure would ensure the greatest administrative adaptability for the firm?

- What effects will federal, state and local laws have on the operation?
- What are the possibilities of attracting additional capital?
- What are the needs for and possibilities of attracting additional expertise?
- What are the costs and procedures associated with starting the operation?
- What is the ultimate goal and purpose of the enterprise and which legal structure can best serve this purpose?

SUMMARY

This chapter began by considering the ease with which a business can be started. Legal structures were evaluated and regulatory bodies considered before the chapter turned to examine the major forms of legal organisation. The advantages and disadvantages of each form were highlighted and compared. In addition, the characteristics and tax considerations of partnerships were compared with those of corporations.

The specific forms of partnerships and corporations were examined. In particular, the requirements and benefits of limited partnerships, incorporated limited partnerships and limited liability companies were presented.

Additional corporation classifications were reviewed and a section was devoted to the corporate considerations of costs. Franchising also was discussed, with emphasis on the advantages and disadvantages as well as concerns over legal protections. Finally, a checklist of key questions for entrepreneurs to consider before structuring their venture was provided.

KEY TERMS AND CONCEPTS

Aktiengesellschaft (AG)
asset protection
cooperative society
corporation
double taxation
flow-through taxation
franchise
GmbH
Inc.
incorporated companies
incorporated limited partnership (ILP)
incorporation
limited liability
limited liability partnership (LLP)
limited partnerships
non-profit organisation
partnerships
private limited company
proprietary limited company (Pty Ltd)
public limited company
regulatory bodies
Sociedad Anónima (S.a.)
sole tradership
trading trust
unincorporated businesses
unlimited liability

REVIEW AND DISCUSSION QUESTIONS

1. Identify the legal forms available for entrepreneurs structuring their ventures.
2. Define each of the following: sole tradership, partnership and corporation.
3. What are the specific advantages and disadvantages associated with each primary legal form of organisation?
4. Compare the major tax considerations of a partnership with those of a corporation.
5. Name three specific types of partners. How do they differ?
6. Explain the limited liability partnership.
7. What is double taxation of corporations?
8. How does a limited partnership work? Give an example.
9. What is a limited liability company?
10. What are the advantages and disadvantages of franchising?
11. What are four key questions to be considered by entrepreneurs before structuring their venture?

The following list of advantages and disadvantages is associated with sole traderships, partnerships and corporations. Place an *S* next to those that relate to sole traderships, a *P* next to those that relate to

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partnerships and a *C* next to those that relate to companies. If the advantage or disadvantage applies to more than one type of organisational form, put all answers on the accompanying line. Answers are provided at the end of the chapter.

ADVANTAGES	DISADVANTAGES
1 Limited liability	1 Unlimited liability ....
2 Sole ownership of profits	2 Governmental regulation ....
3 Unlimited life	3 Lack of continuity ....
4 Ease of formation	4 Double taxation ....
5 Flexibility	5 Difficulty obtaining large sums of capital ....
6 Transfer of ownership	6 Organising expenses ....
7 Relative freedom from governmental control	7 Relatively limited viewpoint and experience ....
8 Increased ability and expertise	8 Activity restrictions ....

CASE 12.1
GLORIA'S DECISION

When Gloria Talavera opened her boutique in Manila six years ago, she had only one full-time employee. Since then Gloria has added two general partners and greatly expanded the operation. Over the past year, it has become obvious that the group could open another boutique that would be equally successful. The problem is money. The partnership lacks funds for expansion.

Gloria's banker has suggested that the partnership borrow $200 000 from the bank and pledge the business assets as collateral. 'This will get you the money you need and once you have the boutique going, you can repay the money', he told them. The idea sounds fine to the partners, although they are concerned about the risk involved. If the second boutique does not do well, it could affect the success of the first boutique by siphoning off funds to repay the loan.

Gloria has been thinking about incorporating the business, selling shares and using these funds for expansion purposes. She has not shared this idea with her banker because she wants to give it more thought, but she intends to talk it over with her partners later in the week.

QUESTIONS

1. What are the benefits of incorporating a company to operate the business and raising money through the issue of shares? Is this a better idea than the banker's proposal of taking a $200 000 loan? Why or why not?
2. What would you recommend to Gloria? Explain in detail.

CASE 12.2
A QUESTION OF INCORPORATION

The Harlow family opened its first motel in 1982. Initially, business was slow. It took almost 11 months to break-even and three years for the Harlows to feel that the operation was going to be a success. They stuck with it and by 1987, they were able to increase the size of the motel from 28 to 50 rooms. They expanded again in 1989, this time to 100 rooms. In each case, the motel's occupancy rate was so high that the Harlows had to turn people away during the months of November to April and the occupancy rate was 85 per cent during the other months. By industry standards, their business was one of the most successful motels in the country.

As they entered the 1990s, Harold and Becky Harlow decided that, rather than expanding, they would be better off buying another motel, perhaps in a nearby locale. They chose to hire someone to run their current operation and spend most of their time at the new location until they had it running properly. In 1992, they made their purchase. Like their first motel, the second location was an overwhelming success within a few years. From then on, the Harlows bought a number of new motels. By 1999, they had seven motels with an average of 100 rooms per unit.

During all of this time, Becky and Harold kept their own financial records, bringing in a chartered accountant only once a year to close the books and prepare their income tax returns. Last week the new accountant asked them how long they intended to keep running seven motels. The Harlows told him that they enjoyed the operation and hoped to keep at it for another 10 years, when they planned to sell out and retire.

Harold admitted that trying to keep all of the motels going at the same time was difficult but noted that he had some excellent managers working for him. The accountant asked him whether he would consider incorporating. ‘If you incorporate’, he said, ‘you could sell shares and use the money to buy more motels. Additionally, you could keep some of the shares for yourself so you could maintain control of the operation, sell some for expansion purposes and sell the rest to raise some money you can put aside in a savings account or some conservative investment. That way, if things go bad, you still will have a nest egg built up’. The accountant also explained to Harold and Becky that, as a partnership, they are currently responsible for all business debts. With a corporation, they would have limited liability; that is, if the corporation failed, the creditors could not sue them for their personal assets. In this way, their assets would be protected, so the money the Harlows would get for selling the shares would be safely tucked away.

The Harlows admitted that they had never really considered another form of organisation. They always assumed that a partnership was the best form for them. Now they are willing to examine the benefits of a corporation and they will go ahead and incorporate their business if this approach promises them greater advantages.

QUESTIONS

1. What are the advantages and disadvantages of a partnership?
2. Contrast the advantages and disadvantages of a partnership with those of a corporation.
3. Provide your opinion on whether the Harlows should incorporate.
4. Would the limited liability company option be of value to them? Explain.

RECOMMENDED CASES FROM HARVARD BUSINESS SCHOOL ONLINE

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The Legal Forms of Organization

Publication date: 30 April 1998
Revision date: 19 February 2004
Author(s): Michael J. Roberts
Product number: 9-898-245

Describes the various legal forms of organisation including proprietorships, partnerships, limited partnerships, corporations and limited liability companies. Explains the tax and liability attributes of each form, as well as other issues, which may influence the choice of legal form.

Global Strategy Lessons from Japanese and Korean Business Groups

Publication date: 15 March 2002
Author(s): Howard S. Tu, Seung Yong Kim, Sherry E. Sullivan
Product number: BH072

Given the growth in Asian markets, it is important for Western managers to understand what drives the success of Japanese and Korean business groups – keiretsus and chaebols. The purpose here is twofold: (1) to analyse, compare and contrast the ownership, structure, government influence, financing and culture of each of these two types of business groups; and (2) to analyse how each has dealt with the financial crisis in Asia. From this analysis emerge important lessons for strategic international management.

Legal Aspects of Entrepreneurship: A Conceptual Framework

Publication date: 21 February 2002
Author(s): Constance E. Bagley
Product number: 9-802-161

Identifies many of the legal issues likely to arise in the course of starting and growing a company. Suggests strategies not only for ensuring compliance with the law but also for using the law and the legal system to increase predictability, maximise value, marshal resources and manage risk. Explains

why entrepreneurs and managers cannot just rely on lawyers to deal with the legal aspects of business and offers ways to manage legal risk and handle legal disputes. Also describes the relevance of a variety of laws to managers and entrepreneurs, including intellectual property, securities regulation, taxes, contracts, employment, business organisation, product liability, environment and alternative dispute resolution.

ANSWERS

ADVANTAGES	DISADVANTAGES
1 C	1 S, P
2 S	2 C
3 C	3 S, P
4 S, P	4 C
5 S, P	5 S, P
6 C	6 C
7 S, P	7 S
8 C	8 C

ENDNOTES

1 World Bank, *Doing Business in 2005: Removing Obstacles to Growth* (Oxford University Press, 2005): 17.

2 The ease of doing business measure is a simple average of the country's ranking in each of the seven areas of business regulation and property rights protection measured in World Bank and International Monetary Fund, *Doing Business in 2005*.

3 Licensed under the GNU Free Documentation Licence from the Wikipedia article 'Private limited company by shares' [en.wikipedia.org/wiki/<balance of info to come>].

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13 Graeme Kennedy, 'Franchising: Bright future predicted', *National Business Review* (Auckland) (15 July 2005).

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16 Russell M. Knight, 'Franchising from the franchisor's and franchisee's points of view', *Journal of Small Business Management* (July 1986): 8–15.

17 Australian Competition and Consumer Commission, 'Franchising code of conduct' [www.accc.gov.au/content/index.phtml/itemId/304806]; August T. Horvath, Silvana Merlino, Andrea B. Engelman and Heather Goldstein, 'New franchise law takes effect in Australia', *Journal of Proprietary Rights* 10(11) (1998): 28.

Online reading

INFOTRAC® COLLEGE EDITION

For additional readings and review on Legal structures for new ventures, explore **InfoTrac® College Edition**, your online library. Go to: **www.infotrac-college.com** and search for any of the InfoTrac key terms listed below:

- **business structure**
- **franchise**
- **incorporation**
- **legal structure**
- **limited liability**

13

LEGAL ISSUES RELATED TO EMERGING VENTURES

A major difficulty for the inexperienced entrepreneur is the host of strange terms and phrases which are scattered throughout most legal documents. The novice in this kind of reading should have some understanding not only of what is contained in such documents, but also why these provisions have been included. If an entrepreneur cannot find the time or take the interest to read and understand the major contracts into which his company will enter, he should be very cautious about being an entrepreneur at all.

Patrick R. Liles, Harvard Business School

CHAPTER OBJECTIVES

1 To understand intellectual asset protection within the process of commercialisation and new product development

2 To examine patent protection, including definitions and preparation

3 To review copyrights and their relevance to entrepreneurs

4 To study trademarks and their impact on new ventures

5 To look at new media such as the Internet in relation to intellectual property protection

6 To review the scope of bankruptcy law in Asia–Pacific

7 To appreciate the impact of 'rogue states' and 'offshore intellectual property havens' in the new economy

INTERNATIONAL PROTECTIONS FOR INTELLECTUAL PROPERTY

This chapter is a bit of 'good news, bad news'. We are going to examine the two legal regimes that an entrepreneur may encounter most frequently. First, we need to know how new products, services and innovations can be protected and exploited for commercial gain. That's called **intellectual property rights**. But we also need to know what to do when a business is unable to pay its bills or has liabilities that exceed its assets. Here we're talking about **bankruptcy**.

Consider these facts:

- approximately 5 to 7 per cent of the world trade is in counterfeit goods[1]
- 35 per cent of the software installed on personal computers worldwide is pirated[2]
- intellectual property theft costs 750 000 jobs a year in the US alone[3]
- the US loses up to US$3.8 billion a year in pirate materials in China alone[4]
- counterfeit drugs make up more than 10 per cent of the global medicines market.[5]

Ideas and knowledge are an important part of global trade. Some would say that in the modern era, intellectual property is the engine that drives the economy. A lot of the value of entrepreneurial products lies in the invention, innovation, research, design and commercialisation of new products – most often abroad. So it is key that entrepreneurs have the incentive to create – and intellectual property rights are central to it because a rising proportion of economic output is conceptual rather than physical.

Intellectual property protection is actually a two-way street. Entrepreneurs can legally obtain and exploit intellectual property from abroad. Or they can protect it abroad, stop others from using it and use these rights to negotiate payment in return for using it. The countries of the Asia–Pacific are actually net importers of intellectual property. That means that many of the creators and inventors of intellectual property consumed in the Asia–Pacific are actually located overseas. It also means that Asia–Pacific entrepreneurs will just as frequently take advantage of licensing intellectual property from abroad as they will protecting it.

Of course, most entrepreneurs are not lawyers, so they need to be knowledgeable about intellectual property protection. The term intellectual property (IP) is used to describe the intellectual assets that have been given some form of legal protection in order to prevent unauthorised use by others. These rights fall under the umbrella of intellectual property rights (IPR) and they include **patents**, **trade secrets**, **copyright**, as well as **trademarks** or service marks. Intellectual property rights provide a specific type of protection for a specific type of intellectual property. For example:

- patents protect utilitarian things such as machines as well as scientific, biotech, Internet and e-commerce innovations
- trade secrets may consist of any formula, pattern, device or compilation of information which is used in one's business and which gives the user an opportunity to obtain an advantage over competitors who do not know or use it
- copyright protects various forms of written and artistic expression (including software)
- trademarks protect a name or symbol that identifies the source of goods or services.

Success in a global economy depends more and more on intellectual property assets. In fact, intellectual property-based businesses and entrepreneurs drive more economic growth in the United States than any other single sector. Unfortunately, intellectual property has also captured the attention of pirates and organised crime. Today, piracy, counterfeiting and the theft of intellectual property pose a serious threat to all businesses. These threats to ongoing invention and innovation make it important to consider securing intellectual property protection, whether in a major multinational firm or a one-person home business. Small businesses and start-ups can be at particular risk because they lack the resources and expertise available to larger corporations. Small businesses may also often lack the familiarity with the process of protecting intellectual property. Only 15 per cent of US small businesses that do business overseas know that a patent or trademark provides protection only in the United States.[6] It has never been more essential for small businesses to consider patenting a business idea or registering the name as a trademark.

Intellectual property protection has advanced considerably in the past 10 years. A great deal of the action is now taking place outside the United States. Global entrepreneurs need to know about these developments:

- The World Trade Organization (WTO) is a place where member governments sort out the trade problems and negotiate compliance with WTO agreements signed by the bulk of the world's trading nations. The WTO's agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPs) is especially important. It is an international agreement covering copyright, patents, trademarks, trade secrets, industrial designs and integrated circuit layouts. TRIPs is the most important international agreement on copyright, patents and other intellectual property rules in force today.

TABLE 13.1: ASIA–PACIFIC PARTICIPATION IN MAJOR INTERNATIONAL PROTECTION REGIMES

Australia	WTO and TRIPs, Berne Convention, PCT Union, WIPO – see [www.ipmenu.com/country/australia.htm] IP Australia is the federal government agency responsible for granting rights in patents, trademarks and designs – see [www.ipaustralia.gov.au]
China, People's Republic	WTO and TRIPs, Berne Convention, PCT Union, WIPO – see [www.ipmenu.com/country/china.htm] State Intellectual Property Office of the People's Republic of China – see [www.sipo.gov.cn] State Administration for Industry and Commerce Trademark Office – [sbj.saic.gov.cn]
Hong Kong	WTO and TRIPs, Berne Convention, PCT Union, WIPO – see [www.ipmenu.com/country/hongkong.htm] Intellectual Property Department of Hong Kong – see [www.ipd.gov.hk/eng/home.htm]
Indonesia	WTO and TRIPs, Berne Convention, PCT Union, WIPO – see [www.ipmenu.com/country/indonesia.htm] Directorate General of Intellectual Property Rights – see [www.dgip.go.id]
Japan	WTO and TRIPs, Berne Convention, PCT Union, WIPO – see [www.ipmenu.com/country/japan.htm] Japan Patent Office (JPO) – see [www.jpo.go.jp]
Korea	WTO and TRIPs, Berne Convention, PCT Union, WIPO – see [www.ipmenu.com/country/korea-south.htm] Korean Intellectual Property Office (KIPO) – see [www.kipo.go.kr]
Malaysia	WTO and TRIPs, WIPO – see [www.ipmenu.com/country/malaysia.htm] Ministry of Domestic Trade and Consumer Affairs Intellectual Property Division – see [www.kpdnhep.gov.my]
New Zealand	WTO and TRIPs, PCT Union, WIPO – see [www.ipmenu.com/country/newzealand.htm] Intellectual Property Office of New Zealand – see [www.iponz.govt.nz]
Singapore	WTO and TRIPs, Berne Convention, PCT Union, WIPO – see [www.ipmenu.com/country/singapore.htm] Intellectual Property Office of Singapore (IPOS) – see [www.ipos.gov.sg]
Thailand	WTO and TRIPs, Berne Convention, WIPO – see [www.ipmenu.com/country/thailand.htm] Department of Intellectual Property of Thailand – see [www.ipthailand.org/English]
Taiwan	WTO and TRIPs, Berne Convention – see [www.ipmenu.com/country/taiwan.htm] The Chinese Taipei Intellectual Property Office – see [www.tipo.gov.tw/eng]

- The Berne Convention for the Protection of Literary and Artistic Works guarantees that copyrights are respected across national borders. Together with the Paris Convention, it is one of the world's oldest treaties and is respected by most of the countries of the world.
- The World Intellectual Property Organization (WIPO) is an international organisation that administers 23 international treaties dealing with different aspects of intellectual property protection. The organisation counts 182 nations as member states.
- The Patent Cooperation Treaty (PCT) streamlines patent applications across several countries at once.

PATENTS

One might say that a patent is a contract between society as a whole and an individual inventor. The objective of a patent is to provide the holder with a temporary monopoly on their innovation and thus to encourage the creation and disclosure of new ideas and innovations in the marketplace. A patent provides the owner with exclusive rights to hold, transfer and license the production and sale of the product or process. The WTO's agreement TRIPs provides the

TABLE 13.2: **INTELLECTUAL PROPERTY INFORMATION SOURCES**

IP MENU is an Internet directory system aimed at users and researchers working in the intellectual property field.	[www.ipmenu.com]
New Zealand's Intellectual Property Framework The Ministry of Economic Development has produced information sheets on various forms of intellectual property in New Zealand	[www.med.govt.nz/buslt/int_prop/info-sheets/framework.html]
IP Australia is the federal government agency responsible for granting rights in patents, trademarks and designs	[www.ipaustralia.gov.au]
The United States Patent and Trademark Office website provides a wealth of valuable information for entrepreneurs Users can locate patent and trademark information, such as registration forms, international patents, legal issues and FAQs Users can also check the status of a trademark or patent application on this site	[www.uspto.gov]
This address also allows direct access to the database of registered trademarks	[www.uspto.gov/tmdb/index.html]
This site, provided by the law offices of Oppedahl and Larson, provides basic patent information in a very organised manner – it is also frequently updated	[www.patents.com]
This site, sponsored by Source Translation and Optimisation, offers assistance with Internet, biotech and e-commerce patents Users also can sign up for the free daily information email, 'Internet patent news service', at this site	[www.bustpatents.com]
The United States Copyright Office at the Library of Congress website provides information on copyright protecting works, licensing and legal issues Users also can search copyright records on the site	[www.loc.gov/copyright]
This site allows the user to look up any topic in a search and yield returns of the actual written law, court precedents and current cases and interpretations The site also gives topical searches that aid the user in getting started as well as a business section to help put the laws into more practical applications	[www.findlaw.com]
West's Business Law Textbook's website offers an overview of the book, cases and updates that allow surfers the ability to check contents before purchasing	[wbl.westbuslaw.com]

ENTREPRENEURIAL EDGE

PATENTING ACROSS THE GLOBE

Set up to offer inventors an efficient system for filing international patent applications, the PCT has seen its membership snowball to 124 members since it began operating in 1978. A single, international PCT application enables an inventor to seek patent protection simultaneously in any or all of the 124 contracting states. The US, Japan and Germany are currently the most prolific PCT user-countries, with major, multinational companies dominating the top 20 list. But PCT use by developing countries is rising fast. The Republic of Korea is now the seventh overall user worldwide, with China moving into thirteenth place. Here are some examples of entrepreneurs who protected their innovations through PCT:

- Apple Computer Inc. used the PCT for its iTunes software, now beating digital piracy with a legal solution for digitally downloading music.
- Ashok Gadgil's UV Waterworks, a simple water disinfection device using UV light, is delivering safe drinking water to rural communities in India, Mexico and the Philippines for $1.50 per person per year. He filed the PCT application in 1997.
- American inventor Dean Kamen has 56 published PCT applications, many in the fields of health care and personal transportation. He is best known for his stair-climbing iBOT™ wheelchair and for the Segway® Human Transporter.
- Japanese ground-breaker Sony used the PCT as it developed sophisticated techniques to control the movements of the company's humanoid robots. Sony remains among the top five PCT filers worldwide.
- Chinese scientists from Tsinghua University filed a PCT application in 2003 for their process for creating a more environmentally-friendly, two-component wet cement.
- In his workshop in Peru, entrepreneur Jose Vidal Martina designed a low-cost drill bit as an alternative to expensive ultrasound machines. Following his PCT application, his device is now selling internationally.

international standard for duration of patent exclusivity, which is 20 years from the date of filing. Under all patent systems, once this period has expired, people are free to use the invention as they wish. Although all WTO members are subject to patent provisions in the TRIPs agreement, patents are actually granted under national laws and so the rights are also national in scope. For example, an Australian patent can be defended only against infringements in Australia. However, the PCT allows entrepreneurs to patent an innovation simultaneously in other countries.

Patents are provided for products or processes that are 'new, involve an inventive step and are capable of industrial application'. A patent is the result of a unique discovery and patent holders are provided protection against infringement by others. In general, machines, products, plants, compositions of elements (chemical compounds) and improvements on already existing items can qualify for patent protection.[7]

How to secure a patent

Because quite often the patent process is complex, careful planning is required. Experts recommend the following basic rules:

- **Rule 1:** Pursue patents that are broad, are commercially significant and offer a strong position. This means that relevant patent law must be researched in order to obtain the widest coverage possible on the idea or concept. In addition, there must be something significantly novel or proprietary about the innovation. Record all steps or processes in a notebook and have them witnessed so that documentation secures a strong proprietary position.

- **Rule 2:** Prepare a patent plan in detail. This plan should outline the costs to develop and market the innovation as well as analyse the competition and technological similarities to your idea. Attempt to detail the precise value of the innovation.
- **Rule 3:** Have your actions relate to your original patent plan. This does not mean a plan cannot be changed. However, it is wise to remain close to the plan during the early stages of establishing the patent. Later, the path that is prepared may change – for example, licensing out the patent versus keeping it.
- **Rule 4:** Establish an infringement budget. Patent rights are effective only if potential infringers fear legal damages. Thus it is important to prepare a realistic budget for prosecuting violations of the patent.
- **Rule 5:** Evaluate the patent plan strategically. The typical patent process takes three years. This should be compared to the actual life cycle of the proposed innovation or technology. Will the patent be worth defending in three years or will enforcement cost more than the damages collected?[8]

Patent applications must include detailed specifications of the innovation that any skilled person in the specific area can understand. A patent application has two parts:

- **Specification** is the text of a patent and may include any accompanying illustrations. Its purpose is to teach those fluent in this area of technology all they need to understand, duplicate and use the invention. The specification may be quite long and typically includes:
  - an introduction explaining why the invention will be useful
  - a description of all prior work that you are aware of and that could be considered similar to the invention; the specification usually lists other patents, by number, with a brief description of each, but you can cite and describe unpatented technology as well
  - a summary of the invention that describes the essence of the new technology and emphasises its difference from prior art, while including all its requisite features, whether novel or not
  - a detailed description of the invention, including anything that could be remotely relevant, reference to all reasonable variations – this section should be detailed enough to really teach a skilled practitioner
  - examples and/or experimental results, in full detail.

  The specification is inherently broad because its intent is to teach and also, as a practical matter, to allow some flexibility in the claims that are based on it.

- **Claims** are a series of short paragraphs, each of which identifies a particular feature or combination of features that is protected by the patent. The entire claims section, at the end of the patent, is typically about one page long or less.

  Claims define and limit the patented invention. The invention can be broad (a process requiring an 'inorganic, non-metal solid' would cover a lot of possibilities, for example) but sharply limited not to cover anything in prior art (other existing processes that use organics or metals).[9]

Once the application is filed, an examiner will determine whether the innovation qualifies for patentability. The examiner will do this by researching technical data in journals as well as previously issued patents. Based on those findings, the application will be rejected or accepted.

Only a small percentage of issued patents are commercially valuable. Consequently, the entrepreneur must weigh the value of the innovation against the time and money spent to obtain the patent. Also, it is important to remember that many patents are declared invalid after being challenged in court. This occurs for several reasons. One is that the patent holder waited an unreasonable length of time before asserting their rights. A second is that those bringing the suit against the patent holder are able to prove that the individual misused the patent rights – for example, by requiring certain purchases of other goods or services as part of the patent-use arrangement. A third is that other parties are able to prove the patent itself fails to meet tests of patentability and is therefore invalid.[10]

Truth be told, the entrepreneur might waste a lot of money on protecting intellectual property that could have funded marketing and product development. One author recommends that the entrepreneur should spend the money on turning investors' heads rather than on high-priced lawyers. Too much protection of intellectual property increases litigation and slow innovation, some say. It is better to stay ahead of the competition by rolling out new products faster than people can copy them.[11]

If, after careful review, an entrepreneur concludes that the innovation will withstand any legal challenge and is commercially worthwhile, a patent should be pursued. If a challenge is mounted, legal fees may be sizable, but a successful defence can result in damages sufficient to compensate for the infringement plus court costs and interest. In fact, the court may award damages of up to three times the actual amount. In addition, a patent infringer can be liable for all profits resulting from the infringement as well as for legal fees.[12]

Most people do not realise that just 2 per cent of all patents ever realise any profits. Considering the cost of the patent process and the amount of time and resources it takes to protect patents, actually getting patent protection may not even be the best way to go. Because of this, many experts suggest that inventors consider licensing their product rather than marketing it themselves.[13] In addition, many experts suggest that a venture capitalist, financially secure business partner, or consultant may be the best way to ensure success (see also chapter 17).

COPYRIGHT

A copyright provides exclusive rights to creative individuals for the protection of their literary or artistic productions. It is not possible to copyright an idea, but the particular way that an idea is expressed often can be copyrighted. This expression can take many forms, including books, periodicals, dramatic or musical compositions, art, motion pictures, lectures, sound recordings and computer programs. Under TRIPs:

- copyright extends 50 years after the death of the author (one exception is photographs, which have only 25 year terms)
- copyright must be granted automatically
- computer programs are viewed as 'literary works' and receive the same level of protection
- national exceptions to copyright – such as the **fair use doctrine** in the United States – must be tightly controlled
- in each state, intellectual property laws may not offer any benefits to local citizens which are not available to citizens of other TRIPs signatories (this is called 'national treatment'); TRIPs also has a most favoured nation clause.

The owner of this copyright may:

- reproduce the work
- prepare derivative works based on it (for example, a condensation or movie version of a novel)
- distribute copies of the work by sale or otherwise

- perform the work publicly
- display the work publicly.

Each of these rights, or a portion of each, also may be transferred.[14]

Understanding copyright protection

For the author of creative material to obtain copyright protection, the material must be in a tangible form so it can be communicated or reproduced. It also must be the author's own work and thus the product of the author's skill or judgement. Concepts, principles, processes, systems, or discoveries are not valid for copyright protection until they are put in tangible form – written or recorded.

Formal registration of a copyright with the National Copyright Office is a requirement before an author can begin a lawsuit for infringement. In addition, an author can find their copyright invalidated if proper notice isn't provided.

Anyone who violates an author's exclusive rights under a copyright is liable for infringement. However, because of the 'fair use' doctrine, it is sometimes difficult to establish infringement. Fair use provides for the legal, non-licensed citation or incorporation of copyrighted material in another author's work under certain, specifiable conditions. The United States is the only country with a fair use doctrine. According to US law, fair use is described as:

> [Reproduction of a copyrighted work for] purposes such as criticism, comment, news reporting, teaching (including multiple copies for classroom use), scholarship, or research, is not an infringement of copyright. In determining whether the use made of a work in any particular case is a fair use the factors to be considered shall include (1) the purpose and character of the use, including whether such use is of a commercial nature or is for non-profit educational purposes; (2) the nature of the copyrighted work; (3) the amount and substantiality of the portion used in relation to the copyrighted work as a whole; and (4) the effect of the use upon the potential market for or value of the copyrighted work.[15]

Outside the US, comparable copyright limitations can be found in many nations' copyright statutes. Most common law countries (especially those with a history as British territories or colonies) have a related doctrine known as *fair dealing* with narrowly drawn exceptions. For example, in Australia, the grounds for fair dealing are:

- research and study
- review and criticism
- 'reporting the news'
- legal advice (although the Crown is deemed to own copyright in federal statutes and each state in state statutes).[16]

If, however, an author substantiates a copyright infringement, the normal remedy is recovery of actual damages plus any profits the violator receives. As a matter of course, any writings that you prepare should be copyrighted by putting the copyright notice (©) on it. It is not necessary to register copyrights with the Copyright Office unless and until you want to sue somebody for infringement. Remember, ideas cannot be copyrighted. Therefore, if someone writes an article and copyrights it, you are certainly free to read that article, digest it, take the ideas from that article and other sources and weave them into your own material without any copyright problems. On the other hand, if someone has copyrighted an article, you cannot simply rephrase it or change minor words and claim it as your own. Exactly where the line is to be drawn is not clear. However, a little common sense will give the appropriate answer in most of these cases.[17]

ENTREPRENEURSHIP IN PRACTICE

WATCH WHAT YOU SAY

The government can't help protect your business from the competition if your employees are willingly sharing valuable information. Copious amounts of sensitive and confidential information are being made public every day by business travellers who pay no heed to the fact that people have ears. Carrying on a seemingly harmless conversation with a co-worker on an airplane, in a bus, or in a restaurant has wreaked havoc for more than one company. An employee of Fuld & Company, a management consulting firm, was riding a shuttle bus when he heard every bit of a company's distribution strategy being discussed in the seat in front of him. Luckily for the two talkers, he wasn't competition. He did, however, let it be known what had just occurred.

Protecting trade secrets is not a new concept, but with the amount of businesspeople travelling every day and the development of technology, the smallest slip can be dangerous. Leonard Fuld, a competitive intelligence expert, states that it's common for companies to overlook the human factor when it comes to information leaking out. He emphasises the point by talking about the 'Nerd Bird', a frequent shuttle flight from Austin, Texas, to San Jose, California, that carries mostly engineers and executives from the semiconductor and software industries. 'I was even told an anecdote about an executive who waited until passengers had disembarked and then quickly roamed the aisle to see if any documents had been left behind'. 'I know of people in firms who justify booking first-class airfares based on the quality of information they might be able to pick up that way', states a Silicon Valley businessperson.

Verbal exchanges aren't the only way travellers are hurting themselves. Rental car trunks, stolen briefcases and the simple misplaced memo are known to be gold mines as well.

Business travellers should keep these things in mind to protect intellectual property that can't be protected by the government:

>> Avoid talking shop in public areas where competitors are likely to be present. Business jargon isn't a code when the executive sitting right beside you is in the same industry.

>> Never expose laptop screens on airplanes, buses, or other conveyances when working on confidential facts and figures. If the work is unavoidable, ask for a window seat and use smaller font sizes.

>> Be particularly vigilant at trade shows. Proprietary technology, new product releases and the like should be discussed in detail only behind closed doors.

>> Pay phones and cell phones pose an amazing opportunity for others to partake in the conversation. Be cautious of your surroundings when making important phone calls.

>> Protect the files on your computer by purchasing a cable lock or security software. Help deter computer theft by labelling both the case and computer and never letting them out of your sight.

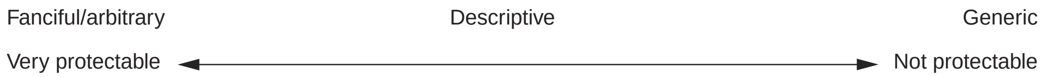
>> Keep unnecessary documentation back at the office. Also check your work area and account for all paperwork after handling important documents to see if anything has 'mysteriously' landed on the floor.

Source: David Barber, 'Loose lips sink you', *Inc.* [www.inc.com] (June 1999).

TRADEMARKS Article 15 (1) of TRIPs states that 'signs, in particular words including names, letters, numerals, figurative elements and combinations of colours as well as any combination of such signs, shall be eligible for registration as trademarks'. A trademark is a distinctive name, mark, symbol, or motto identified with a company's product(s) and registered at the National Trademark Office. Thanks to trademark law, no confusion should result from one venture's using the symbol or name of another.

Specific legal terms differentiate the exact types of marks. For example, trademarks identify and distinguish goods. Service marks identify and distinguish services. Certification marks denote the quality, materials, or other aspects of goods and services and are used by someone other than the mark's owner. Collective marks are trademarks or service marks members of groups or organisations use to identify themselves as the source of goods or services.[18] A trademark can be

FIGURE 13.1 THE SPECTRUM OF TRADEMARK DISTINCTIVENESS



Source: Kenneth DeLeon, 'Trademark law basics' [www.registeringatrademark.com/trademark-law-basics.shtml].

a design, like the Nike Swoosh. It can be a colour like Brown for UPS. It can even be a sound, like the MGM lion's roar.

- **Fanciful trademarks:** These have no meaning before they became trademarks – examples include: Starbucks (coffee), Vero (insurance).
- **Arbitrary trademarks:** These are common words that have an arbitrary relationship to the product – examples include: Apple (computers), Amazon (e-commerce).
- **Suggestive trademarks:** Suggestive trademarks indirectly allude to a quality of the product – examples include: *Playboy* (men's magazine).
- **Descriptive trademarks:** These describe the goods or service they market – examples include: Computerland (computer store), Vision Center for an optics store.
- **Generic trademarks:** Generic trademarks describe a whole class of products – examples include: Personal computer (for a personal computer), Milk (for milk).[19]

Once issued, the trademark is listed in the register of the trademark office. This listing offers several advantages:

- nationwide constructive notice of the owner's right to use the mark (thus eliminating the need to show that the defendant in an infringement suit had notice of the mark
- protection against importers using the mark
- incontestability of the mark after five years.[20]

A trademark registration lasts for a period of 10 years. The registration is thereafter renewable for further periods of 10 years, for an indefinite period. To obtain protection for your trademark overseas, you will need to file an application with intellectual property offices in overseas countries of interest. It is most important to understand that a trademark may be invalidated in four specific ways:

- cancellation proceedings are a third party's challenge to the mark's distinctiveness within five years of its issuance
- cleaning-out procedure refers to the failure of a trademark owner to file an affidavit stating it is in use or justifying its lack of use within six years of registration
- abandonment is the non-use of a trademark for two consecutive years without justification or a statement regarding the trademark's abandonment
- generic meaning is the allowance of a trademark to represent a general grouping of products or services – for example, cellophane has come to represent plastic wrap and scotch tape has come to represent adhesive tape; Xerox is seeking, through national advertising, to avoid having its name used to represent copier machines.

If a trademark is properly registered, used and protected, the owner can obtain an injunction against any uses of the mark that are likely to cause confusion. Moreover, if infringement and damages can be proven in court, a monetary award may be given to the trademark holder.

ENTREPRENEURIAL EDGE

ENTREPRENEURS MUST CHOOSE THEIR WORDS WITH CARE

Entrepreneur magazine is playing hardball to stop entrepreneurs from using the word entrepreneur.

Entrepreneur Media Inc., the magazine's owner, waged a successful six-year legal battle to prevent a California publicist from calling his company EntrepreneurPR and from using the word in a quarterly periodical he once published, *Entrepreneur Illustrated.* It won a $1.4 million judgment against him and is seeking payment even though he says his business, which he long ago rechristened BizStarz, is now in a shambles.

Another publication in *Entrepreneur* magazine's sights was *Publishing Entrepreneur* of Traverse City, Michigan. Its owner folded it into sister publication *Independent Publisher* after being sued.

Seven years ago Entrepreneur Media also tried to thwart the consulting firm Ernst & Young from issuing the *Ernst & Young Entrepreneur of the Year Magazine* in conjunction with its annual awards program. The firm held its ground and Entrepreneur Media backed off.

The Donald H. Jones Center for Entrepreneurship at Carnegie Mellon University chose another course. After receiving a letter from Entrepreneur Media in 2001 describing its quarterly alumni newsletter *The Entrepreneur* as 'a flagrant violation of the trademark', the center renamed it the DJC Newsletter.

In 1999 Entrepreneur Media also sued the holders of the Internet addresses entrepreneurs.com and entrepreneur.net. Though it later dropped the complaints, it served notice that it reserved the right to reinitiate them. 'I can't build a commercial site because there's been the threat of litigation', said Jeff Busche of Huntington Beach, California, a website developer who is the owner of entrepreneur.net. And Gregory McLemore, whose company owns the entrepreneurs.com name, said he 'felt like I was mugged. They are trying to commandeer this word and remove it from the language'.

And so it goes. In all, Entrepreneur Media says that in the last 10 years, it has resolved or settled about 40 instances of actual or potential trademark infringement. It declines to specify how many lawsuits it filed or how many cease-and-desist letters it sent, saying only it deals with infringement on a case-by-case basis.

All of which raises the question: Can a publication claim a common word as its own property? A lot of publications contain the words business, money and times. What is so special about the word entrepreneur?

Entrepreneur Media applied in 1985 to register the word for use in magazines, books and other publications 'pertaining to business opportunities' as well as for computer programs. *Entrepreneur* magazine, which was seven years old at the time, today has a circulation of 560 000.

The law considers a trademark valid after five years of uncontested use. Entrepreneur Media says it believes that other publications containing the word entrepreneur will sow confusion in the public's mind and benefit from its reputation and thus are fair game for legal action.

But some legal experts wonder whether Entrepreneur Media did not just grab a questionable decision by the trademark office and run with it. 'An administrative agency can make mistakes and give protection to marks that shouldn't have been protected', said Roger E. Schechter, professor of law at George Washington University. 'Small businesses are at a disadvantage when this happens because litigation is expensive, risky and takes an owner's mind off the business'.

Source: Amy Zipkin, 'Entrepreneurs must choose their words with care', the *New York Times*, 7 October 2004: C2.

Avoiding the trademark pitfalls

Trademark registration and search can be costly, sometimes ranging into the thousands of dollars. Trademark infringement can be even more expensive. To avoid these pitfalls, one author has noted five basic rules entrepreneurs should follow when selecting trademarks for their new ventures.

- **Rule 1:** Never select a corporate name or a mark without first doing a trademark search.
- **Rule 2:** If your lawyer says you have a potential problem with a mark, trust that judgement.
- **Rule 3:** Seek a coined or a fanciful name or mark before you settle for a descriptive or a highly suggestive one.

ENTREPRENEURIAL EDGE

NIKE VS MIKE: A PARODY ON TRADEMARK INFRINGEMENT

Mike Stanard had a great idea for his daughter to try during summer vacation: Establish an enterprise called 'Just Did It' (a spoof on Nike's 'Just Do It' slogan) and sell T-shirts with the famous swoosh design (identical to Nike's) but accompanied by the word 'Mike' instead of Nike. The T-shirts would be sold for $19.95 and long-sleeved ones for $24.95. They would send out 1400 brochures to college athletes and celebrities named Michael. What a great idea!

Nike did not think so. From 1971 to 1994, Nike had invested more than $300 million advertising its trademarks. Aggregate sales revenues from Nike trademarked apparel had exceeded $10 billion. The 'Just Do It' slogan alone produced 1989–1994 revenue exceeding $15 million. Nike sued Stanard for trademark infringement.

Stanard's defence was parody. A parody must convey two simultaneous and contradictory messages: That it is the original, but also that it is not the original and is instead a parody. The customer must be amused and not confused.

To assess whether a trademark infringement has occurred, the courts consider seven factors: (1) the degree of similarity between the trademarks, (2) the similarity of the products for which the name is used, (3) the area and manner of concurrent use, (4) the degree of care likely to be exercised by consumers, (5) the strength of the complainant's trademark, (6) whether actual product confusion exists among buyers and (7) an intent on the part of the alleged infringer to palm off his or her products as those of another.

Since Stanard sold the shirts by mail (customers had to write a check to 'Just Did It') and he had no apparent intent to copy Nike's products specifically, the court concluded no confusion existed.

Thus, the parody defence succeeded. The parody defence doesn't always work, however. Marketers will have to decide whether the legal risk involved in parody marketing is worth unknown sales results.

Some examples of court rulings include these:

>> Miami Mice was a valid parody of Miami Vice.

>> Starballz was a valid parody of Star Wars.

>> A parody of the O.J. Simpson double murder trial entitled The Cat NOT in the Hat! A Parody by Dr Juice was permitted to do a take-off on Dr Seuss.

>> Hard Rain Cafe was likely to confuse consumers regarding the Hard Rock Cafe.

>> Enjoy Cocaine was not a valid parody of Enjoy Coca-Cola, where both used the familiar red-and-white logo.

>> People Eating Tasty Animals was closed down by People for the Ethical Treatment of Animals (PETA).

>> Bagzilla was a permissible pun of Godzilla and would not confuse consumers.

>> The Danish band Aqua was allowed to use Mattel's Barbie doll to mock the values she supposedly represents.

Source: Maxine S. Lans, 'Parody as a marketing strategy', *Marketing News* (3 January 1994): 20.

- **Rule 4:** Whenever marketing or other considerations dictate the use of a name or a mark that is highly suggestive of the product, select a distinctive logotype for the descriptive or suggestive words.
- **Rule 5:** Avoid abbreviations and acronyms wherever possible and when no alternative is acceptable, select a distinctive logotype in which the abbreviation or acronym appears.[21]

Clearly there's no one guideline. As one legal scholar has said:

> given these disparate court decisions, a parodist has no clear guidelines for what will and will not constitute a parody. A parodist also cannot know until it is too late whether he made too much use of the targeted work.[22]

DOMAIN NAMES

Domain names are the human-friendly forms of Internet addresses and are commonly used to find websites. While designed to serve the function of enabling users to locate computers (and people) in an easy manner, domain names have acquired a further significance as

ENTREPRENEURSHIP IN PRACTICE

SOME INTERESTING WIPO UDRP DECISIONS

- Future Media Architects (FMA) Inc. successfully defended against a challenge from Kiwi European Holdings B.V. over its ownership and use of www.kiwi.com. Kiwi European, a subsidiary of the Sara Lee Corporation, owns the popular KIWI brand of shoe care products. WIPO concluded that FMA neither intended nor created any consumer confusion or disruption relating to the Kiwi Brand. The Panel cited Kiwi European Holdings' behaviour as 'instance of reverse domain name hijacking'.[23]
- Rock star Bruce Springsteen has lost his attempt to evict a fan club from using his name in the web domain brucespringsteen.com. Canadian Jeff Burgar of the Bruce Springsteen Club had not violated the singer's rights, a three-member arbitration panel in Geneva ruled on Wednesday.[24] Top actresses Julia Roberts and Nicole Kidman, Venus and Serena Williams of tennis fame, pop singer Madonna, French film stars Isabelle Adjani and Alain Delon and the estate of American rock legend Jimi Hendrix have all won such cases.
- Telstra Australia received a favourable determination from the WIPO Arbitration and Mediation Centre against a company which had registered the domain name telstra.org.
- The licensee of the America's Cup trademark, which operated an official website at www.americascup.org, filed suit against the New Zealand operator of a site at www.americascup.com. WIPO ruled that both domain names should be transferred to America's Cup Properties and no money changed hands.
- New Zealand businessman Cameron McKenzie registered 'oggi.co.nz' and was forced to hand it back to Oggi Advertising even though the latter did not have a registered trade mark.
- Chanel succeeded in an action in Korea to have the registration 'chanel.co.kr' cancelled. The domain name had been attached to a site selling condoms, pheromone perfumes and lingerie. This act was held to be contrary to Korea's unfair competition legislation.

business identifiers and, as such, have come into conflict with the system of business identifiers (protected by intellectual property rights) that existed before the arrival of the Internet. Domain names may be awarded to trademark holders over others through arbitration or litigation. This means that having trademark registration in the same name as your domain name may ensure that you retain ownership of the name.

The problem is that 'cyber squatters' (people who purchase a large number of domain names in general) offer domain names for sale back to the person or company who should rightfully have the domain under trademark laws. Needless to say, trademark holders object to third parties registering domain names which they believe should be theirs. The domain name registries, many of whom are not governmental organisations, have had to find a solution to this and therefore have dispute resolution systems which operate in parallel with national laws. The majority of the generic top level domain names (.com, .net etc.) now use the Uniform Dispute Resolution Policy (UDRP), but some critics claim that the UDRP process favours large corporations. There have been instances of companies, individuals or governments trying to get domain names away from their current owners by making false claims of trademark violation. Sometimes they are successful. This practice is called reverse-cyber squatting.

TRADE SECRETS

Trade secrets are business processes and information that are unpatentable, patentable but not enforceable, patentable but for some reason you do not wish to disclose. This might include customer lists, plans, research and development, pricing information, marketing techniques and production techniques. Generally, anything that makes an individual company unique and has value to a competitor could be a trade secret.[25] Trade secret protection is only possible with employer and employee diligence. Staff that are privy to trade secrets must be clearly advised of their obligations, especially on leaving the organisation and should be bound to these obligations through their employment contract.

Protection of trade secrets extends both to ideas and to their expression. For this reason and because a trade secret involves no registration or filing requirements, trade secret protection is ideal for software. Of course, the secret formula, method, or other information must be disclosed to key employees. Businesses generally attempt to protect their trade secrets by having all employees who use the process or information agree in their contracts never to divulge it. Theft of confidential business data by industrial espionage, such as stealing a competitor's documents, is a theft of trade secrets without any contractual violation and is actionable in itself.

In many instances, trade secrets are based on discoveries or inventions that could be patented, but the owner has chosen to keep the discovery or invention secret. Trade secrets, such as the formula for Coca-Cola, have been in effect for many years and will continue for as long as the secret is kept from the public. If it had been patented, the formula would have long been in the public domain.

The law clearly outlines the area of trade secrets: Information is a trade secret if

- it is not known by the competition
- the business would lose its advantage if the competition were to obtain it
- the owner has taken reasonable steps to protect the secret from disclosure.[26]

Keep in mind that prosecution is still difficult in many of these cases.

BANKRUPTCY

'Looking back on it, my judgement was often terribly wrong', said one entrepreneur who had burned through more than $20 million trying to launch a web-based business. 'Unfortunately, I was never in doubt.'[27]

How do we define business failure? According to Shepherd, it occurs:

> when a fall in revenues and/or rise in expenses are of such magnitude that the firm becomes insolvent and is unable to attract new debt or equity funding; consequently, it cannot continue to operate under the current ownership and management.[28]

In other words, bankruptcy occurs when a venture's financial obligations are greater than its assets. Shepherd et al. observe three reasons for business failure:

- **The liability of newness:** There are higher costs for new firms in learning new tasks. Organisational conflicts are higher in new firms. There are barriers to entry for new firms. Competitors will sometimes commit unethical acts against new start-ups.
- **Overconfidence:** Entrepreneurs rank their chances of success at over 70 per cent. Perhaps there is a 'hubris theory of entrepreneurship'.
- **Lack of experience:** Entrepreneurs with more experience will generally possess the knowledge to perform more effectively the roles and tasks necessary for success.[29]

No entrepreneur intentionally seeks bankruptcy. Although problems can occasionally arise out of the blue, here are several ways to foresee impending failure:

- new competition enters the market
- other firms seem to be selling products that are a generation ahead
- the research and development budget is proportionately less than the competition's
- retailers always seem to be overstocked.[30]

TABLE 13.3: BANKRUPTCY RATES IN ASIA–PACIFIC, PERCENTAGE OF ALL FIRMS

New Zealand	3.7%
United States	3.7%
Singapore	3.1%
Australia	2.1%
United Kingdom	1.9%
Hong Kong	0.6%
Japan	0.2%
South Korea	0.2%
Thailand	0.1%

Source: Stijn Claessens and Leora Klapper, 'Bankruptcy around the world: Explanations of its relative use' [econ.worldbank.org/files/16064_wps2865.pdf] 2002.
Note: These figures are from 1990–99

The rate of bankruptcy differs from country to country. New Zealand and the United States have relatively high 'churn' or firm failure and that leads to bankruptcy. Other countries, such as Thailand, South Korea and Japan, have extraordinarily low rates of bankruptcy.

In various countries, bankruptcy carries a social stigma with it.[31] The society sees it as a sign of financial irresponsibility and 'failed entrepreneurs' often find it difficult to obtain credit. The entrepreneur may suffer from loss of esteem and other negative social attitudes.

ENTREPRENEURIAL EDGE

MY PERSONAL STORY OF BANKRUPTCY

Howard Frederick writes: When Sir Angus rose to address New Zealand's Innovate *conference in 2002, I knew that something special was about to happen. Knighted in 1999 for his contributions to electronics, the name Angus Tait is synonymous with excellence in electronics as well as for the undying entrepreneurial spirit of New Zealanders.*

When you know his story, it is nothing special that Tait Electronics has offices in 13 countries and employs over 1000 people, with more than 90 per cent of its sales overseas. What is remarkable is that Sir Angus has changed his firm's structure from a privately owned company to a charitable trust to ensure that virtually all the profit is reinvested in the electronics industry in Christchurch. The audience in Christchurch was awe-struck by this speech – so much so that the panel chair, Deputy Prime Minister Jim Anderton, could not bring himself to ring his usual clang warning speakers of running over! The applause was huge, but in good Kiwi style, not a standing ovation. That would have been too much show for modest Sir Angus.

Here is what Sir Angus said:

Failure is a basic human trait. It's part of growing up, part of the business of living. As a child, most of our failures are not very consequential. Occasionally when they are, your social structure of friends gather around you briefly, your nannies embrace you and everyone endeavours to put right what has gone wrong. In the business world, it's a totally different story. When you fail, no one wants to know you. They are repelled by you. You have a contagious disease.

In 1967 after 15 years in business, I went bust. It's a curious social phenomenon. No one rang me up to say they were sorry, to enquire whether I was all right. Later in social occasions, not a word was said; it was as if there was a plague on my house.

How do I explain this? I attribute this to our immaturity. We take delight in malicious gossip about people who are having problems in their business. 'Bill's in trouble – not looking too good for ol' Bill.' It is a mark of our immaturity as a nation. Why is this so? Why do we have

>>

this dreadful problem? I personally think it's part of the tall poppy syndrome. This is the cultural syndrome that dictates we are all uniform persons and that we prefer mediocrity to achievement. If we step out of line to climb just a bit higher than average and then fall down, you can hear the snickers. 'Ha ha', they say, 'he's fallen down. He's gone back to where he should be.' We cling dearly to the flat egalitarian structure and at some considerable price.

When I went into receivership, the bank sent their man in, who politely sidelined me and prepared my entire life's work for the auction block. My first reaction was to punch him in the nose, but that wouldn't have cemented the relation very securely, so I suppressed it and realised that I wanted to keep on eating. What went wrong? I learned a lot about radio technology in the war. I wanted to apply my learnings to mobile communications in an era when technology was king. I felt that if you get the technology right, everything else would line up. I sold this story to the bank, which they unwisely bought. They tolerated my turbulent progress until they had to pull the plug. There I sat next to the receiver while he plucked my assets one by one. Actually, I got a sense of perspective and liked this guy. He was a financial adviser and it certainly was at a reasonable price! We developed good rapport, but ultimately I got the sack.

I saw the error of my ways but still had some cards that I had not played. I still had the technology. I still had the intellectual property in my head. I also still had some human assets – 'twelve good men and true' – who remained with me. So I thought, I'm going to push the boat out again. This was around my 50th birthday, with a second mortgage on my house. I went back to the same bank and asked for an overdraft. I told the banker, a real bureaucrat, 'I won't make the same mistakes again'. He smiled and was happy to hear that. 'No', I said, 'I'll make different mistakes this time.' His smile went away. I learned three lessons from all this: (1) Money needs a minder. (2) Listen to other opinions. I wasn't arrogant; I was just convinced that I knew. (3) Keep your cool. Be patient with people. So I ended up in a position where I could have another go. It was my great good fortune that I could make a small boat and push it out again.

We had a horde of unpaid creditors from the old company. I had put every bob of my own into the company and so the company actually owed me money as a creditor. But most painfully, I owed money to suppliers and friends of long time. I had no legal obligation to pay them. It was the company that had defaulted; I was not personally bankrupt. But it was an ethical issue. Enter once again the receiver, whom I had learned to like, a learned man, who pointed out that there was a provision in tax law to make a 'subvention payment' to previous creditors from profits from the new company, myself included! So we paid them off and that was the most gratifying experience that I had had to date.

Innovative juices were flowing, the products were right, our business was substantial. I recognised that technology may be the entry point, but if you don't know about what is a core part of your business – the financial part – and I hated that part, hire someone who does. That was 30 years ago. Today we design and manufacture mobile communications equipment. We're struggling to break through the $200m sales barrier. All the profits we have poured back into the business. We put $35m into the Christchurch economy last year. We have got a substantial electronics industry in Christchurch and I'm proud to say many of its roots go back to the efforts of the twelve good men of 1969. Lincoln University has estimated that for every real job in our industry there were three jobs in the support industry. That means now 10 000 total jobs in this area. It's a classic cluster in Michael Porter sense.

We are born of innovative stock. My forefathers walked over the hill from Lyttleton with not much more than they could carry. They had to innovate to survive and grow and we have their genes. We are made of the same stuff. We have the same fundamental ability. They founded the egalitarian society which preferred the flat line of ordinariness. Like them, we also like mediocrity. But our country's most urgent need is for lots of peaks of achievement. Isn't it a bit simplistic for me to suggest from whom we come and what we want to become? Yet, there's a grain of truth that we have the cultural inhibition that stands in the way of us achieving our potential. We must rid ourselves of this tall poppy syndrome. But it's not easy to achieve a cultural change. What's hardest is persuading the educators in their ivory castle that they are doing it wrongly. To work on kids is no small task. That's only the one piece of the economic jigsaw. But I'd be prepared to suggest it's a key piece. Suffice it to say that if we don't get it right after all this effort through the last eighteen months, we'll never get it right. The current environment is more supportive than it has ever been in recent history.

For my part I consider it my great good fortune to have lived and work in the period in our country's development. I consider it my good fortune to have arrived upright at this age with most of my marbles and not entirely penniless. Future historians may well look back and note that the first decade of the new millennium recorded a perceptible shift away from dependence on primary production, a shift to a knowledge economy and away from stigmatising failed entrepreneurs to celebrating them.

Source: Transcribed by the author. See also abbreviated summary at [www.taitworld.com/main/index.cfm/4,497,18,47,html].

Efficient bankruptcy laws periodically cleanse the economy of unviable businesses, ones that hinder the productive allocation of assets and human capital. Bankruptcy laws differ around the world in a variety of ways:

- the trigger when a company needs to file for bankruptcy
- who can file for reorganisation or liquidation
- the weight given to the debtor, the creditors (bank loans, trade financing), the company's management and the other stakeholders in preparing reorganisation proposals
- the ability of management to stay during the reorganisation
- whether an automatic stay of assets exists.

The World Bank lists some of these differences (shown in table 13.4).

Japan, Singapore, Taiwan and Australia have the most efficient bankruptcy systems. They take the least time, cost the least and have the highest recovery rates. New Zealand and the United States need to improve to reach those top ranks. Again, Indonesia is the worst with an estimated five-and-a-half-year period needed to complete bankruptcy.

An entrepreneur is well advised to seek legal counsel in the country of residence or operations. However, wherever they are, entrepreneurs should know the early warning signs that indicate that bankruptcy may be imminent:

- financial management is lax – no one knows how the company's money is spent
- company officers, too busy to keep tabs on the bookkeeping, have trouble providing information or documentation of corporate transactions to the accountant
- officers and family members make repeated emergency loans to the company (this usually means the business cannot get credit from banks)
- customers are given large discounts if they pay more promptly; products are put on sale to generate cash – this puts a faltering company in greater jeopardy by reducing needed mark-ups
- contracts are accepted below standard price to generate cash – this is only a temporary (and eventually suicidal) answer to cash-flow problems

TABLE 13.4: BANKRUPTCY LAWS IN THE ASIA–PACIFIC

ECONOMY	TIME (YEARS)	COST (% OF ESTATE)	RECOVERY RATE (CENTS ON THE DOLLAR)
Japan	0.6	4	92.7
Singapore	0.8	1	91.4
Taiwan	0.8	4	89.5
Australia	1	8	80
Hong Kong	1.1	9	81.2
Korea	1.5	4	81.7
New Zealand	2	4	71
United States	2	7	76.3
Malaysia	2.2	14	38.8
China	2.4	22	31.5
Thailand	2.7	36	44
Indonesia	5.5	18	13.1

Source: World Bank and International Monetary Fund, *Doing Business in 2005* (Oxford University Press, 2005): 2, available from [www.doingbusiness.org/EconomyRankings] accessed 5 November 2005.

- the bank wants loans subordinated – if a business owner lends money to the company, the bank wants a guarantee the company will not pay back the owner before the bank (in other words, the bank suspects the business is in danger)
- sales decrease without an accompanying cutback in the amount of inventory ordered – a business owner who lets this inequity mount will inevitably suffer big cash-flow problems
- key personnel depart suddenly
- an inadequate supply of materials delays or halts the company's product shipments – this may indicate suppliers have not received payment for some time and are not extending further credit
- payroll taxes are not paid – this, done in the belief the lag time in catching such delinquencies will give the business time to recover, spells disaster.[32]

In addition, there are certain specific financial ratios that can assist in detecting impending bankruptcy. Table 13.5 lists these ratios, how they are derived and what change to watch for.

ROGUE STATES AND INTELLECTUAL PROPERTY

While the US is toughening patent and copyright protections, the rest of the world is dancing to a different drummer. Some of it is enlightened. Much of it is from the 'dark side' of entrepreneurship replete with piracy and **rogue states**. On the 'positive' side, such countries as Australia and India are sidestepping agriculture patents held by large American multinationals to develop competitive technologies (such as a high-protein potato) and are leaving the intellectual property open and unrestricted. India is skirting patents to create generic AIDS drugs that are much less expensive than those made by the transnational drug companies. Entire nations (for example, China) are leaving Microsoft in the dust as they install open source operating systems on their computers.

TABLE 13.5: BANKRUPTCY – DETECTING FINANCIAL RATIOS

	DERIVATION	CHANGE TO WATCH FOR
LIQUIDITY RATIOS		
Networking capital (sometimes called risk)	Current assets less current liabilities	Fewer dollars
Cash flow versus current liabilities	Net income plus depreciation and other non-cash expenses divided by current liabilities	Lower ratio
DEBT RATIOS		
Cash-flow coverage	Cash flow divided by fixed charges, including interest and dividends	Lower ratio
Times interest earned	Income before interest and taxes divided by interest charges	Lower ratio
Short-term debt to assets	Current liabilities divided by total assets	Higher ratio
ACTIVITY RATIOS		
Inventory turn	Sales divided by inventory	Lower ratio
Average collection period	Accounts receivable divided by average daily sales	Higher ratio
PROFITABILITY RATIOS		
Profit margin	Net income divided by sales	Lower ratio

Source: Adapted from Harlan D. Platt, *Why Companies Fail* (Lexington, MA: Lexington Books, 1985): 86.

While most owners of intellectual property are working fervently to lock in their old entitlements and are pushing for increasingly restrictive laws and enforcement,[33] vast parts of the world are seceding from these intellectual property rights regimes and setting up offshore havens for infringers of intellectual property to carry out their predatory activities. In some ways, intellectual property crime mirrors illicit drug trafficking in its scope, pervasiveness and nimbleness in resisting eradication. (Not that the big firms aren't also engaged in some of these tricks. Their lawyers have many ways to house intellectual property abroad so as to shelter income from overseas sales. For example, a multinational may transfer a patent to a newly formed Bermuda subsidiary so that royalties from sales of products made outside the US flow to the subsidiary, where they accumulate tax-free.)

Rogue states: Asia–Pacific

Rogue states in the Asia–Pacific are particularly active. Here are some examples.[34]

China

Piracy levels are around 90 per cent in all sectors. China has not met its WTO TRIPS commitment to provide effective enforcement and particularly criminal enforcement against piracy 'on a commercial scale'. US firms alone suffered US$25 billion to US$30 billion in global losses from illegal copies of films, software, video games and other copyright industries in 2004. Most of it is in software products, the rest in movies, books and miscellaneous knockoffs, ranging from Gillette blades to Chrysler Jeeps. China exports most of this output to East Asia, where properly licensed products from the United States or Japan must compete at a price disadvantage and must replace defective products to defend their own reputations.

Hong Kong

Hong Kong is actually making progress on intellectual property violations. The publishing industry reports good cooperation. The Customs authorities are helpful in combating illegal activities undertaken by photocopy shops to reproduce overseas texts. The government has also undertaken aggressive measures against pirate video game retailers, exporters and local CD-burning operations. Hong Kong is still being used as an operations base by pirates and counterfeiters operating out of China; these pirates establish an 'office' in the territory that merely receives purchase orders and facilitates delivery of counterfeit products.

Indonesia

Piracy levels in Indonesia are among the highest in the world, at 85 to 95 per cent range for all industry sectors. The huge Indonesian market remains dominated by retail piracy of all copyrighted materials, including optical disc piracy (CDs, VCDs, CD-ROMs and, increasingly, DVDs) and book piracy. Raids under the copyright law rarely lead to effective prosecutions and almost never result in convictions of pirates or imposition of deterrent sentences. The court system remains largely ineffective. Book piracy remains widespread, especially English-language textbooks, reference books and computer-related volumes. Photocopy shops in and around universities are becoming more aggressive and increasing their volume of unauthorised copying. The local recording industry association estimates that seven of every eight sound recordings in the market are pirated. Software piracy in all its forms (business software and entertainment software) remains rampant throughout Indonesia. The audiovisual sector reports a 90 per cent cable piracy rate – one of the highest piracy rates for this form of unauthorised transmission of broadcasts in the world.

Malaysia

Malaysia remains a significant source of production and export of pirated optical discs (CDs, DVDs, VCDs, CD-ROMs, etc.), including what is certain to be a more than doubling of pirate DVD exports leading all around the globe. Malaysia remains the most significant producer/exporter of pirate optical disc entertainment software in the world. The scourge of photocopying on a commercial scale continues. Publishers report that, in response to the expectation of raids on commercial off-campus centres, photocopying operations are moving underground or into on-campus facilities such as libraries, student centres and academic buildings. The problem is being perpetuated further through the active involvement of lecturers, who often provide sample copies they receive from publishing representatives to be used as masters for the photocopying. Institutions of higher learning should be monitored closely to ensure that these practices are not tolerated.

Philippines

Book piracy in the Philippines is endemic, including illegal photocopying of entire books, pirate offset printing and increasingly, books ‘burned’ on CD-R. Primary targets include university textbooks, technical books and professional medical books. Pirates burn hundreds of reference titles or textbooks in professional fields and technical fields onto a single CD and sell the CD for about US$1.00. Popular fiction and non-fiction books are available as well. The motion picture industry suffers from the unauthorised transmission of motion pictures on hundreds of cable systems in the country, damaging the legitimate theatrical and video markets. Roughly 1500 Internet cafés are in operation in the Philippines and virtually all of these establishments profit from unauthorised exploitation of the most popular entertainment software titles.

Taiwan

With the exception of business software, piracy rates continue to remain high in Taiwan. Organised criminal syndicates that control most of the piracy business in Taiwan have moved their operations increasingly to CD-R and DVD-R ‘burning’ and to the Internet. Taiwan has moved aggressively to raid ‘burning’ operations and recent raids have resulted in huge seizures. Taiwan continues, however, to be world’s largest supplier of blank recordable media to pirate operations.

Thailand

The number of optical disc plants and lines continues to grow. Book piracy thrives. Other piracy problems abound, including cartridge-based videogame piracy (including participation in organised rings from China and Taiwan, assembling pirate cartridge-based videogames for export); business software end-user piracy (Thailand holds the dubious distinction of making the top 20 pirating countries in 2003, at an 80 per cent piracy rate); cable piracy; and Internet piracy, including 1.5 million Internet subscribers apparently engaged in peer-to-peer (P2P) downloading of copyrighted content.

Vietnam

Vietnam also suffers from blatant and widespread book piracy, in the form of illegal reprints and photocopies. These are distributed in a variety of venues, from government-owned bookshops to roadside stalls. More than 90 per cent of the English-language educational book market is supplied by unauthorised reprints and adaptations. These are published by entrepreneurs using the licences of state-sector publishers, such as those of the Ministry of Youth and the General Publishing House of Ho Chi Minh City and distributed through the mainstream state bookshops. The software piracy rate in Vietnam in 2003 was 92 per cent, putting Vietnam at the top of the chart with China.

SUMMARY

A patent is an intellectual property right that is a result of a unique discovery. Patent holders are provided protection against infringement by others. This protection is for 14 years in the case of design patents and for 20 years in all other cases.

Securing a patent can be a complex process and careful planning is required. Some of the useful rules to follow in acquiring a patent were set forth in the chapter.

A patent may be declared invalid for several reasons: failure to assert the property right for an unreasonable length of time, misuse of the patent and inability to prove the patent meets patentability tests. On the other hand, if a patent is valid, the owner can prevent others from infringing on it; if they do infringe on it, the owner can bring legal action to prevent the infringement as well as, in some cases, obtain financial damages.

A copyright provides exclusive rights to creative individuals for the protection of their literary or artistic productions. This protection extends for the life of the author plus 50 years. In case of infringement, the author (or whoever holds the copyright) can initiate a lawsuit for infringement. This action can result in an end to the infringement and, in some cases, the awarding of financial damages.

A trademark is a distinctive name, mark, symbol, or motto identified with a company's product(s). When an organisation registers a trademark, it has the exclusive right to use that mark. The registration before 1989 lasts for 20 years. However, after 1989 the registration is for 10 years and is renewable every 10 years thereafter. In case of infringement, the trademark holder can seek legal action and damages.

New forms of business require new forms of intellectual property protection. On the Internet it is important to protect domain names and trademarks. There are international provisions available through the World Intellectual Property Organisation (WIPO) that greatly speed enforcement of provisions.

Trade secrets are business processes and information that are unpatentable and their protection is only possible with employer and employee cooperation. Prosecution is still difficult in many of these cases.

No entrepreneur intentionally seeks bankruptcy, yet it often raises its ugly head. Rates of bankruptcy and the social stigma attached to it vary from country to country. There are warning signals and financial calculations that assist in recognising whether bankruptcy is looming.

There are numerous rogue states and overseas havens when it comes to intellectual property rights protection. The wise entrepreneur has protections in place to guard against profit rip-offs.

KEY TERMS AND CONCEPTS

bankruptcy
copyright
fair use doctrine
intellectual property rights
patents
rogue states
trade secrets
trademarks

REVIEW AND DISCUSSION QUESTIONS

1. In your own words, what is a patent? Of what value is a patent to an entrepreneur? What benefits does it provide?
2. What are four basic rules entrepreneurs should remember about securing a patent?
3. When can a patent be declared invalid? Cite two examples.
4. If a patent is infringed on by a competitor, what action can the patent holder take? Explain in detail.
5. In your own words, what is a copyright? What benefits does a copyright provide?
6. How much protection does a copyright afford the owner? Can any of the individual's work be copied without paying a fee? Explain in detail. If an infringement of the copyright occurs, what legal recourse does the owner have?

7. In your own words, what is a trademark? Why are generic or descriptive names or words not given trademarks?
8. When may a trademark be invalidated? Explain.
9. What are three of the pitfalls individuals should avoid when seeking a trademark?
10. What is a domain name? Give some examples of interesting cases of domain name infringement.
11. What are trade secrets? Why has Coca-Cola benefited from protecting its formula through trade secret rather than patenting the formula?
12. Give some additional examples of rogue states or overseas havens when it comes to intellectual property rights protection.

EXPERIENTIAL EXERCISE

WHAT KIND OF TRADEMARK?

For each of the following trademarks, indicate whether you think it is suggestive, fanciful, arbitrary or generic by placing an S, F, A or G alongside. Answers are provided at the end of the chapter.

1. COPPERTONE for suntan oil
2. REEBOK for shoes
3. ROACH MOTEL for insect traps
4. MERCURY SOFTWARE for software that speeds communication
5. PHOENIX VENTURES for an investing firm that focuses on investing in failing companies and reviving these companies
6. ARETE COACHING for life coaches (‘arete’ is the Greek word for ‘overall excellence’)
7. QANTAS
8. Air New Zealand

EXPERIENTIAL EXERCISE

PROTECTING YOUR LEGAL INTERESTS

Entrepreneurs need to know how to legally protect their interests in a property or work. The most effective way to gain legal protection is to obtain a copyright or a trademark. Two definitions (1) and (2) are given here. Place a C next to the one that defines a copyright; place a T next to the one that defines a trademark. Then, on the list underneath (a to j), place a C next to each item that could be protected with a copyright and a T next to each item that could be protected with a trademark. Answers are provided at the end of the chapter.

1 A distinctive name, mark, symbol, or motto identified with a company’s product
2 An exclusive protection of a literary or an artistic production

a Best-selling novel
b Logo
c Company’s initials (such as IBM or ITT)
d Motion picture
e Word (such as Coke or Pepsi)
f Computer program
g Musical comedy
h Slogan
i Stage play
j Symbol

CASE 13.1:

NEW ZEALAND AND KIWIFRUIT

There are at least three things named ‘kiwi’. There’s the flightless endangered ground dwelling bird in the New Zealand forest. There is the fruit, a relative of the Chinese gooseberry. And there are the people of New Zealand, who are often referred to as Kiwis.

2004 marks the 100th year that the Chinese gooseberry aka kiwifruit arrived on New Zealand shores from China. For years, New Zealand dominated the production of the fruit, but since the early 1990s it lost ground to foreign producers and lost control of the intellectual property related to its production.

While New Zealand was one of the first to export kiwifruit, its history began in China. In 1904, girl's college headmistress Isabel Fraser brought kiwifruit from the Yangtze valley to New Zealand and called it 'Chinese gooseberries'. By the mid-1920s horticulturalist Hayward Wright had developed its shape, colour, fuzzy skin and cool-lime taste. American sailors who landed during World War II were hooked on this 'exotic' fruit and carried its reputation back home. By the 1950s New Zealand was supplying kiwifruit to the English market and was penetrating the American market through San Francisco. Branding advice suggested calling it the kiwifruit after the small national bird's brown fur. As to the fruit's parentage, one Chinese diplomat generously labelled the kiwifruit a 'crystallisation of the profound friendship between two people'. Surprisingly, the world's second largest production comes from Italy, followed by France, Japan and the USA. This increased production led to a decline of kiwifruit prices between 1982 and 1988.

Enter 'Zespri'. Kiwifruit growers, with the support of the New Zealand Kiwifruit Marketing Board, re-engineered the fruit to have a golden colour and a soft honey-like taste. This led to huge growth of Zespri gold kiwifruit during the early 2000s. More importantly, they protected everything to do with its marketing including its 'trade dress' (everything that distinguishes it, the 'total image'): ZESPRI Group Limited is the owner of all intellectual property rights connected with the ZESPRI™ brand and its associated visual identity and trade dress including ZESPRI™, ZESPRI™ logo, D'LISH™, D'LISH™ Logo, ZESPRI™ GREEN Kiwifruit, ZESPRI™ GOLD Kiwifruit, ZESPRI™ BRIGHT GREEN Colour and combinations of the ZESPRI™ BRIGHT GREEN and DARK GREEN Colours of the ZESPRI™ Visual Identity, ZESPRI™ RED Colour, ZESPRI™ GOLD Colour and a combination of the ZESPRI™ RED and GOLD Colours of the ZESPRI™ Visual Identity, zespri.com and related domain names in relation to kiwifruit and related products.

Source: Re-written from Shinyoung Yun, 'New Zealand & Kiwifruit', *TED Case Studies Number 758*, [www.american.edu/TED/kiwi.htm] 2004.

QUESTIONS

1 What lessons did New Zealand kiwifruit growers learn from their experience?
2 What remedies did they seek in developing a new variety of the fruit?

CASE 13.2

A PATENT MATTER

Technological breakthroughs in the machine industry are commonplace. Thus, whenever one company announces a new development, some of the first customers are that company's competitors. The latter will purchase the machine, strip it down, examine the new technology and then look for ways to improve it. The original breakthroughs always are patented by the firm that discovers them, even though the technology is soon surpassed.

A few weeks ago Tom Farrington completed the development of a specialised lathe machine that is 25 per cent faster and 9 per cent more efficient than anything currently on the market. This technological breakthrough was a result of careful analysis of competitive products. 'Until I saw some of the latest developments in the field', Tom told his wife, 'I didn't realise how easy it would be to increase the speed and efficiency of the machine. But once I saw the competition's products, I knew immediately how to proceed'.

Tom has shown his machine to five major firms in the industry and all have placed orders with him. Tom has little doubt he will make a great deal of money from his invention. Before beginning production, however, Tom intends to get a patent on his invention. He believes his machine is so much more sophisticated and complex than any other machine on the market that it will take his competitors at least four years to develop a better product. 'By that time I hope to have improved on my invention and continue to remain ahead of them', he noted.

Tom has talked to a solicitor about filing for a patent. The solicitor believes Tom should answer two questions before proceeding: (1) How long will it take the competition to improve on your patent? (2) How far are you willing to go in defending your patent right? The solicitor's comments were as follows: 'It will take us about three years to get a patent. If, during this time, the competition is able to come out with something that is better than you have, we will have wasted a lot of time and effort. The patent will have little value since no one will be interested in using it. Since some of your first sales will be to the competition, this is something to which you have to give serious thought. Second, even if it takes four years for the competition to catch up, would you be interested in fighting those who copy your invention after, say, two years? Simply put, we can get you a patent, but I'm not sure it will provide you as much protection as you think'.

QUESTIONS

1 Given the nature of the industry, how valuable will a patent be to Tom? Explain.
2 If Tom does get a patent, can he bring action against infringers? Will it be worth the time and expense? Why or why not?
3 What do you think Tom should do? Why?

CASE 13.3:
ALL SHE NEEDS IS A LITTLE BREATHING ROOM

When Bee-Leng Chan started her business 12 months ago in Hong Kong, she estimated it would be profitable within 8 months. That is not what happened. During the first 6 months she lost HK $18 000 and during the next 6 months she lost an additional HK $14 000. Bee-Leng believes the business is going to get better during the next 6 months and that she will be able to break-even by the end of the second year. However, her creditors are not sure. Bee-Leng's business owes the two largest creditors a total of $48 000. The others are owed a total of $38 000.

Bee-Leng believes that if she can postpone paying her creditors for a period of one year, her company will be strong enough to pay off all of its debts. On the other hand, if she has to pay the creditors now, she will be too weak financially to continue and will have to declare bankruptcy. 'I really think it's in everyone's best interest to give me 12 months of breathing room', she explained to her husband. 'If they will do this, everyone is going to come out on top. Otherwise, we are all going to take a financial bath.'

Bee-Leng has considered broaching the subject with her two major creditors. However, she is not sure whether this suggestion would be accepted or would be used as a basis for their bringing legal action against her. 'If they think I am trying to stall them, they just might demand repayment immediately and force me into bankruptcy', she explained to a close friend. 'Of course, if they see things my way, that's a different story. In any event, I'm reluctant to pursue this line of action without talking to my solicitor.'

Bee-Leng hopes she and her lawyer, Mike Tan, can work out a plan of action that will prevent her having to declare bankruptcy and liquidate the firm. During her phone call to set up a meeting with Mike, she commented, 'If everyone remains calm and looks the situation over very carefully, I think they'll agree that my suggestion is a good one. After all, I'm not asking them to put any more money in the business, so the most they can lose is what they are owed currently. On the other hand, if they force my hand, they'll probably be lucky to get 40 cents on the dollar. If they wait, they could end up with all of their money. All I'm asking for is a little breathing room'. Mike suggests they meet later this week to talk about it. 'I'm sure we can think of something', he told her.

QUESTIONS

1 What type of bankruptcy agreement would you recommend? Why?
2 Why would you not recommend the other types of bankruptcy? Be complete in your answer.
3 When selling the creditors on your recommendation, what argument(s) would you use?

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WHY IS PROPERTY RIGHTS PROTECTION LACKING IN CHINA? AN INSTITUTIONAL EXPLANATION

Publication date: 1 May 2004
Author(s): Shaomin Li
Product number: CMR286

China is one of the most important foreign investment markets in both volume and growth. However, property rights protection in China is extremely weak and expropriations by both public and private actions are rampant. How can the booming of foreign investment and the looting of property co-exist? Why

is protecting property rights so difficult in China? Shows that the different paces of institutional change between formal and informal constraints are the major cause behind the lack of property rights protection in China. Discusses policy considerations for China to improve property rights protection and raises two fundamental issues for multinational firms doing business in China.

FIGHTING 21ST CENTURY PIRATES: THE BUSINESS SOFTWARE ALLIANCE IN HONG KONG

Publication date: 1 January 1999
Author(s): Ali F. Farhoomand, Peter Lovelock, Katherine Lo
Product number: HKU059

For computer software firms, software piracy represented a large loss of potential revenues. In response to the trade in pirated software, computer software companies banded together into an international political lobby organisation, the Business Software Alliance (BSA). BSA's challenge in Hong Kong was to clamp down on software piracy and illegal software distribution, while simultaneously increasing the size of the local software market. How could it encourage notoriously protectionist Asian governments to open their computer sectors to free and transparent trade, while simultaneously getting them to strike hard at illicit trade that threatened mostly large US firms?

STRATEGIC MANAGEMENT OF INTELLECTUAL PROPERTY

Publication date: 1 April 2004
Author(s): Markus Reitzig
Product number: 9-SMR-134

By one informed estimate from the late 1990s, three-quarters of the *Fortune* 100s total market capitalisation was represented by intangible assets, such as patents, copyrights and trademarks. In this environment, cautions the author, intellectual property management cannot be left to technology managers or corporate legal staff alone – it must be a matter of concern for functional and business-unit leaders as well as a corporation's most senior officers.

FINDING THE BALANCE: INTELLECTUAL PROPERTY IN THE DIGITAL AGE

Publication date: 26 February 2003
Author(s): Robert A. Burgelman, Philip Meza
Product number: SM107

Digital media – legitimate and otherwise – were one of the few bright spots for high-technology companies in the middle of a deep and protracted recession. These demands left computer makers, builders of components such as microprocessors, software developers and others between a rock and a hard place. Consumers disliked many of the anti-piracy technologies promoted by media companies because they often restricted legal (as well as illegal) uses of the technologies. High-technology companies feared government intrusion, legislating which technologies they could market.

NAPSTER

Publication date: 29 March 2001
Author(s): Constance E. Bagley, Michael J. Roberts, David Kiron
Product number: 9-801-219

Describes the legal battles faced by Napster, the popular website for finding and downloading music files through the Internet. Traces the evolution of copyright law as it has been interpreted in recent cases on digital music. Focuses on the recent suit against Napster by the Recording Industry Association of America (RIAA) and involves the RIAA's arguments alleging that Napster constitutes illegal infringement and Napster's response that it does not.

ANSWERS
WHAT KIND OF TRADEMARK?

1 S
2 F
3 S
4 S
5 S
6 F
7 A
8 G

ANSWERS
PROTECTING YOUR LEGAL INTERESTS

1 T
2 C
a C
b T
c T
d C
e T
f C
g C
h T
i C
j T

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- **World Intellectual Property Organisation**
- **World Trade Organisation**

14

SOURCES OF FINANCE FOR ENTREPRENEURS

> Money is like a sixth sense without which you cannot make a complete use of the other five.
>
> William Somerset Maugham, *Of Human Bondage*

CHAPTER OBJECTIVES

1. To differentiate between debt and equity as methods of financing
2. To examine commercial loans and public stock offerings as sources of capital
3. To know the easiest ways to bootstrap and get bootstrap and start-up financing
4. To discuss private placements as an opportunity for equity capital
5. To study the market for venture capital and to review venture capitalists' evaluation criteria for new ventures
6. To discuss the importance of evaluating venture capitalists for a 'best fit' selection
7. To examine the existing informal risk-capital market (including 'angel capital')

INTRODUCTION

It is often said that if an entrepreneur is the engine that drives new a company, then financing is the fuel that propels it. The best sources of funding for the newest firms are

- bootstrapping – creative ways of launching a business
- informal investment – financial contributions from family, friends and colleagues
- government funding programs.

Formal or 'classic' venture capital funds – including **business angels** – is usually reserved for companies that are already on a high growth track. Beyond this, the growth-oriented entrepreneur will rely heavily on bank loans and other more traditional sources of funding.

What exactly are these sources of funding and what is expected of an entrepreneur applying for these funds?

It is important to understand not only the various sources of funding but also the expectations and requirements of these sources. Without this understanding, an entrepreneur may be frustrated with attempts to find appropriate start-up financing.

Studies have investigated the various sources of finance preferred by entrepreneurs.[1] Table 14.1 outlines some of the most significant sources of finance that entrepreneurs will pursue. These sources range from debt to equity depending upon the type of financing that is arranged. As illustrated in figure 14.1, entrepreneurs have several sources of capital that correspond to the venture's stage of development. Notice that the level of risk and the stage of the firm's development should determine the appropriate source of financing for the entrepreneurial ventures.

In this chapter we examine the various sources of capital available to new ventures, with some insights into the approach required of the entrepreneur. Start-up entrepreneurs have different needs from growing entrepreneurs, so we first start with sources of start-up finance and then go on to look at ways to finance growing companies.

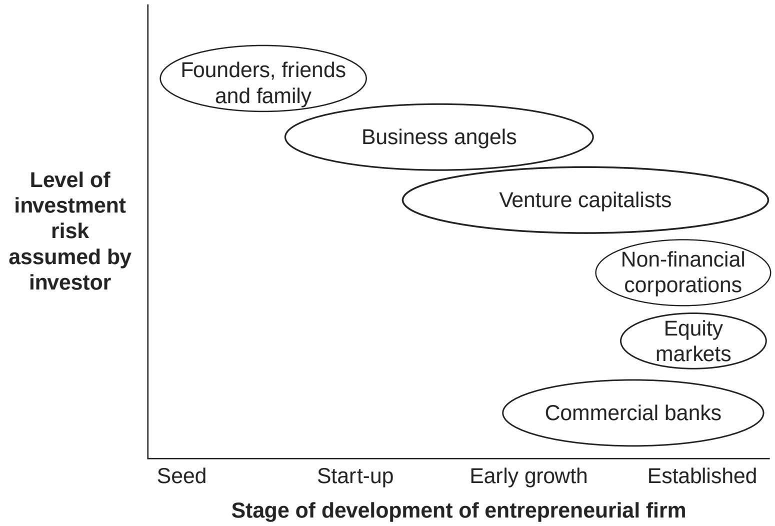
In this chapter we examine the various sources of capital available to new ventures, with some insights into the approach required of the entrepreneur. Start-up entrepreneurs have different needs from other businesses.

TABLE 14.1: SOURCES OF ENTREPRENEURIAL FINANCE

BANK LOANS	Community banks The (self) chosen few Asset-backed borrowing Micro-loans Third-party loan guarantees Venture leasing Credit cards Online credit search engines
FAMILY AND FRIENDS	Tapping personal ties Asset sales
PRIVATE EQUITY	Performance-oriented, flexible terms Redeemable preferred stock The wide world of the Internet
PUBLIC EQUITY	Investment- or commercial-banking links
CORPORATE SUPPORT	Strategic partnerships
INTERNATIONAL FINANCE	Financing international accounts receivable International strategic partnerships
THE RIGHT CONTACTS	Capital intermediaries Entrepreneurship programs

Source: Jill Andresky Fraser, 'How to finance anything', *Inc.* (March 1999): 32–48.

FIGURE 14.1 SOURCES OF FINANCE THROUGHOUT THE EVOLUTION OF THE ENTREPRENEURIAL FIRM



Source: Mark Van Osnabrugge and Robert J. Robinson, *Angel Investing* (San Francisco: Jossey-Bass: 2000): 37. This material is used by permission of John Wiley & Sons Inc.

BOOTSTRAPPING YOUR BUSINESS

Bootstrapping is a means of financing a small firm through highly creative acquisition and use of resources without raising equity from traditional sources or borrowing money from a bank. Bootstrapping means starting a new business without start-up finance. It offers many advantages for entrepreneurs and, aside from getting money from friends and family, is probably the best method to get an entrepreneurial firm operating and well-positioned to seek **debt financing** from banks or equity finance from outside investors at a later time.

Bootstrapping relies greatly on networks, trust, cooperation and wise use of the firm's existing resources, rather than going into debt or giving away equity. Have a hard look at the firm's financial position. Sometimes financing is not even needed.

Here are the main tips: Look for the 'low-hanging fruit'. Use a copycat idea. Find quick, break-even, cash-generating products. Firms that are already making money are able to build credibility in the eyes of investors. Meanwhile, keep growth in check. Too many start-ups fail because they grow beyond their financial means. Focus on cash (not on profits, market share, or anything else). Because of their financial means, bootstrapped firms cannot afford to pursue a number of strategic goals. For example, bootstrapped firms cannot pursue loss-making strategies to build a market share or a customer base. Having a healthy cash flow is critical to survival, so sales strategies must ensure healthy returns from the outset.[2]

Ever think of **barter**? The Bartercard network has taken the age-old concept of barter and added flexibility, allowing a business to pay for some of their business expenses with their own products. Members go out of their way to do business with other members, which is why Bartercard guarantees additional business. The US Department of Commerce estimates that 20 to 25 per cent of world trade is now barter.[3] The most basic barter transaction is a direct exchange of goods or services between two entities. More complex transactions that barter companies have developed include the exchange of trade credits for under-performing assets, remarketing of merchandise, and the retirement of the trade credits for goods and services.

Of course, you need to cultivate the banks even before you become creditworthy. Bank financing is usually unavailable to start-up firms, especially if little or no collateral is offered. However, bank financing is quite important for small firms once they are established and making some profit. Keeping good books, immaculate records and sound balance sheets from day one allows you to approach your banker with confidence once the firm has been in operation for a few years and is creditworthy.

ENTREPRENEURSHIP
IN PRACTICE

HOW TO BOOTSTRAP A BUSINESS

BOOTSTRAPPING OPTIONS FOR PRODUCT DEVELOPMENT

- Prepaid licences, royalties, or advances from customers
- Special deals on access to product hardware
- Development of product at night and on weekends while working elsewhere
- Customer-funded research and development
- Turning a consultant project into a commercial product
- Least useful methods here are research grants and university-based research incubators

BOOTSTRAPPING OPTIONS FOR BUSINESS DEVELOPMENT

- Foregone, delayed or reduced compensation
- Working from home using personal savings
- Deals with professional service providers at below-competitive rates
- Space at below-market or very low rent
- Personal credit cards and home equity loans
- Least useful here are severance payments, barter and special terms with customers

BOOTSTRAPPING OPTIONS TO MINIMISE THE NEED FOR CAPITAL

- Buy used equipment instead of new
- Borrow equipment from other businesses for short-term projects
- Use interest on overdue payments from customers
- Hire personnel for shorter periods instead of employing permanently
- Coordinate purchases with other businesses (mutual purchasing of goods)
- Lease equipment instead of buying
- Cease business relations with customers who frequently pay late
- Offer same conditions to all customers (no preferential treatment)
- Buy on **consignment** or trade credit from suppliers
- Deliberately choose customers who pay quickly
- Share business premises with others or run business out of your house
- Employ relatives or friends at non-market salaries
- Least useful are sharing of equipment and employees employed with other local businesses

BOOTSTRAPPING OPTIONS TO MEET THE NEED FOR CAPITAL

- Withhold entrepreneur's salary payment for short or long period of time
- Pay employees with company **stock** (give employees some ownership)
- Seek out best purchasing conditions with suppliers
- Deliberately delay payment to suppliers
- Use the entrepreneur's private credit card for business expenses
- Obtain loans from relatives and friends
- Barter under-used products or services with other firms
- Franchise or license the product or business idea to others for a **royalty** fee
- The least employed methods here include raising capital from a **factoring** company – through selling the firm's **accounts receivable** – and obtaining central or state subsidies[4]

Source: Vadim Kotelnikov, 'Bootstrapping: The most common source of initial equity for entrepreneurial firms' [www.1000ventures.com/venture_financing/bootstrapping_methods_fsw.html]

STARTING UP WITH 'INFORMAL INVESTING'

Informal investing is often mistakenly called 'business angel activity' (which we reserve in this book for more professional and commercial investors – see below). In fact, most of the start-up capital for new ventures doesn't usually come from banks or **venture capitalists**. It comes from the founders of the businesses themselves and from those we call **informal investors**, or the 4Fs – friends, family, founders and other 'foolhardy investors' (to that we could also add neighbours, work colleagues and even strangers).

These people use their own money and carry out their own (sometimes haphazard) **due diligence** to invest in the entrepreneurial opportunities of other entrepreneurs. In 2004, 3.3 per cent of adults around the world in the **Global Entrepreneurship Monitor (GEM)** survey were informal investors (see table 14.2).[5] China had the world's highest rate at 6.2 per cent followed by Thailand at 5.7 per cent. In those two countries, ask 17 people and you'll find an informal investor. New Zealand at 4.7 per cent did better than average, while Australia was below par with 2.9 per cent. Ask 21 New Zealanders and you'll find an investor; ask 9 men aged 35 to 54 and you will find a possible investor for your company. In Japan, less than 1 per cent of the adult population give money to start-up ventures.

For all the GEM nations combined, the average amount needed to start a business is $53 673 and, as expected, more is needed for an opportunity-pulled venture ($58 179) than a necessity-pushed one ($24 467). The amount needed to start a business is highest in the business services sector ($76 263) and lowest in the consumer-oriented sector ($39 594). Entrepreneurs themselves are four times as likely as non-entrepreneurs to be informal investors in another entrepreneur's business.

Who are these informal investors? First and foremost they are: close family relatives of the entrepreneurs (49.4 per cent), next are friends and neighbours (26.4 per cent); these are followed by other relatives (9.4 per cent), work colleagues (7.9 per cent) and strangers (6.9 per cent) as shown in table 14.3. What financial return do informal investors expect? The median expected payback time is two years and the median amount returned is one times the original investment. In other words, they expect zero return on investment. Interestingly, the payback time and times return are the same for all types of investees except strangers. In addition, the amount invested in strangers is the highest. The most likely reason is that investments in strangers are made in a more detached and business-like manner than investments in relatives and friends.

TABLE 14.2: PREVALENCE RATE OF INFORMAL INVESTORS IN THE ASIA–PACIFIC, ADULTS 18–99 YEARS

	BUSINESS ANGEL PREVALENCE RATE (18–64 YEARS) IN THE GENERAL POPULATION, 2002–05	AVERAGE ANNUAL INFORMAL INVESTMENT PER INVESTOR, 2002–05, US$
China	6.2%	$1 474
Thailand	5.7%	$1 204
New Zealand	4.7%	$13 642
United States	4.5%	$9 238
Singapore	3.1%	$12 568
Hong Kong†	2.8%	$6 635
Australia	2.6%	$13 061
United Kingdom	1.5%	$16 360
Taiwan†	1.0%	$25 740
Korea†	1.0%	$15 164
Japan	0.56%	$16 729

† Figures for Hong Kong, Taiwan and Korea are 2003 only

TABLE 14.3: INFORMAL INVESTORS AND THEIR RETURN EXPECTATIONS

RELATIONSHIP: INVESTOR–ENTREPRENEUR	% TOTAL	MEAN AMOUNT INVESTED US$	MEDIAN PAYBACK TIME IN YEARS	MEDIAN MULTIPLE ON RETURN
Close family	49.4%	23 190	2	1×
Other relative	9.4%	12 345	2	1×
Work colleague	7.9%	39 032	2	1×
Friend, neighbour	26.4%	15 548	2	1×
Stranger	6.9%	67 672	2–5	1×
Average		24 202	2	1×

Here's the bottom line for entrepreneurs – by far the rarest source of capital for nascent entrepreneurs is **classic venture capital**. Fewer than 37 out of every 100 000 companies were backed by classic venture capital.[6] One could say that the attention paid to venture capital funding is inversely proportional to its importance to start-up entrepreneurs!

Informal investors, on the other hand, spread their money all over the entrepreneurial landscape. In general, classic venture capital flows only to companies with super-star potential, while informal investment flows to companies in all segments, including the super-stars. Furthermore, whereas essentially every company begins with informal investment from the 4Fs, very few companies have formal venture capital at the outset. The paradox is that if there was no informal investment there would be virtually no new ventures. In contrast, if there was no venture capital, new ventures by the millions would still be getting off the ground!

How to get money from your family

You may have heard of the 'elevator pitch' for raising money from venture capital investors. But have you heard of the 'kitchen table pitch'? If you are thinking of raising money from someone close to you, here are some tips:

- Know your investor's motivations. Some relatives and friends are truly into it for the altruism, but like all people, your relatives and friends are also into it for the profit motive. When you are making the pitch around the kitchen table, be sure you list 'what is in it for you'.
- Debt is better than equity for relatives and friends. Equity is 'funny money' to most people unless you intend to on-sell the business quickly. Let's say your sister invests $10 000 into your restaurant. The restaurant grows and her equity share grows too. But if you divorce and have to split shares with your ex-husband, or the restaurant simply closes rather than being sold, your sister's investment is devalued or disappears.
- Make the pitch in person but follow-up with a written memo. Your relatives don't necessarily care about a formal business plan. But give them some documentation so there's no misunderstanding.[7]
- Try to treat them as if they were strangers. Get some distance from the transaction. Have a friend present or have a lawyer prepare the promissory note.
- Try to avoid a repayment schedule. Tie your repayments to your cash flow. Give your relative a percentage of your operating cash flow until you have repaid the whole amount. If nothing else, this gives you a constant reminder of your obligation and is less likely to sour your personal relationships.
- Don't give voting stock. Often a family member or friend will be willing to finance your start-up but also insists on a voting board seat. One thing you don't want is your 'rellies' looking over your shoulder and second-guessing every decision.[8]

ENTREPRENEURSHIP
IN PRACTICE

INNOVATIVE WAYS TO OBTAIN BUSINESS CAPITAL

- **Build-out allowances from landlords:** Banks will often allow you to count build-out allowances as capital in your source and use of funds statement. While the money comes in and goes out, it does increase the overall cash flow and size of your deal.
- **Vertical integration**: Capital can often be raised from outside companies with a vested interest in developing either distribution channels, or assuring themselves of adequate product flow from cash-starved companies. Example: A distributor invested in his supplier in order to assure himself adequate inventory.
- **Professionals associated with the business:** Just present a way for investors to be more profitable in their own companies through the proposed investment. Law firms, advertising agencies, executive recruiters and professional consultants will often accept partial payment in stock, warrants or options in return for services. This is an excellent way to build a powerful team of professionals with a vested interest in your success and your success in raising capital. Many of these professionals are also angel investors, who can champion your cause with other private investors.
- **White knights**: If you are a retailer with poor credit and cannot get merchandise shipped without a direct payment, have someone with better credit buy the products and resell them to you. You may pay the white knight a few percentage points each month. If you have a high turnover ratio, it will allow you to re-establish cash flow and credit. Only a few specialists handle these types of operations, but you can find them through factoring companies.
- **Technical or professional expertise:** Many professionals are willing to reduce their fees in exchange for equity. Although the services will not be totally free, they are usually reduced by about 50 per cent. You may even be able to arrange options or warrants to avoid initial dilution. Plus, you can provide the professional an **exit strategy** prior to an initial public offering, if another large investor enters your market.
- **Sell licences or marketing rights:** Selling off rights to foreign or geographic markets or private labelling products is an excellent vehicle for young companies. You can use both exclusive and non-exclusive arrangements. All methods should have some type of quota and non-competition clauses. The downside is that later investors may feel that you have sold off too much of the potential, so they will not invest as readily.

Source: Adapted from Venture Planning Associates, '28 ways to finance your venture' [www.ventureplan.com/how.to.finance.your.venture.html].

BANK OR EQUITY FINANCING? Entrepreneurs need both debt financing and **equity financing** – all at the right time. Equity financing is best in the early start-up stages, especially during research and development and product development. It is also quite appropriate in later rounds, for example, when bringing on highly qualified staff, ramping up sales, for marketing and acceleration purposes. Debt financing is best used for working capital and to build up the infrastructure.

Most entrepreneurs start out by financing growth through equity and then move on to sources of debt funding once they have built up value. Usually debt is cheaper than giving equity away in the early stages of an investment. But equity investors (both passive and active) are willing to take greater risk; hence your potential for reward should be greater.

How do debt and equity ultimately affect profitability or cash flow? Debt financing involves a payback of the funds plus a fee (called interest) for the use of the money. Equity financing involves a transfer of ownership and a payback of **dividends** for the use of the money. Debt places a burden of repayment and interest on the entrepreneur, while equity financing forces the entrepreneur to relinquish some degree of ownership and control. In the extreme, the choice for the entrepreneur is to take on debt without giving up ownership in the venture, or to relinquish a percentage of ownership

TABLE 14.4: HOW DIFFERENT FINANCE OPTIONS WILL AFFECT PROFITABILITY OR CASH FLOW

EQUITY FINANCING		DEBT FINANCING	
ADVANTAGES	DISADVANTAGES	ADVANTAGES	DISADVANTAGES
Can provide a large injection of capital	Capital is usually only available in very large amounts	Amount borrowed can vary according to your needs	It creates a debt obligation
No interest payments	It means 'selling' a part of your business	As long as it is repaid, it will not affect your ownership of the company	Interest will be charged – affecting profitability
No obligation to repay capital	Venture capitalists expect high returns on their investments (at least 25% pa)		Collateral is usually required and banks will value your assets conservatively
	Investors may require you to buy them out at a future point		If you borrow from friends or relatives it can sour relations if the business fails

Source: Multimedia Development Corporation (Malaysia), 'Raising capital' [www.technopreneurs.net.my/cms/General.asp?whichfile=&ProductID=20816&CatID=86].

in order to avoid having to borrow. In most cases, a combination of debt and equity proves most appropriate. Table 14.4 shows a summary of the differences between equity and debt financing.

Many new ventures find that debt financing is necessary. Short-term borrowing (one year or less) is often required for working capital and is repaid out of the proceeds from sales or other revenue. **Long-term debt** (term loans of one to five years or long-term loans maturing in more than five years) is used to finance the purchase of property or equipment, with the purchased asset serving as collateral for the loans. Commercial banks are the major source of debt financing for small business.

Commercial banks

Although some banks will make unsecured short-term loans, most bank loans are secured by fixed assets, receivables (amount owed by customers), inventories, or other assets. In about 90 per cent of these cases, banks require collateral, generally consisting of stocks, machinery, equipment and real estate and systematic payments over the life of the loan. Whether in Australia or the US, banks are not really interested in the entrepreneurs' future prospects and do not really look at business plans indicating the viability of businesses and their capacity to meet debt repayments out of cash flow.

Yet these days entrepreneurs can actually expect more from a bank than just a loan. In the US, banks offer several services to a new venture, including computerised payroll preparation, letters of credit, international services, lease financing and money market accounts. Look for this trend to expand internationally. Asian banks outside of Singapore have been slow to expand their scope beyond credit to offer lucrative fee-based services, such as cash management, trade finance and treasury and risk management. More and more banks realise that fee-based products typically incur minimal or no charges for capital, making the returns far more attractive. Yet fee-based offerings are not well developed in Asian markets compared to leading US banks.[9]

To secure a bank loan, an entrepreneur typically will have to answer five questions. Five of the most common, together with descriptive commentaries, are:

- *What do you plan to do with the money?* Do not plan on using funds for a high-risk venture. Banks seek the most secure venture possible.
- *How much do you need?* Some entrepreneurs go to their bank with no clear idea of how much money they need. All they know is that they want money. The more precisely the entrepreneur can answer this question, the more likely the loan will be granted.

- *When do you need it?* Never rush to the bank with immediate requests for money with no plan. Such a strategy shows that the entrepreneur is a poor planner and most lenders will not want to get involved.
- *How long will you need it?* The shorter the period of time the entrepreneur needs the money, the more likely they are to get the loan. The time at which the loan will be repaid should correspond to some important milestone in the business plan.
- *How will you repay the loan?* This is the most important question. What if plans go awry? Can other income be diverted to pay off the loan? Does collateral exist? Even if a quantity of fixed assets exists, the bank may be unimpressed because it knows from experience that assets sold at a liquidation auction bring only a fraction of their value. Five to 10 cents on the dollar is not unusual.[10]

Remember that banks are businesses too. They have **stockholders** to whom they must report and they are highly regulated by federal and state agencies. They may sometimes not lend to certain industries based on their corporate policy.

Debt financing has both advantages and disadvantages. On the plus side, you don't have to give up ownership of your company. More borrowing allows for potentially greater return on equity. And during periods of low interest rates, the **opportunity cost** is justified since the cost of borrowing is low. On the minus side, you'll have regular (monthly) interest payments. Continual cash-flow problems can be intensified because of payback responsibility. And heavy use of debt can inhibit growth and development.

Other debt-financing sources

Other debt-financing sources include trade credit, accounts receivable factoring, finance companies, leasing companies, mutual savings banks, savings and loan associations and insurance companies. Table 14.5 provides a summary of these sources, the business types they often finance and their financing terms.

TABLE 14.5: COMMON DEBT SOURCES

	BUSINESS TYPE FINANCED		FINANCING TERM		
SOURCE	START-UP FIRM	EXISTING FIRM	SHORT TERM	INTERMEDIATE TERM	LONG TERM
Trade credit	Yes	Yes	Yes	No	
Commercial banks	Sometimes, but only if strong capital or collateral exists	Yes	Frequently	Sometimes	Seldom
Finance companies	Seldom	Yes	Most frequent	Yes	Seldom
Factors	Seldom	Yes	Most frequent	Seldom	No
Lending companies	Seldom	Yes	No	Most frequent	Occasionally
Mutual savings banks and savings-and-loan associations	Seldom	Real estate ventures only	No	No	Real estate ventures only
Insurance companies	Rarely	Yes	No	No	Yes

Trade credit is credit given by suppliers who sell goods on account. This credit is reflected on the entrepreneur's balance sheet as accounts payable and in most cases it must be paid in 30 to 90 days. Many small, new businesses obtain this credit when no other form of financing is available to them. Suppliers typically offer this credit as a way of attracting new customers.

Accounts receivable financing is short-term financing that involves either the pledge of receivables as collateral for a loan or the sale of receivables (factoring). Accounts receivable loans are made by commercial banks, whereas factoring is done primarily by commercial finance companies and factoring concerns.

Accounts receivable bank loans are made on a discounted value of the receivables pledged. A bank may make receivable loans on a notification or non-notification plan. Under the notification plan, purchasers of goods are informed that their accounts have been assigned to the bank. They then make payments directly to the bank, which credits them to the borrower's account. Under the non-notification plan, borrowers collect their accounts as usual and then pay off the bank loan.

Factoring is the sale of a business's accounts receivable. Under this arrangement, the receivables are sold, at a discounted value, to a factoring company. Some commercial finance companies also do factoring. Under a standard arrangement the factor will buy the client's receivables outright, without recourse, as soon as the client creates them by its shipment of goods to customers. Factoring fits some businesses better than others and it has become almost traditional in industries such as textiles, furniture manufacturing, clothing manufacturing, toys, shoes and plastics.

Hire purchase is an extended payment scheme entered into between the entrepreneur/hirer and the owner (equipment manufacturer or financial institution). Under the hire purchase, the hirer only needs to pay a small deposit upfront and then make regular instalment payments. Only on final instalment does the hirer acquire ownership.

Finance companies are asset-based lenders that lend money against assets such as receivables, inventory and equipment. The advantage of dealing with a commercial **finance company** is that it often will make loans that banks will not. The interest rate varies from 2 to 6 per cent over that charged by a bank. New ventures that are unable to raise money from banks and factors often turn to finance companies.

Other ways to raise cash include equity instruments (discussed in the next section), which give investors a share of the ownership. Here are examples.

- Loan with warrants provides the investor with the right to buy stock at a fixed price at some future date. Terms on the warrants are negotiable. The warrant customarily provides for the purchase of additional stock, such as up to 10 per cent of the total issue at 130 per cent of the original offering price within a five-year period following the offering date.
- **Convertible debentures** are unsecured loans that can be converted into stock. The conversion price, the interest rate and the provisions of the loan agreement are all areas for negotiation.
- **Preferred stock** is equity that gives investors a preferred place among the creditors in the event the venture is dissolved. The stock also pays a dividend and can increase in price, thus giving investors an even greater return. Some preferred stock issues are convertible to common stock, a feature that can make them even more attractive.
- **Common stock** is the most basic form of ownership. This stock usually carries the right to vote for the board of directors. If a new venture does well, common-stock investors often make a large return on their investment. These stock issues often are sold through public or private offerings.

Global entrepreneurs today are exposed to all kinds of potential losses. It is often wise to take out political risk insurance for losses resulting from risks associated with cross-border transactions, primarily in developing countries, including confiscation, expropriation, nationalisation, contract frustration, licence cancellation or the non-honouring of guarantees. It protects against physical damage to assets resulting from political violence, including war and civil uprisings. It can protect investments, plant and machinery, inventories and contracts. Political risk insurance also protects against actions of the entrepreneur's home government, such as embargo and forced cancellation.

EQUITY FINANCING

Equity financing is money invested in the venture with no legal obligation for entrepreneurs to repay the **principal** amount or pay interest on it. The use of equity funding thus requires no repayment in the form of debt. It does, however, require sharing the ownership and profits with the funding source. Since no repayment is required, **equity capital** can be much safer for new ventures than debt financing. Yet the entrepreneur must consciously decide to give up part of the ownership in return for this funding.[11] Equity capital can be raised through two major sources: public stock offerings and **private placements**. In both cases, entrepreneurs must follow the local laws pertaining to raising such funds. The entire process can be difficult, expensive and time-consuming. On the other hand, successful stock offerings can help a fledgling enterprise raise a great deal of money. The smart entrepreneur will keep an eye on **dual or triple tracking** the firm. That means simultaneously preparing for an initial public offering, a **trade sale** or venture capital/private-equity round, depending on the balance of advantage.

Public offerings

One type of equity financing is the **initial public offering (IPO)**. This is a company's first-ever sale of shares to the public. In many cases, it's the first time people outside the company have the opportunity to buy its shares. That's why a company is often said to be 'going public' or 'floating' when it conducts an initial public offering. Here are some of the advantages to this approach:

- size of capital amount – selling securities is one of the fastest ways to raise large sums of capital in a short period of time
- liquidity – the public market provides liquidity for owners since they can readily sell their stock
- value – the marketplace puts a value on the company's stock, which in turn allows value to be placed on the corporation
- image – the image of a publicly traded corporation often is stronger in the eyes of suppliers, financiers and customers.[12]

The global initial public offering market has been a roller-coaster since the late 1990s. It still has not seen a full recovery back to pre-crash levels of 1998–2000. Global initial public offering activity did rise sharply in 2004 to reach 1997 levels. In 2004, Japan and China accounted for the majority of activity, both raising $13 billion, while India experienced high growth in capital raised in initial public offerings. Activity also remained lively in Hong Kong ($3.6 billion capital raised), South Korea ($3.1 billion), Thailand ($1.7 billion), Malaysia ($1.1 billion) and Singapore ($0.9 billion). On the other hand, Taiwan was one of the few Asian economies to suffer a downturn. In 2004, initial public offering activity increased in both Australia and New Zealand, with the region accounting for 12 per cent of global deals and 5 per cent of the global total capital raised. Australia ranked fourth in the world with $7.8 billion invested in 166 deals, while 19 deals raising $0.6 billion were completed in New Zealand. Deal numbers were up 105 per cent in Australia and 138 per cent in New Zealand. Indeed, in 2004, the Australian private equity market had matured and investor confidence was high.[13]

TABLE 14.6: ASIA–PACIFIC INITIAL PUBLIC OFFERING ACTIVITY BY COUNTRY, 2004

	TOTAL CAPITAL RAISED US$ M	NUMBER OF IPOs
Japan	$12946	171
China	$12548	142
Australia	$7808	166
Hong Kong	$3560	40
South Korea	$3077	71
India	$2857	21
Thailand	$1742	45
Malaysia	$1146	80
Singapore	$903	45
New Zealand	$620	19
Taiwan	$561	93
Pakistan	$144	2
Indonesia	$101	8
Sri Lanka	$26	1
Philippines	$18	1
Macau	$4	1

The mechanics of going public

An initial public offering (IPO) can be tough, expensive and complex. With all the accounting, financial reporting and security law, the average entrepreneur usually does not have expertise in these areas. Entrepreneurs should be aware of the concerns confronting them when pursuing the initial public offering market. Many new ventures recognise some disadvantages of going public. A few of these follow:

- **Costs:** The expenses involved with a public offering are significantly higher than for other sources of capital. Accounting fees, legal fees and prospectus printing and distribution, as well as the cost of underwriting the stock, can result in high costs.
- **Disclosure:** Detailed disclosures of the company's affairs must be made public. New-venture firms often prefer to keep such information private.
- **Requirements:** The paperwork involved with government regulations, as well as continuing performance information, drains large amounts of time, energy and money from management. Many new ventures consider these elements better invested in helping the company grow.
- **Shareholder pressure:** Management decisions are sometimes short term in nature in order to maintain a good performance record for earnings and dividends to the shareholders. This pressure can lead to a failure to give adequate consideration to the company's long-term growth and improvement.[14]

The advantages and disadvantages of going public must be weighed carefully. If the decision is to undertake a public offering, then it is important the entrepreneur understand the process involved.

The mechanics of going public are governed by security laws in each country, but there are some common elements across all countries.[15] According to Richard Pettway at the University of Technology, Sydney, these common elements are:

- **Investor information:** There are requirement levels of firm information that must be given to investors prior to the initial public offering, like a prospectus. Also, the place of listing or trading the new shares may require specific information, like the number of prior years of financial data, etc.

- **Investment banker or underwriter:** Most firms select a lead investment banker to sell the new securities. The issuing firm tends to charge the investment banker somewhat uniform fees (7 per cent of the issue value in the US and 6 per cent in Japan). If 'book building' is used, the selected investment banker conducts 'road shows' or other types of information-gathering activities to measure the demand for the securities at different prices. Underwriter reputation has been shown to affect initial return levels.
- **Ownership structure:** With an initial public offering, the ownership structure will change and the shares sold in the initial public offering are designated as primary shares (which are new shares) and secondary shares. Secondary shares are shares that were previously owned by existing shareholders, usually founders and managers of the firm. The size of the new issue relative to the existing shares and their distribution will change the ownership structure. The initial public offering is often a method of moving from firm founders toward a professional management of the firm. The initial public offering generally occurs at the end of the 'entrepreneur activities' of the founder, but usually they will play a role in the future of the company.
- **Lock-up provisions:** When going public, initial public offerings almost always commit to a 'lock-up period', whereby insiders are prohibited from selling shares without the written permission of the lead underwriter until a certain amount of time has passed. On average, the waiting time is 180 days or 6 months. Obviously, using these lock-up provisions is an attempt by insiders or existing shareholders to control the supply of shares sold during the period after the initial public offering.
- **The presence of venture capitalists:** Many firms may be financed by venture capitalists who take an ownership position and have partial control over the entrepreneurs. The initial public offering may change this control as the venture capitalist distributes the shares to their limited partners. The use of an initial public offering may be a cheaper form of financing than that provided by venture capital and will certainly provide liquidity to the existing pre-initial public offering shareholders.
- **Issue size:** Because of the fixed costs required of an initial public offering to create a liquid market, the number of new shares in the initial public offering should be large enough to provide sufficient liquidity. The number should also be small enough so that the issuing firm does not raise more cash than it can profitably use.
- **Mechanism for pricing initial public offerings:** There tend to be three mechanisms used in initial public offerings around the world: auctions, fixed-priced offers, or book building. In auctions the market-clearing price is determined after bids are submitted. In a fixed-price offer, the price has been set prior to the allocation. If there is excess demand, shares are rationed on a pro rata or lottery basis. In book building, the investment bank canvases potential buyers and then sets an offer price. Book building has become the predominant mechanism by which initial public offering shares are sold around the world.

The *prospectus* is a formal written offer to sell securities that provides an investor with the necessary information to make an informed decision. If a company is raising capital by offering its shares or other securities to the public for the first time (usually called a 'float' or 'initial public offering'), it will issue a disclosure document called a prospectus. In Australia, for example, a prospectus must be lodged with the Australian Securities and Investments Commission (ASIC). After lodging, the prospectus will be available in an electronic format, called e-Prospectuses, via the internet.

The prospectus must fully disclose all pertinent information about a company and must present a fair representation of the firm's true prospects. All negative information must be clearly highlighted and explained. Some of the specific detailed information that must be presented includes:

- history and nature of the company
- **capital structure**
- description of any material contracts
- description of securities being registered
- salaries and security holdings of major officers and directors and the price they paid for holdings
- underwriting arrangements
- estimate and use of net proceeds
- audited financial statements
- information about the competition with an estimation of the chances of the company's survival.

Private placements

Private placement is money invested in a company usually from private investors in the form of stocks or sometimes bonds. It is sometimes possible to avoid issuing a prospectus, but rules will differ from country to country. In most cases a placement agent (usually a stock broking firm or investment bank) will manage the process for a fee.

The ideal small business candidate for private placement is a company looking for growth or expansion funding. A private placement is suitable when you need an injection of capital to jump to the next level of growth and you have a proven track record of profitability.

A *private placement memorandum* (PPM) is the document that discloses everything the investors need to know to make an informed investment decision about the direct public offering (DPO) being considered. This includes:

- the offering structure
- the share structure of the company
- disclosures about the securities being purchased
- company information
- information on company operations
- risks involved with the investment
- management information
- use of proceeds
- information on certain transactions that could affect the investor and investor suitability data.[16]

The private placement memorandum is very important because it provides the investor with all of the prescribed data they will need to make an investment decision and includes the actual documentation to effect the investment transaction.

- **Advantages of private placements:** A key advantage of a placement is that the company has a considerable degree of control over the terms of the placement (who participates, the amount and price of equity issued). Also, investors who participate in placements are less likely to want day-to-day control over the business operations (unlike venture capitalists or business angels).
- **Disadvantages of private placements:** Private placements can be quite time consuming as you will need to prepare a detailed information memorandum which outlines your business, past performance, future plans and viability. The cost of a placement can be

prohibitive as you will need not only a placement agent, but also accountants and lawyers who are experienced with the process. Another downside of placements is the level of disclosure required. Your vision and detailed plans for the business become known to investors and competitors alike.[17]

Private placements are undergoing significant advancements. New Zealand is a good example.[18] Historically, offerers had a limited ability to advertise without triggering the disclosure requirements. Under recent changes, issuers can now seek non-binding expressions of interest from the public (a useful mechanism to test the market before preparing a prospectus). In the past, an offer could only be made to 'private' persons (such as relatives or close business associates). Now the offer can go to any person regarded as having been selected other than as a member of the public. In line with the Australian law, up to $500 000 is excluded from the Securities Act. The most dramatic new turn is that if subscription to an offer is restricted to 'eligible persons' (which are persons who are either 'wealthy' or 'experienced'), the offer is exempt from nearly all of the disclosure obligations under the act and regulations.

It is important that entrepreneurs in each country take advice on the limits of private placement.

Management buyouts

A **management buyout (MBO)** is exactly what it says – the buyout of a business from its owners by the existing management team running the business. Management buyouts afford a wonderful opportunity for experienced managers to satisfy their latent entrepreneurial instincts while providing a distinctive and unique solution to the vendor's specific requirements. The importance of the entrepreneurial skills of the management team cannot be overemphasised. There are a number of well documented cases where experienced managers from large, well reputed organisations were brought in to run smaller businesses, which required considerable entrepreneurial skills. However, these managers, who were used to more structured organisations, lacked the skills required of entrepreneurs and failed to deliver.[19]

THE VENTURE CAPITAL MARKET

Venture capitalists are a valuable and powerful source of equity funding for new ventures. These experienced professionals provide a full range of financial services for new or growing ventures, including the following:

- capital for start-ups and expansion
- market research and strategy for businesses that do not have their own marketing departments
- management-consulting functions and management audit and evaluation
- contacts with prospective customers, suppliers and other important businesspeople
- assistance in negotiating technical agreements
- help in establishing management and accounting controls
- help in employee recruitment and development of employee agreements
- help in risk management and the establishment of an effective insurance program
- counselling and guidance in complying with a myriad of government regulations.

The following are the different stages of venture investing:

- **Seed financing** provides the initial funds for a business concept to be developed. This may involve additional research, product development and initial marketing to reach out to early-adopter customers. The companies receiving funding at this stage may be in the process of just being incorporated or may have been in operations for a while.

ENTREPRENEURSHIP IN PRACTICE

GOING PUBLIC: THE ACID TEST

Public versus private is a major decision and one not to be taken lightly or made hastily. Initial public offerings are complex and time-consuming transactions and not all have favourable endings. Following are six questions that will provide an idea about whether your company is best suited for the public or private scene.

- **Are you building a company that can run without you?** The work leading up to a public offering is so intensive and detailed that it will take an entrepreneur's focus away from the everyday operations, ultimately hurting the business. Unless you have a strong management team, consider hiring a chief financial officer (CFO) that has experience taking companies, preferably small, through the rigors of going public.
- **Can you get to a market capitalisation within three years of going public?** Your financials can answer this question for you. The value of a public company is a multiple of what it earns. Take the average price–earnings ratio for your industry and apply it to the earnings you project for the third year after your company goes public. If the result isn't near $100 million, staying private may be best. This number is a good indicator because it is the level of earnings at which the company will begin attracting brokers and investors.
- **Are you building a company with high gross and operating margins?** A high sales volume will be reached only if the company has access to adequate funding to promote and finance sales. The bottom line truly rests on the top line and a public company cannot afford to lose its most important number. High margins will help curb any unexpected losses.
- **Can your business deliver double-digit sales and earnings growth, year in and year out?** The competition among public companies, mutual funds and other investment networks is fierce. Investors won't look twice at a company that doesn't grow fast enough to warrant the use of their time and money.
- **Are you building a family business?** If the succession plan for the business is set in stone to be passed on to the kids, don't go public. Families measure the success of a business generation by generation. Money movers are interested in the quarter-to-quarter progress. Going public will eventually be the end of any succession strategy.
- **Can the business be built inexpensively?** The main reason companies go public is to raise initial funds for major growth. As a result, sales and growth need to reflect the use of the first round of financing. If it's perceived that another round of financing will be necessary to achieve the original plan, investors will look elsewhere.[20]

Source: David Evanson and Art Beroff, 'Burnt offerings?' *Entrepreneur* (July 1999): 56–9.

- **Early stage financing** is provided to companies that have completed the product development stage and test marketing as well, but require additional financing to expand commercial manufacturing and sales.
- **Expansion financing** is provided when the start-up company is poised to grow rapidly. The business is viable and is reaching break-even point. The funds may be used to increase production capacity, market or product development and/or provide additional working capital.
- **Late-stage funding** refers to the pre-initial public offering investments in a company for the purpose of strengthening the positioning of the company and gaining endorsements from the top venture capital firms as the company prepares for its listing.

Exit mechanisms

In most venture investments, exit conditions are agreed in the term sheet at the time of the investment. There are five main exit mechanisms:

- trade sale to another company – the venture capitalist may not exit completely, but retain some quoted shares if they believe further growth is likely[21]

- repurchase of the venture capitalist's shares by the investee company management – a share repurchase is where a company buys back its shares from the investors
- refinancing or purchase of the venture capitalist's equity by a longer-term investment institution (like an investment trust) – this can occur when the venture capitalist is looking for an exit but the investee company is unwilling to go for a listing or a trade sale
- stock market listing – going public allows for the realisation of owner's capital; funds available for expansion; marketable shares available for acquisitions; enhancement of status and public awareness; and increased employee motivation via share incentive schemes
- finally, involuntary exit through receivership or liquidation.

Venture capital environment in Australasia

The venture capital environment in the Asia–Pacific is quite different from the US, which is usually used as a benchmark. Of course, the sheer scale of the US venture capital market dwarfs the rest of the world. Australia and Japan both crossed the US$1 billion dollar threshold compared to the $20.9 billion in the US. Aside from Australia, Asia–Pacific venture capitalists tend to fund more seed and early-stage companies than the United States. The increase in Australian venture capital has been concentrated in the more conservative buyout/acquisition sector. While the typical company in the US can count on $8.7 million average investment, in New Zealand that amount is only $1.7 million (see table 14.7).

Best places for entrepreneurs to invest

Hong Kong, Singapore, Australia and New Zealand are in the top ranks of the top countries in the world for entrepreneurs to invest. The Capital Access Index is a comprehensive analysis of the breadth, depth and vitality of capital markets showing efficient financial markets that make capital accessible to the entrepreneurs. In 2005, for the first time since the rankings began in 1998, the United Kingdom topped the index. Hong Kong (2004's number one) dropped to second, followed by Singapore and the United States. Papua New Guinea jumped 15 places in 2005.[22]

TABLE 14.7: VENTURE CAPITAL ENVIRONMENT IN THE ASIA–PACIFIC COMPARED TO US, 2004

	VENTURE CAPITAL INVESTMENTS BY BOTH DOMESTIC AND FOREIGN VENTURE CAPITALIST FIRMS, 2004, US$'000S	NO. DOMESTIC COMPANIES RECEIVING VENTURE CAPITAL	NO. DOMESTIC AND FOREIGN COMPANIES	SEED STAGE %	EARLY-STAGE %	EXPANSION/ LATE STAGE %	BUYOUT/ ACQUISITION/ OTHER	AMOUNT INVESTED PER DOMESTIC COMPANY US$'000S
Australia	1 536 202	122	156	2	2	27	68	3 980.78
China	273 831	232	232	5	13.5	82.5		1 180.30
Japan	1 375 362	1 816	2 245	1	53	16	29	536.99
New Zealand	99 958	54	59	10	61	25	5	1 757.33
Singapore	143 160	51	53	13	35	49	3	2 701.13
United States	20 993 400	2 399	2 399	2	19	80	0	8 751.77

TABLE 14.8: BEST MARKETS FOR ENTREPRENEURIAL FINANCE, 2005

RANKING	PLACE	PREVIOUS RANKING
1	United Kingdom	3
2	Hong Kong	1
3	Singapore	2
4	United States	6
7	Australia	7
14	New Zealand	18
16	Malaysia	14
19	Japan	21
23	Korea	28
25	Taiwan	23
30	Thailand	24
38	China	43
57	Indonesia	53
58	Philippines	49
62	Papua New Guinea	77
98	Vietnam	87

ENTREPRENEURSHIP IN PRACTICE

DISPELLING VENTURE CAPITAL MYTHS

Because many people have mistaken ideas about the role and function of venture capitalists, many myths have sprung up about venture capitalists. Some of these, along with their rebuttals, follow.

>> **Myth 1:** Venture capital firms want to own control of your company and tell you how to run the business.

No venture capital firm intentionally sets out to own control of a small business. Venture capitalists have no desire to run the business. They do not want to tell entrepreneurs how to make day-to-day decisions and have the owner report to them daily. They want the entrepreneur and the management team to run the company profitably. They do want to be consulted on any major decision, but they want no say in daily business operations.

>> **Myth 2:** Venture capitalists are satisfied with a reasonable return on investments.

Venture capitalists expect very high, exorbitant, unreasonable returns. They can obtain reasonable returns from hundreds of publicly traded companies. They can obtain reasonable returns from many types of investments not having the degree of risk involved in financing a small business. Because every venture capital investment involves a high degree of risk, it must have a correspondingly high return on investment.

>> **Myth 3:** Venture capitalists are quick to invest.

It takes a long time to raise venture capital. On average, it will take two to six months in the Australian venture capital industry from the initial contact to raise venture capital. If the entrepreneur has a well-prepared business plan, the investor will be able to raise money in that time frame. A venture capitalist will see from 50 to 100 proposals a month. Out of that number, 10 will be of some interest. Out of those 10, two or three will receive a fair amount of analysis, negotiation and investigation. Of the two or three, one may be funded. This funnelling process of selecting one out of hundreds takes a great deal of time. Once the venture capitalist has found that one, they will spend a significant amount of time investigating possible outcomes before funding it.

>> **Myth 4:** Venture capitalists are interested in backing new ideas or high-technology inventions – management is a secondary consideration.

Venture capitalists back only good management. If an entrepreneur has a bright idea but a poor managerial background and no experience in the industry, the individual should try to find someone in the industry to bring on to the team. The venture capitalist will have a hard time believing that an entrepreneur with no experience

>>

in that industry and no managerial ability in their background can follow through on a business plan. A good idea is important, but a good management team is even more important.

- **Myth 5:** Venture capitalists need only basic summary information before they make an investment.

  A detailed and well-organised business plan is the only way to gain a venture capital investor's attention and obtain funding. Every venture capitalist, before becoming involved, wants the entrepreneur to have thought out the entire business plan and to have written it down in detail.

Sources: Ian C. MacMillan, David M. Kulow and Roubina Khoylian, 'Venture capitalists' involvement in their investments: Extent and performance', *Journal of Business Venturing* (January 1989): 27–47; Sharon Gifford, 'Limited attention and the role of the venture capitalist', *Journal of Business Venturing* 6 (1997): 459–82; Gregory F. Chiampou and Joel J. Kallet, 'Risk/return profile of venture capital', *Journal of Business Venturing* (January 1989): 1–10; Howard E. Van Auken, 'Financing small technology-based companies: The relationship between familiarity with capital and ability to price and negotiate investment', *Journal of Small Business Management* 39(3) (2001): 240–58; David J. Gladstone, *Venture Capital Handbook* (Reston, VA: Reston, 1983), 21–4.

DO'S AND DON'TS OF APPROACHING VENTURE CAPITALISTS

ENTREPRENEURSHIP IN PRACTICE

So you want a piece of the venture capital pie? Venture capitalists are busy people, constantly inundated with business plans that range from pipe dreams to the next software giant. Keep these things in mind if you want to capture their attention.

DO

- Prepare all materials before soliciting firms.
- Send a business plan and cover letter first.
- Solicit several firms.
- Keep phone conversations brief – have 1-minute and 3-minute conversations.
- Remain positive and enthusiastic about your company, product and service.
- Know your minimum deal and walk away if necessary.
- Negotiate a deal you can live with.
- Investigate the venture capitalist's previous deals and current portfolio structure.

DON'T

- Expect a response.
- Dodge questions.
- Give vague answers – know what you can and cannot disclose before you start talking so that you do not stumble over awkward questions.
- Hide significant problems.
- Switch off – be an active listener, you will always learn something.
- Expect immediate decisions.
- Fixate on pricing.
- Embellish facts or projections.
- Bring your lawyer.

Source: Adapted from Paul DeCeglie, 'The truth about venture capital', *Business Start-Ups* (February 2000): 40–7.

How do venture capitalists evaluate proposals?

Considering venture capitalists receive many proposals, some level of screening is necessary. Researchers have discovered that venture capitalists reached a 'go/no-go' decision in an average of six minutes on the initial screening and less than 21 minutes on the overall proposal evaluation. They found that the venture capital firm's requirements and the long-term growth and profitability of the proposed venture's industry were the critical factors for initial screening. In the more detailed evaluation, the backgrounds of the entrepreneurs as well as the characteristics of the proposal itself were important for further consideration.[23] Table 14.9 portrays the key screening criteria.

In addition to initial screening venture capitalists seek to evaluate product ideas and management strengths. Researchers suggest there are numerous criteria used by venture capitalists to evaluate new-venture proposals.[24] A list of eight critical attributes that venture capitalists use to evaluate if they will invest or not are exhibited in table 14.10. The level at which the attribute applies and its definition are also provided.

In a study examining the 'demand side' of venture capital, researchers surveyed 318 private entrepreneurs who sought out venture capital in amounts of $100 000 or more. The study found that entrepreneurs' success with acquiring funding is related to four general, variable categories:

- characteristics of the entrepreneurs, including education, experience and age
- characteristics of the enterprise, including stage, industry type and location (for example, rural or urban)
- characteristics of the request, including amount, business plan and prospective capital source
- sources of advice, including technology, preparation of the business plan and places to seek funding.[25]

TABLE 14.9: VENTURE CAPITALISTS' SCREENING CRITERIA

Venture capital firm requirements	• Must fit within lending guidelines of venture firm for stage and size of investment • Proposed business must be within geographic area of interest • Prefer proposals from someone known to venture capitalist • Proposed industry is type of industry invested in by venture firm
Nature of the proposed business	• Projected growth is relatively large within five years of investment • Industry must be capable of long-term growth and profitability • Economic environment of the proposed industry should be favourable to a new entrant
Proposed business strategy	• Selection of distribution channel(s) must be feasible • Product must demonstrate defendable competitive position • Financial information on the proposed business must be timely • Financial projections should be realistic
Proposal characteristics	• Reasonable length, easy to scan, executive summary, professionally presented • Proposal must contain a balanced presentation of risks and opportunities • Use graphics and large print to emphasise key points
Entrepreneur/team characteristics	• Must have relevant experience • Should have a balanced management team in place • Management must be willing to work with venture partners • Entrepreneurs who have successfully started previous business are given special consideration

Source: John Hall and Charles W. Hofer, 'Venture capitalists' decision criteria in new venture evaluation', *Journal of Business Venturing* (January 1993): 37.

TABLE 14.10: ATTRIBUTES IN VENTURE CAPITALISTS' EVALUATION PROCESS

ATTRIBUTE	LEVEL	DEFINITION
Timing of entry	Pioneer	Enters a new industry first
	Late follower	Enters an industry late in the industry's stage of development
Key success factor stability	High	Requirements necessary for success will not change radically during industry development
	Low	Requirements necessary for success will change radically during industry development
Educational capability	High	Considerable resources and skills available to overcome market ignorance through education
	Low	Few resources or skills available to overcome market ignorance through education
Lead time	Long	An extended period of monopoly for the first entrant prior to competitors entering the industry
	Short	A minimal period of monopoly for the first entrant prior to competitors entering this industry
Competitive rivalry	High	Intense competition among industry members during industry development
	Low	Little competition among industry members during industry development
Entry wedge mimicry	High	Considerable imitation of the mechanisms used by other firms to enter this, or any other, industry – for example, a franchisee
	Low	Minimal imitation of the mechanisms used by other firms to enter this, or any other, industry – for example, introducing a new product
Scope	Broad	A firm that spreads its resources across a wide spectrum of the market – for example, many segments of the market
	Narrow	A firm that concentrates on intensively exploiting a small segment of the market – for example, targeting a niche
Industry-related competence	High	Venturer has considerable experience and knowledge with the industry being entered or a related industry
	Low	Venturer has minimal experience and knowledge with the industry being entered or related industry

Source: Dean A. Shepherd, 'Venture capitalists' introspection: A comparison of "in use" and "espoused" decision policies', *Journal of Small Business Management* (April 1999): 76–87; 'Venture capitalists' assessment of new venture survival', *Management Science* (May 1999): 621–32.

The business plan is a critical element in a new-venture proposal and should be complete, clear and well presented. Venture capitalists will generally analyse five major aspects of the plan:

- the proposal size
- financial projections
- investment recovery
- competitive advantage
- company management.

Stages of the evaluation process

The evaluation process typically takes place in stages. The four most common stages are:

- **Stage 1:** Initial screening – a quick review of the basic venture to see if it meets the venture capitalist's particular interests.
- **Stage 2:** Evaluation of the business plan – where a detailed reading of the plan is done in order to evaluate the factors mentioned earlier.
- **Stage 3:** Oral presentation – the entrepreneur verbally presents the plan to the venture capitalist.
- **Stage 4:** Final evaluation – after analysing the plan and visiting suppliers, customers, consultants and others, the venture capitalist makes a final decision.

This four-step process screens out approximately 98 per cent of all venture plans. The rest receive some degree of financial backing.

Evaluating the venture capitalist

The venture capitalist will evaluate the entrepreneur's proposal carefully and the entrepreneur should not hesitate to evaluate the venture capitalist. Does the venture capitalist understand the proposal? Is the individual familiar with the business? Is the person someone with whom the entrepreneur can work? If the answers reveal a poor fit, it is best for the entrepreneur to look for a different venture capitalist.

One researcher found that venture capitalists do add value to an entrepreneurial firm beyond the money they supply, especially in high-innovation ventures. Because of this finding, entrepreneurs need to choose the appropriate venture capitalist at the outset and, most important, they must keep the communication channels open as the firm grows.[26]

On the other hand, it is important to realise that the choice of a venture capitalist can be limited. Although funds are available today, they tend to be controlled by fewer groups and the quality of the venture must be promising. In addition, the trend towards concentration of venture capital under the control of a few firms is increasing.[27]

Finding suitable venture capital investors is one of the biggest challenges for the entrepreneur in a company's early stage. Not all money is the same. 'You can divorce your spouse, but you can't divorce your investor', say venture capitalists. So, be very selective and try to find investors who would add not only money but also great value to your venture. The entrepreneur should not be deterred from evaluating prospective venture capitalists. The following Entrepreneurship in practice provides a list of important questions that a prospective venture capital firm should answer. Evaluating and even negotiating with the venture capitalist are critical to establishing the best equity funding:

> You may worry that if you rock the boat by demanding too much, the venture capital firm will lose interest. That's an understandable attitude; venture capital is hard to get and if you've gotten as far as the negotiating process, you're already among the lucky few.
>
> But that doesn't mean you have to roll over and play dead. A venture capital investment is a business deal that you may have to live with for a long time. Although you'll have to give away ground on many issues when you come to the bargaining table, there is always a point beyond which the deal no longer makes sense for you. You must draw a line and fight for the points that really count.[28]

ANGEL FINANCING

Not all venture capital is raised through formal sources such as public and private placements. Many wealthy people are looking for investment opportunities. They are referred to as *business angels*. Here we distinguish ‘business angels’ from the 4F informal investors – friends, family, founders and other ‘foolhardy’ investors – which we looked at earlier.

How big is the angel capital market? Studies in the US[29] and Scandinavia[30] suggest that the angel capital market is probably about 10 times the size of the venture capital market. Mason and Harrison estimate that angel capital investment in the UK is broadly equivalent to the amount of institutional venture capital provided to start-up and early stage ventures.[31] They also point out that the smaller average size of investments in the informal venture capital market is reflected in the fact that eight times more businesses raise finance from business angels than from institutional venture capital funds.

Business angels are active, in one way or another, in every country worldwide. To illustrate, the early expansion of the Body Shop was supported by an investment through a business angel whose £4000 investment was worth in excess of £140 million in the early 1990s. Business angels tend not to have any previous relationship with the entrepreneur and therefore take a more objective approach to determining whether or not to invest. Angel investors range from those taking a passive approach (backing others’ judgements), through to hands-on investors providing advice or direct management input to help the business become established. In many cases, the latter group of angel investors will take as rigorous an approach to their investing as some venture capitalists. A key difference between angel and venture investors is that angels tend to invest as individuals (often as part of a group) operating part-time, whereas venture capital generally comes

ENTREPRENEURSHIP IN PRACTICE

ASKING VENTURE CAPITALISTS THE RIGHT QUESTIONS

There are a number of important questions that entrepreneurs should ask of venture capitalists. Here are seven of the most important along with their rationales.

>> Does the venture capital firm in fact invest in your industry? How many deals has the firm actually done in your field?

>> What is it like to work with this venture capital firm?

Get references. (An unscreened list of referrals, including CEOs of companies that the firm has been successful with as well as those it has not, can be very helpful.)

>> What experience does the partner doing your deal have and what is their clout within the firm?

Check out the experiences of other entrepreneurs.

>> How much time will the partner spend with your company if you run into trouble?

A seed-stage company should ask, ‘You guys are a big fund and you say you can seed me a quarter of a million dollars. How often will you be able to see me?’ The answer should be at least once a week.

>> How healthy is the venture capital fund and how much has been invested?

A venture firm with a lot of troubled investments will not have much time to spare. If most of the fund is invested, there may not be much money available for your follow-on rounds.

>> Are the investment goals of the venture capitalists consistent with your own?

>> Have the venture firm and the partner championing your deal been through any economic downturns?

A good venture capitalist won’t panic when things get bad.

Source: Reprinted from Marie-Jeanne Juilland, ‘What do you want from a venture capitalist?’ *Venture* (August 1987), for Entrepreneurial Business Owners & Investors, by special permission. Copyright © 1987 Venture Magazine, Inc., 521 Fifth Ave., New York, NY 10175-0028.

via a company or fund with full-time managers and a board of directors, using formal analysis and investment procedures.

This type of investor is defined as someone who has already made their money and now seeks out promising young ventures to support financially. 'Angels are typically entrepreneurs, retired corporate executives, or professionals who have a net worth of more than $100 000 a year. They're self-starters. And they're trying to perpetuate the system that made them successful'.[32] If entrepreneurs are looking for such an angel, Wetzel advises them, 'Don't look very far away – within 50 miles or within a day's drive at most. And that's because this is not a full-time profession for them'.[33]

Why would individuals be interested in investing in a new venture from which professional venture capitalists see no powerful payoff? It may be, of course, that the reduced investment amount reduces the total risk involved in the investment. However, informal investors seek other, non-financial returns, among them the creation of jobs in areas of high unemployment, development of technology for social needs (for example, medical or energy), local revitalisation, assistance to indigenous peoples and personal satisfaction from assisting entrepreneurs.[34] Table 14.11 describes the major differences between business angels and venture capitalists.

How do informal investors find projects? Research studies indicate that they use a network of friends. Additionally, many localities are formulating venture capital networks, which attempt to link informal investors with entrepreneurs and their new or growing ventures.

In New Zealand, the bizAngels Scheme is designed to match and introduce investors who wish to invest directly into small and emergent businesses (angel investors), with small and medium sized businesses seeking capital investment. bizAngels functions under an exemption to the Securities Act. This exemption allows businesses who register using defined protocols to be presented to registered investors, without having to complete the onerous task of developing a full prospectus and registering this with the Companies Office, as is required by the Securities Act when a business issues shares to the public. This exemption process is only available for capital investments of under NZ$ 5 000 000.[35]

One Australian example is the Founders Forum, a not-for-profit angel investor network devoted to assisting early-stage investment opportunities. Members invest, sit on boards, make

FIGURE 14.2 WHERE ANGELS FIT IN THE MIX

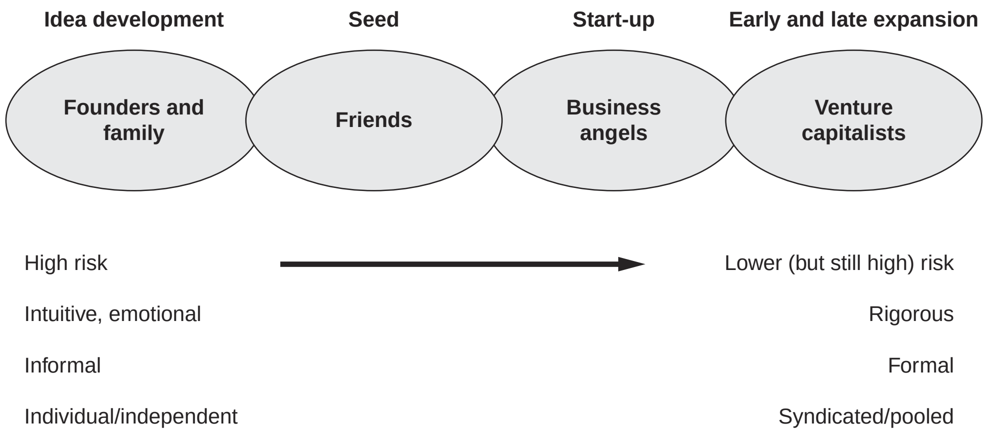


TABLE 14.11: **DIFFERENCES BETWEEN BUSINESS ANGELS AND VENTURE CAPITALISTS**

MAIN DIFFERENCES	BUSINESS ANGELS	VENTURE CAPITALISTS
Personal	Entrepreneurs	Investors
Firms funded	Small, early-stage	Large, mature
Due diligence done	Minimal	Extensive
Location of investment	Of concern	Not important
Contract used	Simple	Comprehensive
Monitoring after investment	Active, hands-on	Strategic
Exiting the firm	Of lesser concern	Highly important
Rate of return	Of lesser concern	Highly important

Source: Osnabrugge and Robinson, *Angel Investing*, 111. This material is used by permission of John Wiley & Sons, Inc.

introductions, consult and share their experiences with other angels and business associates. A voluntary board has members from key community groups and networks such as universities and local investors. Typically, four companies are selected from a pool of applicants to present their business proposition to the audience attending the member meetings.[36]

Though angel investing has both its advantages and disadvantages, it is widely agreed that the advantages of business angels generally outweigh their disadvantages, making an active, informal venture capital market a prerequisite for a vigorous enterprise economy.[37]

Types of angel investors

Angel investors can be classified into five basic groups:

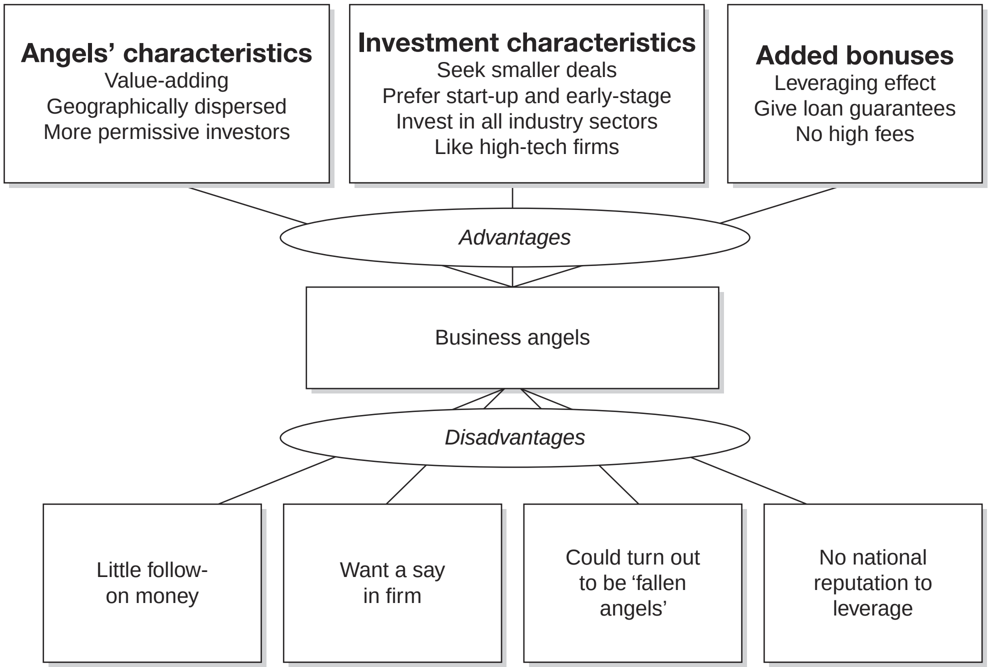
- **Corporate angels:** Typically, so-called corporate angels are senior managers who have been laid off with generous severances or have taken early retirement. In addition to receiving the cash, an entrepreneur may persuade the corporate angel to occupy some senior management position, such as in business development.
- **Entrepreneurial angels:** The most prevalent type of investors, most of these individuals own and operate highly successful businesses. Because these investors have other sources of income and perhaps significant wealth from initial public offerings or partial buyouts, they will take bigger risks and invest more capital. The best way to market your deal to these angels, therefore, is as a synergistic opportunity. Reflecting this orientation, entrepreneurial angels seldom look at companies outside of their own area of expertise and will participate in no more than a handful of investments at any one time. These investors almost always take a seat on the board of directors but rarely assume management duties. They will make fair-sized investments – and invest more as the company progresses.
- **Enthusiast angels:** Whereas entrepreneurial angels tend to be somewhat calculating, enthusiasts simply like to be involved in deals. Most enthusiast angels are aged 65 or older, are independently wealthy from success in a business they started and have abbreviated work schedules. For them, investing is a hobby. As a result, they typically play no role in management and rarely seek to be placed on a board. Because they spread themselves across so many companies, the size of their investments tends to be small.
- **Micro-management angels:** Micro-managers are very serious investors. Some of them were born wealthy, but the vast majority attained wealth through their own efforts. Unfortunately, this heritage makes them dangerous. Because most have successfully

built a company, micro-managers attempt to impose the tactics that worked for them on their portfolio companies. Although they do not seek an active management role, micro-managers usually demand a seat on the board of directors. If business is not going well, they will try to bring in new managers.

- **Professional angels:** The term 'professional' in this context refers to the investor's occupation, such as doctor, lawyer and, in some very rare instances, accountant. Professional angels like to invest in companies that offer a product or service with which they have some experience. They rarely seek a board seat, but they can be unpleasant to deal with when the going gets rough and may believe that a company is in trouble before it actually is. Professional angels will invest in several companies at one time.[38]

Obviously, informal networks are a major potential capital source for entrepreneurs. However, every entrepreneur should be careful and thorough in their approach to business angels. There are advantages and disadvantages associated with 'angel financing.' Figure 14.3 illustrates some of the critical pros and cons of dealing with business angels. It is only through recognising these issues that entrepreneurs will be able to establish the best relationship with a business angel.

FIGURE 14.3 THE PROS AND CONS OF BUSINESS ANGEL INVESTMENT



Source: Osnabrugge and Robinson, *Angel Investing*, 64. This material is used by permission of John Wiley & Sons, Inc.

SUMMARISING INFORMATION

Bottom line on getting your venture financed

- There's plenty of money out there but most young firms aren't 'investment ready'.
- A business plan is important, but it is better to spend money first on marketing, sales and a website. Venture capitalists and mentors will help you with the business plan anyway; what they want to see is revenue!
- Only one in 10 000 will ever see the inside of a venture capitalist's office. Concentrate on other sources of funding.
- Government money is available but it's sometimes a slog filling out all the forms and doing the reports.
- After you max out your own finances, look to friends, family and other 'foolish' investors!
- Get the numbers right, be honest and don't exaggerate.
- Don't become a tail-wagging dog, when you have unwittingly become reliant on one or two large investors and they start to bark orders at you.
- Less risky cash is preferred to more risky finance.
- Investors are interested in the company. Don't sell the product, sell the company.
- Investors will look at your business ideas from a much narrower perspective than you.
- When considering initial public offering activity, think of using the de-coupled approach which provides more flexibility and minimises market risk, thus improving the outcomes of each deal.

TABLE 14.12: DIFFERENCES BETWEEN FUNDING SOURCES

	BOOTSTRAPPING	INFORMAL INVESTMENT	DEBT FINANCING	EQUITY FINANCING	VENTURE CAPITAL	ANGEL FUNDING
Objective	Launch capital	Launch capital	Interest and principal	Share of ownership	**Capital gains**	Capital gains
Holding period	Short	Short-to-mid term	Short-to-mid term	Mid-to-long term	Mid-to-long term	Short-to-mid term
Collateral	None (sometimes credit cards)	Often none, sometimes goodwill/family relations	Yes	No	No	No
Criteria	Faith in entrepreneur	Faith and trust	Interest spread and security	Potential returns on investment	Potential returns on investment	Potential returns on investment
Impact on balance sheet	Increase leverage	Increase leverage	Increase leverage	Reduce leverage	Reduce leverage	Reduce leverage
Impact on cash flow	Creative acquisition of resources	Interest/principal repayment or sometimes none	Interest/principal repayment	Dividend payout	Dividend payout	Dividend payout
Monitoring	Monthly accounting	Family or friends over your shoulder	**Loan servicing**	Employment contacts, board seat, operational reports	Seat on board of directors, operational reports	Management control in day-to-day operations and decision making
Value add	Positioning before other financing	Sometimes expertise, contacts	None	Employee expertise, public credibility	Management assistance, strategic alliances	Management assistance, strategic alliances
Exit mechanism	Re-pay or re-invest	Re-pay or re-invest	Principal repayment	IPO, trade sales, buy-back	IPO, trade sales, buy-back	Trade sale, buy-back

TABLE 14.13: WEB RESOURCES

Singapore Venture Capital Association	[www.svca.org.sg]
Hong Kong Venture Capital Association Ltd	[www.hkvca.com.hk]
Thai Venture Capital Association	[www.venturecapital.or.th]
Malaysian Venture Capital Association	[www.mvca.org.my]
MSC Technopreneur Development Flagship (TDF)	[www.technopreneurs.net.my/cms]
Taiwan Venture Capital Association	[www.tvca.org.tw]
Australian Venture Capital Association	[www.avcal.com.au]
New Zealand Venture Capital Association	[www.nzvca.co.nz]
Global Entrepreneurship Monitor	[www.gemconsortium.org]

SUMMARY

It should be noted that different enterprises present different risk profiles to financiers, hence the need for different funding regimes such as grants, debt financing, venture capital and angel funding. Enterprises that do not fit the criteria for one funding regime may well fit another. For example, a solid yet low-growth company may not be suited for venture capital funding but would be better served by a working capital loan to finance its operations. Similarly, a company heavily involved in research and development (R&D) should target the many R&D grants available rather than apply for debt financing. Table 14.12 summarised the differences.

This chapter has examined the various forms of capital formation for entrepreneurs. Initial consideration was given to bootstrapping and informal investors, where budding entrepreneurs have their best chances of getting funded. The chapter then moved on to debt and equity financing in the form of commercial banks, trade credit, accounts receivable financing, factoring and finance companies and various forms of equity instruments.

Public stock offerings have advantages and disadvantages as a source of equity capital. Although large amounts of money can be raised in short periods of time, the entrepreneur must sacrifice a degree of control and ownership. In addition, different economic systems have vastly diverse and complex regulations that have to be followed.

Private placements are an alternative means of raising equity capital for new ventures. This placement's greatest advantage to the entrepreneur is limited company disclosure and only a small number of shareholders.

In recent years the venture capital market has grown dramatically. Billions are now invested annually to seed new ventures or help fledgling enterprises grow. The individuals who invest these funds are known as venture capitalists. A number of myths that have sprung up about these capitalists were discussed and refuted.

Venture capitalists use a number of different criteria when evaluating new-venture proposals. In the main these criteria focus on two areas: the investment potential of the venture and the entrepreneur. The evaluation process typically involves four stages: initial screening, business plan evaluation, oral presentation and final evaluation.

KEY TERMS AND CONCEPTS

accounts receivable
barter
bootstrapping
build-out allowances
business angels
capital gains
capital structure
classic venture capital
common stock
convertible debentures
corporate angels
debt financing
disclosure
dividends
dual or triple tracking
due diligence
early stage financing
entrepreneurial angels
equity capital
equity financing
exit strategy
expansion financing
factoring
feasibility study
finance company
Global Entrepreneurship Monitor (GEM)

hire purchase
informal investors
initial public offering (IPO)
investment banker
late-stage funding
letter of credit
loan servicing
long-term debt
management buyout (MBO)
market capitalisation
opportunity cost
preferred stock
principal
private placements
prototype development
royalty
seed financing
shareholder
stock
stockholders
trade credit
trade sale
underwriter
value add
venture capitalists
vertical integration
white knight

REVIEW AND DISCUSSION QUESTIONS

1 Table 14.1 outlines some of the most notable sources of capital for entrepreneurs. Identify four of these sources.
2 Why would a start-up company want to postpone debt and equity financing?
3 What are the 4Fs and can you identify 4F investors that you know?
4 What are the benefits and drawbacks of equity and of debt financing? Briefly discuss both.
5 Identify and describe four types of debt financing.
6 If a new venture has its choice between long-term debt and equity financing, which would you recommend? Why?
7 Why would a venture capitalist be more interested in buying a convertible debenture for $50 000 than in lending the new business $50 000 at a 10 per cent interest rate?
8 What are some of the advantages of going public? What are some of the disadvantages?
9 Why do entrepreneurs look forward to the day when they can take their company public?
10 How large is the venture capital pool today? Is it growing or shrinking?
11 Is it easier or more difficult to get new-venture financing today? Why?
12 Some entrepreneurs do not like to seek new-venture financing because they feel that venture capitalists are greedy. In your opinion, is this true? Do these capitalists want too much?
13 Identify and describe three objectives of venture capitalists.
14 How would a venture capitalist use table 14.10 to evaluate an investment? Use an illustration in your answer?
15 Identify and describe four of the most common criteria venture capitalists use to evaluate a proposal.
16 In a new-venture evaluation, what are the four stages through which a proposal typically goes? Describe each in detail.
17 An entrepreneur is in the process of contacting three different venture capitalists and asking each to evaluate her new business proposal. What questions should she be able to answer about each of the three?
18 An entrepreneur of a new venture has had no success in getting financing from formal venture capitalists. He now has decided to turn to the informal risk capital market. Who is in this market? How would you recommend the entrepreneur contact these individuals?
19 How likely is it that the informal risk capital market will grow during the next five years? Defend your answer.
20 Of all the sources of capital formation, which is ideal? Why?

EXPERIENTIAL EXERCISE

ANALYSING THE FUNDING SOURCES

For each funding source, write down what the text says about its usefulness for small firms. Then seek out and interview a representative of each source to find out the person's point of view of their relationship to small firms.

Source	What the text says	Source's point of view
Banks		
Long-term loans		
Short-term loans		
Intermediate-term loans		
Private placement		
Informal investing		
Public offerings (IPO)		
Finance company		
Factor		
Trade credit		
Business angel investors		
Venture capitalist		

CASE 13.1

LOOKING FOR CAPITAL IN MALAYSIA

When Ananda and Suda Kumar opened their bookstore one year ago in Malaysia, they estimated it would take them six months to break even. Because they had gone into the venture with enough capital to keep them afloat for nine months, they were sure they would need no outside financing. However, sales have been slower than anticipated and most of their funds now have been used to purchase inventory or meet monthly expenses. On the other hand, the store is doing better each month and the Kumars are convinced they will be able to turn a profit within six months.

At present, Ananda and Suda want to secure additional financing. Specifically, they would like to raise $100 000 to expand their product line. The store currently focuses most heavily on how-to-do-it books and is developing a loyal customer following. However, this market is not large enough to carry the business. The Kumars feel that if they expand into an additional market such as cookbooks, they can develop two market segments that, when combined, would prove profitable. Suda is convinced that cookbooks are an important niche and she has saved clippings from national newspapers and magazines reporting that people who buy cookbooks tend to spend more money per month on these purchases than does the average book buyer. Additionally, customer loyalty among this group tends to be very high.

The Kumars own all of their inventory, which has a retail market value of $280 000. The merchandise cost them $140 000. They also have at a local bank a line of credit of $10 000, of which they have used $4000. Most of their monthly expenses are covered out of the initial capital with which they started the business ($180 000 in all). However, they will be out of money in three months if they are not able to get additional funding.

The owners have considered investigating a number of sources. The two primary ones are a loan from their bank and a private stock offering to investors. They know nothing about how to raise money and these are only general ideas they have been discussing with each other. However, they do have a meeting scheduled with their accountant, a friend, who they hope can advise them on how to raise more capital. For the moment, the Kumars are focusing on writing a business plan that spells out their short business history and objectives and explains how much money they would like to raise and where it would be invested. They hope to have the plan completed before the end of the week and take it with them to the accountant. The biggest problem they are having in writing the plan is that they are unsure of how to direct their presentation. Should they aim it at a banker or a venture capitalist? After their meeting with the accountant, they plan to refine the plan and direct it towards the appropriate source.

QUESTIONS

1 Would a commercial banker be willing to lend money to the Kumars? How much? On what do you base your answer?
2 Would this venture have any appeal for a venture capitalist? Why or why not?
3 If you were advising the Kumars, how would you recommend they seek additional capital? Be complete in your answer.

CASE 14.2:

THE 120 MILLION BAHT VENTURE

The Friendly Market is a large supermarket in a Thai provincial city. ‘Friendly’s’, as it is popularly known, has more sales per square metre than any of its competitors because it lives up to its name. The personnel go out of their way to be friendly and helpful. If someone asks for a particular brand-name item and the store does not carry it, the product will be ordered. If enough customers want a particular product, it is added to the regular line. Additionally, the store provides free delivery of groceries for elderly citizens and credit for those who have filled out the necessary application and have been accepted into the ‘Friendly Credit’ group.

The owner, Pacapol Anurit, believes that his marketing-oriented approach can be successfully used in any area of the country. He is therefore thinking about expanding and opening two new stores, one in the northern part of the same city and the other in a city located 50 kilometres east. Locations have been scouted and a detailed business plan has been drawn up. However, Pacapol has not approached anyone about providing the necessary capital. He estimates he will need about THB 120 million to get both stores up and going. Any additional funding can come from the current operation, which has a cash flow of about THB 4 million monthly.

Pacapol first considers two avenues are available to him: debt and equity. His local banker has told him the bank would be willing to look over any business plan he submits and would give him an answer within five working days. Pacapol is convinced he can get the bank to lend him THB 120 million. However, he does not like the idea of owing that much money. He believes he would be better off selling stock to raise the needed capital. Doing so would require him to give up some ownership, but this is more agreeable to him than the alternative.

The big question now is: How can the company raise THB 120 million through a stock offering? Pacapol intends to check into this over the next four weeks and make a decision within eight weeks. A number of customers have approached him over the past year and have asked him if he would consider making a private stock offering. Pacapol is convinced he can get many of his customers to buy into the venture, although he is not sure he can raise the full THB 120 million this way. The other approach he sees as feasible is to raise the funds through an informal investor network connected with the ICC chain of food products. This might be the best way to get such a large sum, but Pacapol wonders how difficult it would be to limit his food range to ICC products on a long-term basis. In any event, as he said to his wife yesterday: ‘If we’re going to expand, we have to start looking into how we can raise more capital. I think the first step is to identify the best source. Then we can focus on the specifics of the deal’.

QUESTIONS

1 What would be the benefits of raising the THB 120 million through a private placement? What would be the benefits of raising the money through ICC? What are the risks and benefits of going through the bank?
2 Of these three approaches, which would be best for Pacapol? Why?
3 What would you recommend Pacapol do now? Briefly outline a plan of action he can use to get the financing process started.

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Gobi Partners: October 2004

Publication date: 18 January 2005
Revision date: 29 November 2005
Author(s): G. Felda Hardymon, Ann Leamon
Product number: 9-805-090

The general partners of Gobi Partners, a venture fund located in Shanghai, are trying to decide the best way to raise money for their first fund without either abandoning the strategy that has won them a measure of success in such a short time or bringing on more strategic investors with goals that might conflict with those currently in the fund.

Angel Investing: Innovation Within the Establishment

Publication date: 1 November 2002
Author(s): John W. Glynn Jr, Janet Feldstein
Product number: E127

Introduces angel investing as a concept and discusses recent developments in the industry. Focuses on the new generation of angel investors and the steps taken on both sides of the investing equation to mitigate the risks inherent in the relationship.

The Band of Angels

Publication date: 11 March 1998
Revision date: 11 August 1999
Author(s): Michael J. Roberts, Christina Darwall
Product number: 9-898-188

'The Band of Angels' is a well-organised but independent group of wealthy entrepreneurs. This case details the principles and processes used by the band and offers two perspectives from entrepreneurs who have been financed.

Zipcar

Publication date: 10 October 2001
Revision date: 24 August 2005
Author(s): Myra M. Hart, Wendy Carter
Product number: 9-802-085

Provides a detailed description of the processes and tasks associated with creating a new venture in an emerging industry (subscription car-sharing for urban dwellers). Chronicles the entrepreneur's concept development, industry analysis, market research, identity definition and brand building. Also provides background on writing the business plan, creating a budget and building financials, developing a management team, creating business partnerships and financing the businesses.

Nanpo (Holdings) Ltd: Initial public Offering

Publication date: 9 August 1999
Revision date: 16 July 2001
Author(s): Larry Wynant, Geoff Crum, Peter Yuan
Product number: 99N018

Nanpo (Holdings) Ltd, a Hong Kong-based Chinese food distributor, is planning for its initial public offering on the stock exchange of Hong Kong. Three weeks away from the planned initial public offering, Jack Yang, a director of Nanpo, is once again reviewing the details of pricing.

AsiaInfo: The IPO Decision

Publication date: 4 May 2004
Author(s): Michael J. Roberts, Donald N. Sull
Product number: 9-804-183

The co-founder and CEO of AsiaInfo, a Chinese system integrator that built 70 per cent of China's Internet backbone, must decide whether to list equity in the United States to fund future growth. Describes the company and the decision.

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part 4

ENTREPRENEURIAL CASE ANALYSIS

THE PLAYBOY EMBLEM: A CASE OF TRADEMARK INFRINGEMENT

Dr Donald F. Kuratko, Kelley School of Business, Indiana University

THE LETTER On 26 August 1982, a disturbing and almost unbelievable letter arrived certified mail (return receipt requested) at the tavern. The letter to John P. Browne stated:

> Re: RABBIT HEAD Design Trademark Infringement – Bunny's Tavern, Brookfield, Illinois
>
> Gentlemen:
>
> It has been brought to our attention that Bunny's Tavern has painted on the outside wall of its establishment a rabbit head design virtually identical to our company's RABBIT HEAD Design trademark. The RABBIT HEAD Design is a trademark owned by Playboy Enterprises, Inc., and Bunny's unauthorised use of our mark constitutes trademark infringement and unfair competition. Bunny's continued use of our mark is likely to cause confusion to the general public, in that the public could consider Bunny's Tavern as being in some way sponsored by or otherwise associated with our company.
>
> Unless Bunny's Tavern immediately and permanently ceases and desists its unauthorised use of our company's RABBIT HEAD Design trademark or any other mark or design similar thereto owned by or associated with our company within ten days of the date of this letter, we will recommend to management that legal action be taken against it to protect our company's rights.
>
> Should Bunny's Tavern wish to avoid the possibility of future unpleasantness and the needless expense of litigation, please have an authorised representative sign, date, and return the enclosed copy of this letter. Such signature will evidence Bunny's agreement to settle this matter according to the terms of this letter.
>
> Should Bunny's Tavern continue its unauthorised use of our company's mark, it does so at its own risk.
>
> Very truly yours
> PLAYBOY ENTERPRISES, INC.
> Harriet E. Earle
> Trademarks Coordinator

BACKGROUND: JOHN P. BROWNE AND HIS TAVERN In November 1948 John P. Browne opened a neighbourhood tavern of modest means. Located on 47th Street in Brookfield, Illinois (a western suburb of Chicago), the small building provided a room with 16 bar stools and no tables. A few arcade games (bowling and pinball) were available for entertainment of the clientele.

For over 34 years the tavern operated successfully (by standards of a lifestyle venture, that is, John P. Browne was able to make a profit and provide for his family). The customers were local neighbourhood friends and workers from the surrounding factories located down the street (for example, Electro-Motive and Materials Service). The clientele was loyal, and a strong rapport was established through the years with owner/operator John P. Browne and his customers, since he handled most of the bartending duties himself. In his later years his father, Patrick J., also bartended, which provided the clientele with a family influence on the Browne establishment.

Throughout the continuous operation of this tavern business and loyal development of the clientele, John P. Browne became a well-liked and well-respected businessman in the local community. The Brookfield community (now with a population of 21 000) knew the purpose of his business and his clientele, which was to provide a local gathering spot for beer and alcohol consumption combined with a neighbourhood atmosphere.

John P. Browne is known by all as 'Bunny Browne' and has been all of his life. Sixty-three years ago a nurse in a Chicago hospital coined the nickname when she thought he was as 'cute as a bunny'. The nickname remained through his early years, and when John developed into a lightweight boxer in the Chicago area 'Golden Gloves', the nickname characterised his bouncing style in the ring.

Thus, it was only fitting that John use his popular name for his neighbourhood establishment in 1948. Therefore, 'Bunny' Browne's Tap was named officially.

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THE RABBIT HEAD EMBLEM The idea of painting an emblem on the side of Bunny Browne's tavern was conceived five years after the tavern opened. In 1954, one of the tavern's patrons, Joe Karasek, developed the idea as a gesture of friendship and gratitude to his friend Bunny Browne.

After discussing various caricatures that could be painted on the wall, both Bunny Browne and Joe Karasek agreed that a simple rabbit's head would be the easiest to distinguish from a distance and would clearly represent the nickname 'Bunny'.

Thus, in the summer of 1954 Joe began his task of painting the east side of the tavern black and then drawing the rabbit's head in white (see figure A).

FIGURE A

Note: Playboy Enterprises developed its rabbit head design in 1953. It was designed by Arthur Paul, and it has stood for over 40 years as the Playboy symbol. In addition, Playboy had its emblem registered as a trademark that same year – 1953. Thus, it became a protected property item of the Playboy domain (see figure B).

FIGURE B

BUNNY'S RESPONSE Bunny Browne was astounded that Playboy would ever consider his emblem any type of threat to its powerful sexual domain, especially considering that his type of tavern could never be misconstrued as a copy, replica, or even a poor imitation of the Playboy Clubs. Thus, how could a sole proprietor of a small local tavern in existence before Playboy started its empire in 1953 be guilty of 'unfair competition' through a trademark infringement?

'I thought it was a joke,' Bunny Browne said. 'After all, it has been up there for nearly 30 years, and I am unaware of anyone ever having confused my establishment with the Playboy Club.'

According to Bunny, he himself has never owned a copy of Playboy magazine, and, noting that at age 63 he is often the youngest person in the bar, his clientele wouldn't have any use for that kind of bunny. 'Basically, I feel I'm absolutely no threat to their organisation. They are simply nitpicking!' Bunny stated.

It seemed appropriate that a letter of clarification to Playboy's chief executive officer – Christine Hefner – would be the simplest approach. Surely there was a misunderstanding of Bunny Browne's tavern and once Christine Hefner understood, there would probably be no further action.

The return letter from Bunny Browne to Christine Hefner was sent on 3 September 1982. It read:

> Dear Ms Hefner:
>
> Enclosed is a copy of a letter I received by certified mail from the office of your general counsel. As you see, it is addressed to Bunny's Tavern and says that my modest tavern, place of business, is guilty of unfair competition, and the use of a rather tired-looking emblem I have on the side wall could confuse the public, and cause the public to believe that my little tavern is associated with Playboy Enterprises, Inc.
>
> In a way it is flattering to be considered a competitor of a giant enterprise, but it is disturbing to read the reference to expensive litigation and unpleasantness.
>
> When you read what is involved (and I hope you will be given this letter), you too may feel that your lawyer's letter does not express your feeling and does not reflect favourably on Playboy Enterprises.
>
> I was first called Bunny by a nurse in the hospital where I was born over 63 years ago. I have been known as Bunny all of my life. I have lived my life in Brookfield (pop. 21&&000) and very few of the people in the village know me as John. I began my business as Bunny's in November 1948 and have operated it continuously since that time. My tavern is not large (16 stools and no tables). My trade is from Brookfield and the surrounding neighbourhood. The emblem of Bunny has been on the wall since the 1950s. It is

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> inconceivable that anyone would confuse my emblem and tavern with the Playboy Club. My patrons and the people of Brookfield would, I know, be astonished to learn of Playboy's fears and I am sure would be upset to learn that I have fears of future unpleasantness and expensive litigation.
>
> Ms Hefner, I hope you will inform me that you consider the action of your lawyers to be unnecessary and in this case not in the best interest of Playboy.
>
> Sincerely
> John P. Browne
> Bunny's Tavern

PLAYBOY'S RESPONSE The letter from John 'Bunny' Browne did apparently reach Christine Hefner and, through her counsel Howard Shapiro, she replied in a letter dated 13 September 1982. It read:

> Dear Mr Browne:
>
> Christine Hefner has asked me to reply to your letter to her of 3 September 1982.
>
> Although our 'Bunny' is not quite as old as you, we take quite a paternal interest in protecting it. Since 1953, when it was created for Playboy by Arthur Paul, it has become a symbol of our company and like an overprotective parent, we have gone to great lengths to keep it from harm.
>
> It seems that a lot of our readers are also very protective of our Rabbit Head Design mark. Several of them, evidently, drove past your tavern and contacted us to inquire why our mark was on the side of your building. This is how your establishment came to our attention. It's obvious from this contact that people saw your 'tired-looking personal emblem' and thought of our company, and it is for this reason that Ms Earle sent her letter.
>
> It's obvious that you have a lot of pride in your tavern and in your reputation in the community. If someone else moved into your community, opened a tavern and utilised the name 'Bunny's', we would hope that you would feel that something that belonged to you was being taken away, just as we feel that the use of a Rabbit Head Design on the side of your building is taking something away from us.
>
> Litigation is expensive and we have no desire to go that route unless it becomes absolutely necessary. It sounds as if this whole thing can be solved by a coat of paint rather than by lawyers and legal fees. If it's acceptable to you, we'd be willing to close our file on this matter on your representation that at some point within the next three to six months, your 'tired-looking personal emblem' will be replaced with something that not only you can be proud of but we will be happy with too.
>
> If this is acceptable to you, please sign a copy of this letter and return it to me.
>
> Very truly yours
> PLAYBOY ENTERPRISES, INC.
> Howard Shapiro

THE MEDIA REACTION The case of Bunny Browne's problem with Playboy spread throughout the community of Brookfield, the surrounding suburbs, and finally into Chicago. The newspapers reviewed the disagreement as a simple 'attack' by big business against the 'little guy'. Articles quickly appeared in the local newspaper, and eventually editorials appeared by noted columnists Art Petacque and Hugh Hough of the *Chicago Sun-Times* and Mike Royko of the *Chicago Tribune.* (See excerpts here.)

> Splitting Hares: Bunny's Tavern, a neighbourhood bar in west suburban Brookfield, has never been mistaken for a Playboy Club by its beer-quaffing customers. But that didn't stop Playboy Enterprises from threatening legal action against the bar's owner, John P. 'Bunny' Browne.
> (Petacque & Hough – *Chicago Sun-Times*)
>
> There was a duel between Playboy Enterprises and a neighbourhood tavern in Brookfield called Bunny's.
>
> For three decades, the Bunny's tavern had a big painting of a rabbit head on the side of its building.
>
> Then Playboy decided that the tavern's rabbit looked too much like Playboy's rabbit symbol and threatened to sue.
>
> It seemed unfair, because the tavern sells booze, not Hefner's kinky fantasies.
> (Royko – *Chicago Tribune*)

By October 1982 the news had travelled as far as Natchez, Mississippi, where Bunny Browne had friends and acquaintances in the likes of Ben Chase Callun and Mayor Tony Byrne. After years of visits, Bunny Browne was fondly dubbed an 'honorary citizen' of Natchez. Thus, the Natchez paper carried an article concerning Playboy's squabble over Bunny's emblem.

It wasn't long before the local television stations sent their minicams to film the tavern and interview Bunny over this incident with Playboy. While the television interviews were brief spots on the evening news, the interest in this little tavern in Brookfield, Illinois, was astounding.

Visitors came from all over the city and suburbs just to see this tavern and its rabbit head emblem that was upsetting Playboy Enterprises. To have a beer at Bunny's became something of a vogue – at least for a brief period of interest and curiosity.

BUNNY'S DILEMMA The fanfare subsided in a few weeks, and Bunny Browne's Tap returned to its normal routine and loyal clientele. They, being proud of Bunny's Tap in addition to being

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Overmatter of pg. 409

loyal, encouraged Bunny to take a stand against Playboy. 'Let's fight 'em all the way, Bunny!' they shouted. Bunny retorted, 'Maybe I'll have to get in the ring and box with Playboy's best – like the old Golden Gloves days!' The bar cheered and toasted Bunny.

But the reality Bunny Browne faced was a different dilemma from the old Golden Gloves days – and he knew it. As he closed up the tavern on this late November evening, Bunny pondered about his rabbit head emblem that had for 30 years been a 'friend' and now seemed to be the centre of so much controversy. The now badly peeling painting had never been touched up in all those years. Bunny thought to himself that it never would be touched up if Playboy would simply let it fade away. Bunny said with an Irish grin, 'I wish Playboy would just let my rabbit die a natural death – the way I'm doing'. As he turned off the tavern lights, Bunny knew he must decide what to do.

DISCUSSION QUESTIONS

1 If you were Bunny Browne, what exactly would you do? Why?
2 Explain what a trademark is and what rights it provides the owner.
3 Apply the 'unfair competition' idea of trademark infringement to this case.
4 Do alternative solutions exist for Bunny Browne's tavern? If so, what are they?
5 What must a small business do to avoid infringing on the trademark rights of someone else?
6 Discuss the implications for Playboy Enterprises of pressuring a small business.
7 What lessons can be learned from Bunny Browne's situation?
8 Discuss the pros and cons of Bunny's decision (based on what you have recommended in question 1).

Source: This case was prepared by Dr Donald F. Kuratko, College of Business, Ball State University, and is intended to be used as a basis for class discussion. Presented and accepted by the refereed Midwest Society for Case Research Workshop, 1986. All rights reserved to the author and to the Midwest Society for Case Research. Copyright © 1986 by Donald F. Kuratko.

PART FIVE:
GROWTH AND DEVELOPMENT OF ENTREPRENEURIAL VENTURES

15

STRATEGIC ENTREPRENEURSHIP FOR EMERGING VENTURES

I have often heard it said that big companies, the corporate giants, are the ones that need to think about their business strategically. Smaller, more entrepreneurial companies, by contrast, do not need strategy; they can pursue other routes to business success. In my view, that is exactly backward. Unlike the giants, small businesses cannot rely on the inertia of the marketplace for their survival. Nor can they succeed on brute force, throwing resources at problems. On the contrary, they have to see their competitive environment with particular clarity and they have to stake out and protect a position they can defend. That is what strategy is all about.

Michael E. Porter, Harvard Business School

CHAPTER OBJECTIVES

1. To introduce the importance of planning for an entrepreneurial venture
2. To discuss the nature of strategic planning
3. To examine the key dimensions that influence a firm's planning process
4. To discuss some of the reasons why entrepreneurs do not carry out strategic planning
5. To relate some of the benefits of strategic planning
6. To examine four of the most common approaches entrepreneurs use to implement a strategic plan
7. To review the nature of operational planning for a venture

THE NATURE OF PLANNING IN EMERGING FIRMS

Two fields – strategic management and entrepreneurship – have quite different origins. Strategic management is typical of large corporations and is the domain of the chief executive officer and the executive team. The entrepreneur of course often works alone or in small teams and is more concerned with survival than paying executives. But these days the two are really inseparable.[1] Both are focused on how firms adapt to change and how they operate amid uncertainty and risk. Both come together in their strong emphasis on wealth creation. It's a two-way street: Strategists must take advantage of the entrepreneurial mindset and entrepreneurs must take a strategic approach to how they perceive opportunities, mobilise their resources and exploit opportunity.

Venkataram and Sarasvathy see it a bit like Shakespeare's Romeo on the balcony. Strategy without the entrepreneurial mindset is like the balcony without Romeo. The entrepreneurial mindset without strategy is like Romeo without the balcony. So strategic entrepreneurship is 'entrepreneurial action with a strategic perspective'.[2] That means we integrate the opportunity-seeking entrepreneurial mindset with the advantage-seeking strategic perspective.

When the business slows or when it speeds up, when the business is a monopoly or when it is in a strongly competitive market, when the business is successful or when it is not, in all these cases entrepreneurs need to turn their attention to strategic planning to find sources of new growth and to maintain existing advantages. Although most entrepreneurs do some form of planning for their ventures, it often tends to be informal and unsystematic.[3] The actual need for systematic planning will vary with the nature, size and structure of the business. In other words, a small two-person operation may successfully use informal planning because little complexity is involved. But an emerging venture that is rapidly expanding with constantly increasing personnel size and market operations will need to formalise its planning because a great deal of complexity exists.

There are a variety of strategic planning tools ranging in sophistication and time commitment. An entrepreneur's planning will need to shift from an informal to a formal systematic style for many reasons. First is the degree of uncertainty with which the venture is attempting to become established and to grow. With greater levels of uncertainty, entrepreneurs have a stronger need to deal with the challenges facing their venture and a more formal planning effort can help them to do this. Second, the strength of the competition (in both numbers and quality of competitors) will add to the importance of more systematic planning in order for a new venture to monitor its operations and objectives more closely.[4] Finally, the amount and type of experience the entrepreneur has may be a factor in deciding the extent of formal planning. A lack of adequate experience, either technological or business, may constrain the entrepreneur's understanding and thus necessitate formal planning to help determine future paths for the organisation.

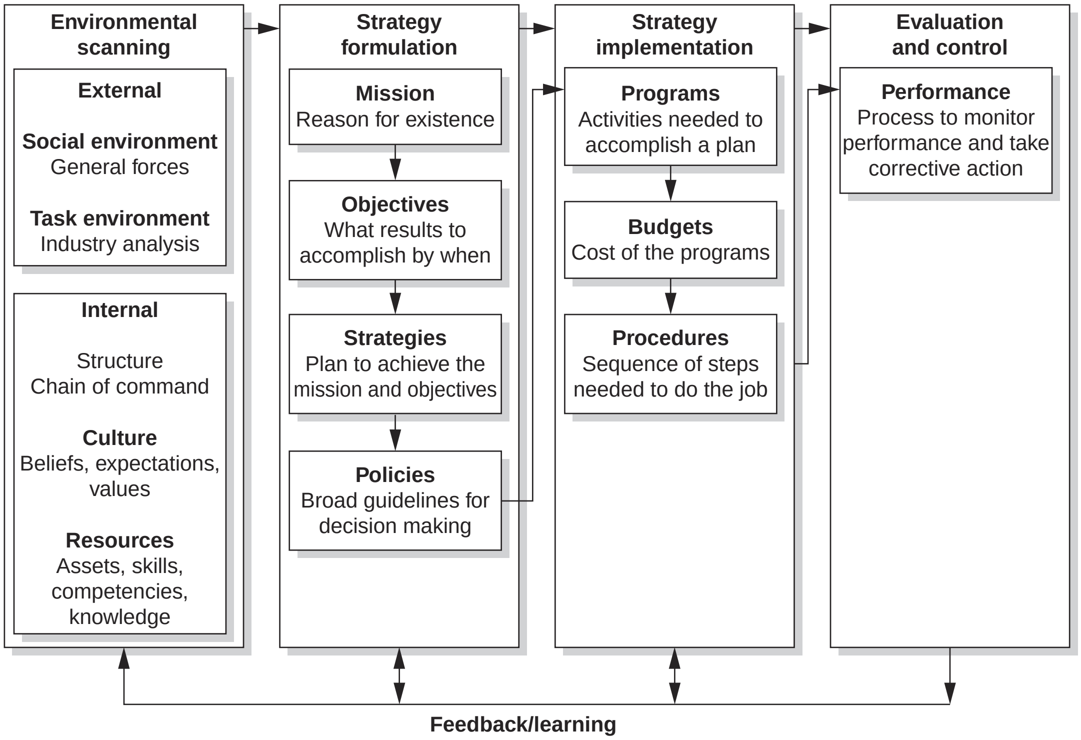
Formal planning is usually divided into two major types: strategic and operational. We shall begin by examining the nature of **strategic planning** and then we will discuss **operational planning**.

STRATEGIC PLANNING

Strategic planning is the formulation of long-range plans for the effective management of environmental opportunities and threats in light of a venture's strengths and weaknesses. It includes defining the venture's mission, specifying achievable objectives, developing strategies and setting policy guidelines.[5] Thus, strategic planning is the primary step in determining the future direction of a business. The 'best' strategic plan will be influenced by many factors, among them the abilities of the entrepreneur, the complexity of the venture and the nature of the industry. Yet, whatever the specific situation, five basic steps must be followed in strategic planning (see figure 15.1):

- environmental scanning – examine the internal and external environments of the venture (strengths, weaknesses, opportunities, threats)

FIGURE 15.1 **STRATEGIC MANAGEMENT MODEL**



Source: Thomas L. Wheelen and J. David Hunger, *Strategic Management and Business Policy*, 7th edn, 2000. Reprinted by permission of Pearson Education Inc., Upper Saddle River, NJ.

- strategy formulation – formulate the venture's long-range and short-range strategies (mission, objectives, strategies, policies)
- strategy implementation – implement the strategic plan (programs, budgets, procedures)
- evaluation and control – evaluate the performance of the strategy
- feedback/learning – take follow-up action through continuous feedback.

The first step – scanning the environment – can be one of the most critical for an emerging venture. We have touched on this in chapter 7 and here we see how it fits into the strategic perspective. A clear review of a venture's internal and external factors is needed and both sets of factors must be considered when performing an environmental analysis. This analysis is often called a **SWOT analysis**. SWOT is an acronym for a venture's internal strengths and weaknesses and its external opportunities and threats. Figure 15.2 provides a matrix of the key components of the SWOT analysis and a template for use.

The analysis should include not only the external factors most likely to occur and to have a serious impact on the company but also the internal factors most likely to affect the implementation of present and future strategic decisions. By focusing on this analysis, an emerging venture can proceed through the other steps of formulation, implementation, evaluation and feedback. Table 15.1 shows how the SWOT analysis could help an entrepreneur decide to go into China.

FIGURE 15.2 DEFINITIONS OF SWOTS

	Helpful to achieving the objective	**Harmful** to achieving the objective
Inside (attributes of the organisation)	Strengths	Weaknesses
Outside (attributes of the environment)	Opportunities	Threats

Source: GNU Licence 'SWOT analysis' [en.wikipedia.org/wiki/SWOT_analysis].

It should be remembered that the greatest value of the strategic planning process is the 'strategic thinking' it promotes among business owners. Although not always articulated formally, strategic thinking synthesises the intuition and creativity of an entrepreneur into a vision for the future.[6]

This chapter now examines the different aspects of strategic planning for emerging ventures.

What influences a firm's strategic planning activities?

Five factors shape the strategic management activities of growing companies. They are discussed below.

Demand on strategic managers' time

The increasing demand on key owner-managers' time that accompanies the complexity brought on by growth of the entrepreneurial firm brings about a need for more rigorous strategic management practices. This logically appealing proposition has been offered in the past by many researchers. From their perspective, increased strategic planning activity provides the means to accommodate owner-managers' needs to maintain control and direction of the enterprise, while giving up some activities in recognition of increased time pressures.

Decision-making speed

As the firm expands, the decisions to be made can be expected to increase both in number and frequency. These pressures are referred to as 'delegation demands' on the growing firm's

TABLE 15.1: HOW TO SUCCEED IN CHINA: A SWOT ANALYSIS

STRENGTHS	WEAKNESSES
National strength since reform in 1978	Hard to control distribution of products
Accelerated economic development	Energy and transportation issues are slowing growth
Increased comprehensive national strength	High inflation
Leads world in direct foreign investment	Outdated equipment and infrastructure
Moving market economy	Employees need training
Rich in natural resources	Large proportion of illiterates
Huge opportunity for low-end products	Little concept of quality control
Low labour cost factor	Shortage of energy (fuel and electricity)
Committed to economic growth at national policy level	Lack of modern pollution control
Good shift for manufacturing labour-intensive products	Currency transactions require a premium
OPPORTUNITIES	THREATS
Provide advanced technology	Lack of modern financial reporting in China
Easy-to-target bottleneck industries	Lack of modern legal structure
Opportunity to increase energy production	Cultural differences cause business conflicts
Demand for foreign infrastructure loans	Prefer harmony to competition
Need for overseas investments in ports	Non-Western work habits and slow bureaucracy
Bicycle economy moving to cars	Strict advertising rules
China has joined World Trade Organization	Rising social unrest
APEC seeks free trade economies with China	Lack of intellectual property protection
Huge infrastructure projects	Lack of access to capital
Chinese partners help with bureaucracy	Lack of transparency in tax and labour regulations

Source: Adapted from Marilyn M. Helms. 'How to be successful in China: A SWOT analysis', *Competitiveness Review* 9(2) (1999): 1–10.

management. More systematic strategic planning practices are needed for entrepreneurs to guide and control the increasing decision making within the firm.

Problems of internal politics

Strategic planning practices are seen as one way to alleviate difficulties associated with the dysfunctional effects of internal politics on organisational decision making. By providing a formal process by which to channel partisan organisational priorities, strategic planning helps to control the politics that emerge as an entrepreneurial firm grows and develops organisational power seekers.

Environmental uncertainty

Research has suggested that the need for strategic planning is greater in the presence of increased environmental uncertainty. Thus, it appears likely that environmental uncertainty is a key factor influencing the strategic management activities of entrepreneurial firms with an increasingly life cycle-diverse product and market base.[7]

The entrepreneur's vision

To a large degree, venture planning is an extension of the entrepreneurial ego. Planning is the process of transforming entrepreneurial vision and ideas into action. This process involves three basic steps:

- **Step 1:** Commitment to an open planning process. Many entrepreneurs are suspicious of planning. They fear the loss of control and of flexibility. Quite often this fear is the chief obstacle to future success because it blinds the entrepreneur to the ideas of other knowledgeable people. This, in turn, closes the door on new ideas and greatly limits the benefits associated with an open planning process.

- **Step 2:** Accountability to a corporate conscience. This often takes the form of an advisory board, which is a highly effective form of corporate conscience. It can substantially enhance the functioning of entrepreneurial ego. This committee differs from a board of directors by its lack of legal standing and the fact its primary objectives are to increase the owner's sensitivity to larger issues of direction and to make the owner accountable, albeit on a voluntary basis.
- **Step 3:** Establishment of a pattern of subordinate participation in the development of the strategic plan. The planning process can create organisational energy, especially if key members of the organisation are instrumental in creating it. Interviews with key subordinates have revealed that the absence of the organisational and personal guideposts needed to chart and monitor a successful course of executive action tend to result in little support for the plan.[8]

These three steps may seem obvious to any entrepreneur attempting to translate their vision into a planning process. The fact remains, however, that such planning is too often lacking in many new small ventures.

The value of strategic planning

Research has shown that new ventures often do not go through a strategic planning process. Five reasons for this lack have been found.

- **Time scarcity:** Managers report that their time is scarce and difficult to allocate to planning in the face of day-to-day operating schedules.
- **Lack of knowledge:** Small firm owners/managers have minimal exposure to and knowledge of, the planning process. They are uncertain of the components of the process and the sequence of those components. The entrepreneurs are also unfamiliar with many planning information sources and how they can be used.
- **Lack of expertise/skills:** Small-business managers typically are generalists and they often lack the specialised expertise necessary for the planning process.
- **Lack of trust and openness**: Small firm owners/managers are highly sensitive and guarded about their businesses and the decisions that affect them. Consequently, they are hesitant to formulate a strategic plan that requires participation by employees or outside consultants.
- **Perception of high cost:** Small-business owners perceive the cost associated with planning to be very high. This fear of expensive planning causes many business owners to avoid or ignore planning as a viable process.[9]

Does strategic planning pay off for small business entrepreneurs? Of course, it all depends on the 'intensity' of planning, but much research shows that it does.[10]

In a study of Australian small-scale businesses, Griggs found that strategic planning intensity does have an effect on organisational performance and that Victorian firms used it more intensively than Tasmanian equivalents.[11] Ackelsburg and Arlow, in a study of 732 US firms, found that most of the small businesses did plan and that planning firms engaged in more goal-setting activities, forecasting and other planning procedures than non-planners.[12] Shuman, Shaw and Sussman surveyed the planning practices of the *Inc.* 500 and found that a majority of the entrepreneurs did not have a business plan when they started their firms but as the firms grew, the planning process became more prevalent and formalised.[13] In another study of 70 000 failed firms, lack of planning was identified as a major cause of failure,[14] and still another investigation demonstrated that firms engaged in strategic planning out-performed those that did not use such planning.[15]

A study conducted by Bracker and Pearson characterised the planning levels of small firms as structured strategic plans (SSP), structured operational plans (SOP), intuitive plans (IP) and unstructured plans (UP). Table 15.2 illustrates these types of plans. Firms using structured strategic planning outperformed all other planning categories with regard to overall financial performance.

Why strategic plans fail

For all their value, strategic plans don't work nearly often enough. Famous cases of failed strategic plans litter the history of business. Common reasons include:

- **Communications:** The plan isn't properly communicated. The front-line staff often is ignorant of the plan they're responsible for implementing. A leader has to repeat the mission and vision over and over again until people understand what they're supposed to do with it.
- **Leadership:** Strategic plans require a visionary and motivating leader with long-term commitment, someone who has the authority to implement. It won't work if the leader is reluctant to accept responsibility for tough decisions.
- **All ideas, no plan:** Here, intentions are undeveloped and not able to be implemented. The bright ideas people have may not be good on execution. The problem with most strategic plans is that they are long on 'what to do' and short on the 'how to do it'. There is little value in such plans. If any plan lands on your desk without the 'how to do it', send it back.[16]
- **Short vision:** Sounds like an oxymoron, but many strategic plans founder because they fail to think strategically. They focus on short-term needs and processes. Threats and opportunities are viewed from an operational, rather than strategic, viewpoint.
- **Overdeveloped:** The plan may well be over-baked and far too detailed. The plan becomes a laundry list. Perfection with the outlining function of the word processor is a time-waster.

TABLE 15.2: STRATEGIC PLANNING LEVELS

STRUCTURED STRATEGIC PLANS (SSP)	Formalised, written long-range plans covering the process of determining the major outside interests focused on the organisation Expectations of dominant inside interests Information about past, current and future performance Environmental analysis Determination of strengths and weaknesses of the firm and feedback – typically 3 to 15 years in nature
STRUCTURED OPERATIONAL PLANS (SOP)	Written short-range operational budgets and plans of action for current fiscal period The typical plan of action would include basic output controls, such as production quotas, cost constraints and personnel requirements
INTUITIVE PLANS (IP)	These formal plans are developed and implemented based on the intuition and experience of the firm's owner They are not written and are stored in the memory of the owner They are of a short-term duration, no longer than one year in nature They depend on objectives of the owner and the firm's present environment
UNSTRUCTURED PLANS (UP)	No measurable structured planning in the firm

Source: Jeffrey S. Bracker and John N. Pearson, 'Planning and financial performance in small, mature firms', *Strategic Management Journal* 7 (1986): 507.

ENTREPRENEURSHIP IN PRACTICE

MASTERING COMPETITIVE INTELLIGENCE

In general terms, competitive intelligence (CI) is defined as anything that could provide a competitive advantage. It is important for companies to learn competitors' information (and sometimes secrets) while protecting their own. According to experts, small companies tend to ignore the value of CI because the entrepreneur can't afford the time or because the entrepreneur thinks he or she knows everything there is to know about the environment. Fortunately, an aggressive CI effort doesn't require the work of a full-time employee. Part-time help or using customer service will provide enough feedback to make wise decisions. Competitive intelligence can help a company in many ways, including anticipating a competitor's next move, learning from a competitor's successes and failures and identifying new opportunities.

Planning is critical for competitive intelligence, which requires three strategic approaches:

- Collecting readily available information through databases, trade journals, trade shows and public documents.
- Researching facts buried in secondary sources, which can include details gained from the government on equipment and zoning.
- Gleaning secrets from intermediate sources, such as professionals, trade organizations, or a salesperson from a supplier in the industry.

In the latter of the three approaches, entrepreneurs must think of three things when conducting an interview: offence, defence and victory. They must think offensively when identifying competitor vulnerability, when exposing potential opportunities and when assessing the impact that their strategic actions might make on competitors. They must think defensively when identifying competitors' technological development, distribution channels, marketing tactics and financial information. Finally, they must fight for victory by using the competitive intelligence they've gathered, ranking the competition and preparing an attacking strategy.

One entrepreneur, Jay Bloom, has his own ways of staying on top of what the competition is and isn't doing. Bloom, once in risk management, stumbled upon his business idea (pet insurance) when his pet Labrador was diagnosed with a disease for which treatment was not covered on the dog's health insurance policy. His work experience helped him to do more CI work than most business owners, ultimately enabling him to be the best. Bloom subscribes to periodicals tailored for the pet and veterinary industries. He reads *Cat Fancy*, *Dog Fancy* and *Veterinary Economics* to find articles and advertisements about his rivals. Furthermore, Bloom employs a clipping agency that examines numerous publications and cuts out articles that contain predetermined words. As customer feedback is one of the most popular and useful ways to get information on what the competition is doing, Bloom gathers information collected by his customer service representatives and personally distributes it to the sales and marketing departments. His employees are also part of the ongoing pursuit for competitive intelligence: they sign up for the competition's policies. Lastly, PetAssure, Bloom's company, has financial backers keeping their eyes peeled and 2000 member veterinarians calling to discuss competitors' offers.

Experts recommend remembering two key things about competitive intelligence. If Entrepreneur A can get Entrepreneur B's information, Entrepreneur B can get Entrepreneur A's valuable information, too. One must not forget to protect personal plans, strategies and policies. Next, it is important to verify the material or data that is gathered. Knowledge is power only if it's accurate.

Source: Edward Parker, 'The spy fighters', *Success* (April 1994): 33–9; Mark Henricks, 'Spy away', *Entrepreneur* (March 2000): 98–104.

Fatal vision in strategic planning

The actual execution of a strategy is almost as important as the strategy itself. Many entrepreneurs make unintentional errors while applying a specific strategy to their own specific venture. Competitive situations differ and the particular application of known strategies must be tailored to those unique situations.

Researcher Michael E. Porter has noted five fatal mistakes entrepreneurs continually fall prey to in their attempt to implement a strategy.[17] Outlined next are these flaws and their explanation.

- **Flaw 1:** Misunderstanding industry attractiveness. Too many entrepreneurs associate attractive industries with those that are growing the fastest, appear to be glamorous, or use the fanciest technology. This is wrong, because attractive industries have high barriers to entry and the fewest substitutes. The more high-tech or high-glamour a business is, the more likely a lot of new competitors will enter and make it unprofitable.
- **Flaw 2:** No real competitive advantage. Some entrepreneurs merely copy or imitate the strategy of their competitors. That may be an easy tactic and it is certainly less risky, but it means an entrepreneur has no competitive advantage. To succeed, new ventures must develop unique ways to compete.
- **Flaw 3:** Pursuing an unattainable competitive position. Many aggressive entrepreneurs pursue a position of dominance in a fast-growing industry. However, they are so busy getting off the ground and finding people to buy their products that they forget what will happen if the venture succeeds. For example, a successful software program will be imitated quickly. So the advantage it alone gives cannot be sustained. Real competitive advantage in software comes from servicing and supporting buyers, providing regular upgrades, getting a company online with customers so their computer departments depend on the organisation. That creates barriers to entry. Sometimes, small companies simply cannot sustain an advantage.
- **Flaw 4:** Compromising strategy for growth. A careful balance must exist between growth and the competitive strategy that makes a new venture successful. If an entrepreneur sacrifices their venture's unique strategy in order to have fast growth, then the venture may grow out of business. Although fast growth can be tempting in certain industries, it is imperative that entrepreneurs maintain and grow their strategic advantage also.
- **Flaw 5:** Failure to explicitly communicate the venture's strategy to employees. It is essential for every entrepreneur to clearly communicate the company's strategy to every employee. Never assume employees already know the strategy. Always be explicit.

As Porter says:

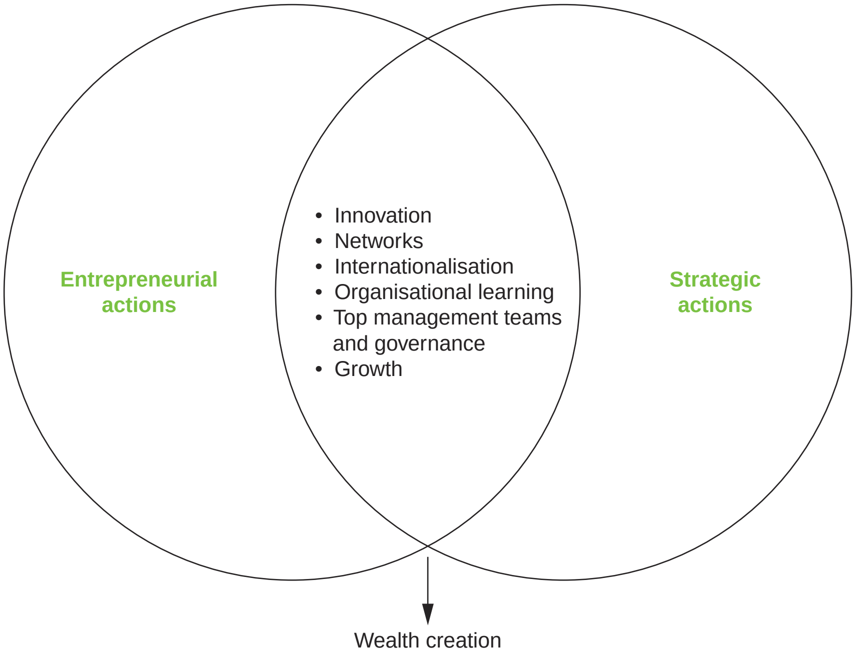
> One of the fundamental benefits of developing a strategy is that it creates unity, or consistency of action, throughout a company. Every department in the organization works toward the same objectives. But if people do not know what the objectives are, how can they work toward them? If they do not have a clear sense that low cost, say, is your ultimate aim, then all their day-to-day actions are not going to be reinforcing that goal. In any company, employees are making critical choices every minute. An explicit strategy will help them make the right ones.[18]

Entrepreneurial and strategic actions

Entrepreneurship and strategic management are both dynamic processes concerned with firm performance. Strategic management calls for firms to establish and exploit competitive advantages within a particular environmental context. Entrepreneurship promotes the search for competitive advantages through product, process and market innovation. A new venture is typically created to pursue the marketplace promise from innovations.

Researchers Ireland, Hitt, Camp and Sexton argue that entrepreneurial and strategic actions are often intended to find new market or competitive space for the firm to create wealth. Firms try to find fundamentally new ways of doing business that will disrupt an industry's existing competitive rules, leading to the development of new business models that create new competitive life forms. The degree to which the firm acts entrepreneurially in terms of innovativeness, risk-taking and proactivity is related to dimensions of strategic management. Specific domains have been delineated from the commonalities of entrepreneurial and strategic actions. These domains

FIGURE 15.3 THE INTEGRATION OF ENTREPRENEURIAL AND STRATEGIC ACTIONS



Source: R. Duane Ireland, Michael A. Hitt, S. Michael Camp and Donald L. Sexton, 'Integrating entrepreneurship and strategic management actions to create firm wealth', *Academy of Management Executive* 15(1) (February 2001): 49–63.

are: innovation, networks, internationalisation, organisational learning, top management teams and governance, and growth (see figure 15.3). Understanding the critical intersections of these specific domains allows entrepreneurs to increase their knowledge which, in turn, leads to higher quality entrepreneurial and strategic actions.[19]

Strategic positioning: The entrepreneurial edge

Strategic competition can be thought of as the process of perceiving new positions that attract customers from established positions or draw new customers into the market. In principle, incumbents and entrepreneurs face the same challenges in finding new strategic positions. In practice, entrepreneurs often have the edge.

Strategic positionings are often not obvious and finding them requires creativity and insight. Entrepreneurs often discover unique positions that have been available but simply overlooked by established competitors. In addition, entrepreneurial ventures can prosper by occupying a position that a competitor once held but has ceded through years of imitation and straddling. (See table 15.3 for alternative views of strategy.)

There are certain fundamental approaches to strategic positioning that include establishing and defending a defensible position, leveraging resources to dominate a market and pursuing opportunities to establish new markets (see table 15.4). Entrepreneurs must understand that the pursuit of opportunities provides the best choice for capitalising on change.

TABLE 15.3: ALTERNATIVE VIEWS OF STRATEGY

THE IMPLICIT STRATEGY MODEL OF THE PAST DECADE	SUSTAINABLE COMPETITIVE ADVANTAGE
One ideal competitive position in the industry	Unique competitive position for the company
Benchmarking of all activities and achieving best practice	Activities tailored to strategy
Aggressive outsourcing and partnering to gain efficiencies	Clear trade-offs and choices vis-à-vis competitors
Advantages rest on a few key success factors, critical resources and core competencies	Competitive advantage arises from fit across activities
Flexibility and rapid responses to all competitive and market changes	Sustainability comes from the system, not the parts activity
	Operational effectiveness a given

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TABLE 15.4: STRATEGIC APPROACHES: POSITION, LEVERAGE, OPPORTUNITIES

STRATEGIC LOGIC	Establish position	Leverage resources	Pursue opportunities
STRATEGIC STEPS	Identify an attractive market Locate a defensible position Fortify and defend	Establish a vision Build resources Leverage across markets	Jump into the confusion Keep moving Seize opportunities Finish strong
STRATEGIC QUESTION	Where should we be?	What should we be?	How should we proceed?
SOURCE OF ADVANTAGE	Unique, valuable position with tightly integrated activity system	Unique, valuable, inimitable resources	Key processes and unique simple rules
WORKS BEST IN	Slowly changing, well-structured markets	Moderately changing, well-structured markets	Rapidly changing, ambiguous markets
DURATION OF ADVANTAGE	Sustained	Sustained	Unpredictable
RISK	It will be too difficult to alter position as conditions change	Company will be too slow to build new resources as conditions change	Managers will be too tentative in executing on promising opportunities
PERFORMANCE GOAL	Profitability	Long-term dominance	Growth

Source: Reprinted by permission of *Harvard Business Review* from Kathleen M. Eisenhardt and Donald N. Sull, 'Strategy as simple rules' (January 2001): 109. Copyright © 2001 by the Harvard Business School Publishing Corporation; all rights reserved.

Most commonly, new positions open up because of change. New customer groups or purchase occasions arise; new needs emerge as societies evolve; new distribution channels appear; new technologies are developed; new machinery or information systems become available. When such changes happen, entrepreneurial ventures, unencumbered by a long history in the industry, can often more easily perceive the potential for a new way of competing. Unlike incumbents, these organisations can be more flexible because they face no trade-offs with their existing activities.[20]

Implementing a strategic plan

New ventures can use a number of approaches to implement a strategic plan. The specific choice will be a function of the entrepreneur's personality and the environment in which the firm operates. Four basic approaches presented in this chapter are the **opportunity management approach**, the **milestone planning approach**, the **entrepreneurial strategy matrix** and the **multistaged contingency approach**. Each offers a comprehensive approach to strategic planning, although in practice entrepreneurs tend to draw the best elements from each rather than choose one while ignoring the others.

Opportunity management approach

The opportunity management approach is based most heavily on environmental analysis.[21] The process begins with the construction of a strategic profile that considers:

- an evaluation of internal resources
- a forecast of external market conditions
- an evaluation of company strengths and weaknesses
- a formulation of business objectives (see figure 15.4).

Quite often a formal worksheet is constructed to help the entrepreneur conduct a detailed analysis. Figure 15.5 provides an example of a form that can be used to evaluate company strengths and weaknesses. By saving these worksheets and comparing them on a year-by-year basis, the organisation also can make a running analysis of opportunity management considerations over time and note the strategic changes influencing enterprise direction. Figure 15.5 provides a template which rates the key business elements by contribution to business success in the principal market/industry and the company compatibility.

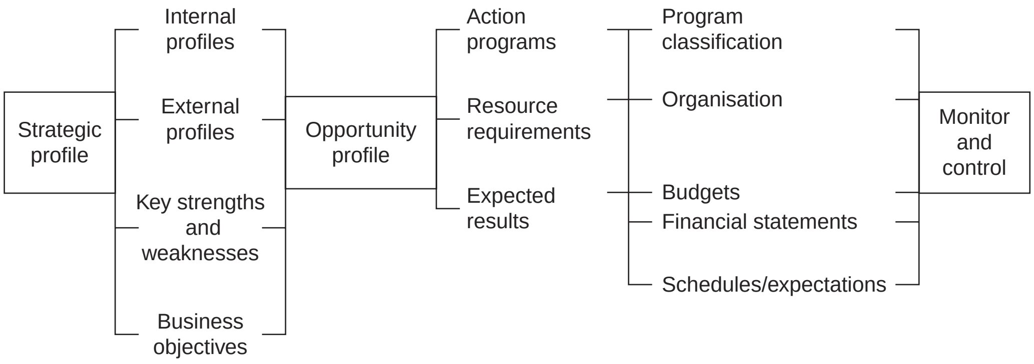
On the basis of this strategic profile, an opportunity profile is constructed. Figure 15.5 is designed to help the enterprise gain maximum advantage from its resources. In this profile, action programs are designed, resources are allocated and expected results are identified. Implementation and control steps follow, including organising personnel, establishing budgets, formulating schedules and analysing financial statements. On the basis of the results, a new strategic profile and/or opportunity profile is constructed and the process begins anew.

The opportunity management approach is popular because it is easy to understand and because implementation can be adjusted to meet changing conditions. The approach is based heavily on the first law of strategy – lead from strength – which means doing what one does best.

Milestone planning approach

The milestone planning approach is based on the use of incremental goal attainment that takes a new venture from start-up through strategy reformulation.[22] Each important step is completed

FIGURE 15.4 **THE OPPORTUNITY MANAGEMENT APPROACH**



Source: Adapted from Dean F. Olson and Omar L. Carey, *Opportunity Management: Strategic Planning for Smaller Businesses* (Reston, VA: Reston, 1985): 59.

FIGURE 15.5 KEY STRENGTHS AND WEAKNESSES PROFILE

Key success requirements **Year** ________

Factor	**Principal market/industry success requirements (importance 1–10)**	**Company compatibility rating (1–10)**
Marketing		
Production		
Innovation		
Finance		
Management		
Location		
Employee skills		

Company strengths	**Company weaknesses**

before moving on to the next one and all are linked together into an overall strategic plan. Three major advantages of milestone planning are:

- the use of logical and practical milestones
- the avoidance of costly mistakes caused by failure to consider key parts of the plan
- a methodology for replanning, based on continuous feedback from the environment.[23]

Table 15.5 provides an example of a schedule that might be used in the milestone planning approach.

The milestone planning approach is popular with new ventures that are technical in nature, have multiple phases, or involve large sums of money. The approach is also used when close linkage between milestones or major objectives is needed. In contrast to opportunity management, milestone planning is more comprehensive and typically involves a greater investment of time and money.

An entrepreneurial strategy matrix model

Based on the structure of traditional strategy matrices (such as the Boston Casualty Group [BCG] matrix) that have been used for portfolio analysis, researchers Sonfield and Lussier developed an entrepreneurial strategy matrix that measures risk and innovation.[24]

For the purpose of this matrix, innovation is defined as the creation of something new and different. In terms of measurement, the newer and more different the proposed product or service is, the higher it would be scored on an innovation measurement scale.

TABLE 15.5: **A MILESTONE PLANNING APPROACH**

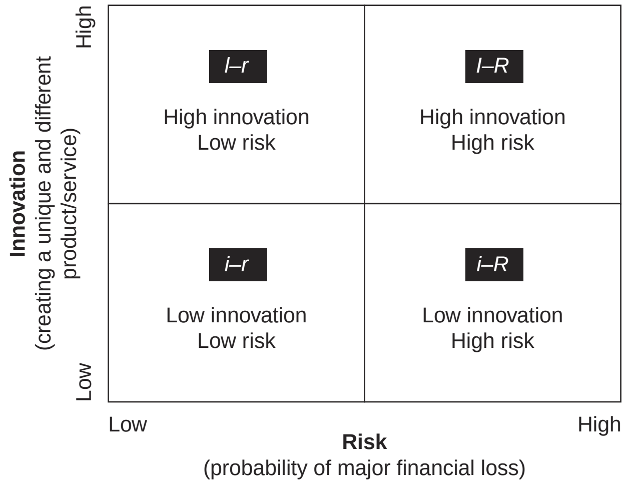
MILESTONE	DESCRIPTION	KEY QUESTIONS
1	Formulation of the basic idea for the new venture	Has a need for the new venture been established?
2	Completion of a prototype (in this case, a new product)	What initial assumptions were made about development time and costs and how have they changed? What has been learned about labour, material and equipment and how does this affect pricing plans? Do the product's characteristics still fit with the original concept and plan?
3	Raising the seed capital	Is the venture acceptable to investors? How is the venture being perceived in the marketplace?
4	Conducting a pilot operation	Have any of the venture's basic assumptions been challenged in the initial operations? Check specifically: • suitability and costs of materials • processing costs and skills • training needs for production personnel • reject percentages and costs and quality-control requirements.
5	Market testing	Why are customers buying the product? Why are they not buying the product? Is the product different from or superior to the competition? How should estimates of achievable market share and size be modified?
6	Start-up of operations	Are selling and delivery commitments accurate? Do the market and financing requirements make sense?
7	Sale to first major account	How does the product compare with that of the competition? Should the initial selling method be continued or changed?
8	Reaction to the competition	What counter-moves should be taken in response to the competition? What changes in advertising, promotion, sales, inventory, or other operations are likely?
9	Redesign or redirection of strategy	What differences exist between the market and what the venture offers currently? What changes are needed in pricing, financing, design, marketing, or other aspects of the strategy?

Risk is defined as the probability of major financial loss. What are the chances of the entrepreneurial venture failing? How serious would be the resulting financial loss? Whereas many ways exist to increase innovation, reducing risk largely focuses on financial factors, with a secondary consideration of self-image and ego.

The model allows even the most inexperienced entrepreneurs to characterise their new or existing venture situations and identify appropriate strategies. The model places innovation on the vertical axis and risk on the horizontal axis. It denotes the levels of these two variables by using *I* and *R* for high levels and *i* and *r* for low levels (see figure 15.6).

The value of the entrepreneurial strategy matrix is that it suggests appropriate avenues for different entrepreneurs. When the entrepreneur identifies the cell that best describes the new or

FIGURE 15.6 THE ENTREPRENEURIAL STRATEGY MATRIX: INDEPENDENT VARIABLES



Source: Matthew C. Sonfield and Robert N. Lussier, 'The entrepreneurial strategic matrix: A model for new and ongoing ventures', Reprinted with permission from *Business Horizons* (May/June 1997), by the trustees at Indian University, Kelley School of Business.

existing venture being contemplated, then certain strategies are indicated as more likely to be effective (see figure 15.7).

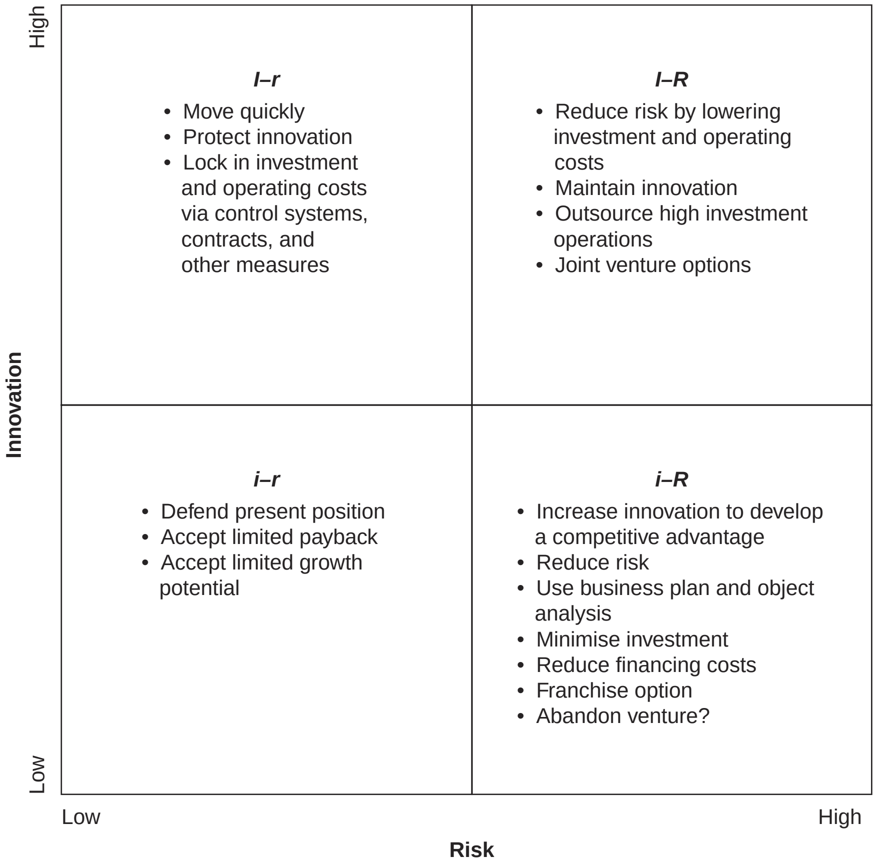
It should be obvious that certain cells are more advantageous than others. A high-innovation/low-risk venture is certainly preferable to a low-innovation/high-risk one. Yet for every venture found in *I–r*, large numbers of ventures can be found in *i–R*. Risk is more common than innovativeness in the business world.

The strategic implications of the matrix are twofold. First, entrepreneurs will find certain cells preferable to others and one set of appropriate strategies involves moving from one cell to another. Second, such movement is not always possible for an entrepreneur, so the appropriate strategies involve reducing risk and increasing innovation within a cell.

Multistage contingency approach

A final approach presented here is the multistage contingency approach. This process was developed by reviewing the various approaches to entrepreneurship. Three distinct variables are critical to any strategic analysis: the individual, the venture and the environment. However, the stages of any venture (idea, pre-venture, start-up, early growth, harvest) are also critical to strategic analysis. In addition, a career perspective should be considered, which means the entrepreneur's career stage (early, middle, or late) can be a decisive factor when differentiating the variables within the venture development stages. Thus, it may be necessary to visualise entrepreneurial strategies as contingencies. In other words, all of the evolving and emerging conditions involved with any entrepreneurial pursuit cause a constant dynamism. If newly emerging entrepreneurial issues such as global expansion, the growth in numbers of women entrepreneurs and corporate entrepreneurship are also introduced, then a model of entrepreneurial strategy would be multidimensional, multistage and contingency based. Table 15.6 attempts to capture all of these factors in a three-dimensional model that emphasises the need for contingency strategies based on the evaluation and assessment of the various elements.[25]

FIGURE 15.7 THE ENTREPRENEURIAL STRATEGY MATRIX: APPROPRIATE STRATEGIES



	Low	High
High	***I–r*** • Move quickly • Protect innovation • Lock in investment and operating costs via control systems, contracts, and other measures	***I–R*** • Reduce risk by lowering investment and operating costs • Maintain innovation • Outsource high investment operations • Joint venture options
Low	***i–r*** • Defend present position • Accept limited payback • Accept limited growth potential	***i–R*** • Increase innovation to develop a competitive advantage • Reduce risk • Use business plan and object analysis • Minimise investment • Reduce financing costs • Franchise option • Abandon venture?

Source: Sonfield and Lussier, 'The entrepreneurial strategic matrix', Reprinted with permission from *Business Horizons,* by the trustees at Indian University, Kelley School of Business.

Although all of these variables must be examined from a strategic perspective, the traditional strategic management process may provide assistance. As discussed earlier in the chapter, this perspective is summarised in the acronym SWOT (strengths, weaknesses, opportunities and threats).[26] Thus, table 15.6 shows entrepreneurial contingency issues for the purpose of entrepreneurial development and, eventually, entrepreneurial continuation.

THE NATURE OF OPERATIONAL PLANNING

Having examined the various factors and theories relating to strategic planning, we now review some of the basic concepts involved in operational planning.

Operational planning, also referred to as short-range planning or functional planning, consists of the specific practices established to carry out the objectives set forth in the strategic plan. The operational plan is thus an extension of the strategic planning process. In the areas of

TABLE 15.6: ENTREPRENEURIAL STRATEGY: A CONTINGENCY MULTISTAGE APPROACH

STRATEGIC ENTREPRENEURIAL ASSESSMENT	NEW-VENTURE INITIATION	ENTREPRENEURIAL DEVELOPMENT AND CONTINUATION	EMERGING ENTREPRENEURIAL ISSUES
Opportunity evaluation SWOT analysis (strengths/weaknesses/opportunities/threats)	New-venture initiation • Creativity • Assessment evaluation • Feasibility The business plan process • Definition • Benefits • Business plan development	Entrepreneurial growth and development • Understanding the entrepreneurial company Managing paradox and contradiction Acquisition of a venture Valuation and succession of entrepreneurial ventures • Methods of valuation • Succession strategy	Corporate entrepreneurship International: The global expansion Women entrepreneurs Family business Entrepreneurial careers

Source: Donald F. Kuratko and Harold P. Welsch, *Entrepreneurial Strategy* (Fort Worth, TX: The Dryden Press, 1994): 10.

ENTREPRENEURIAL EDGE

BETTER PLANNING = BETTER PERFORMANCE

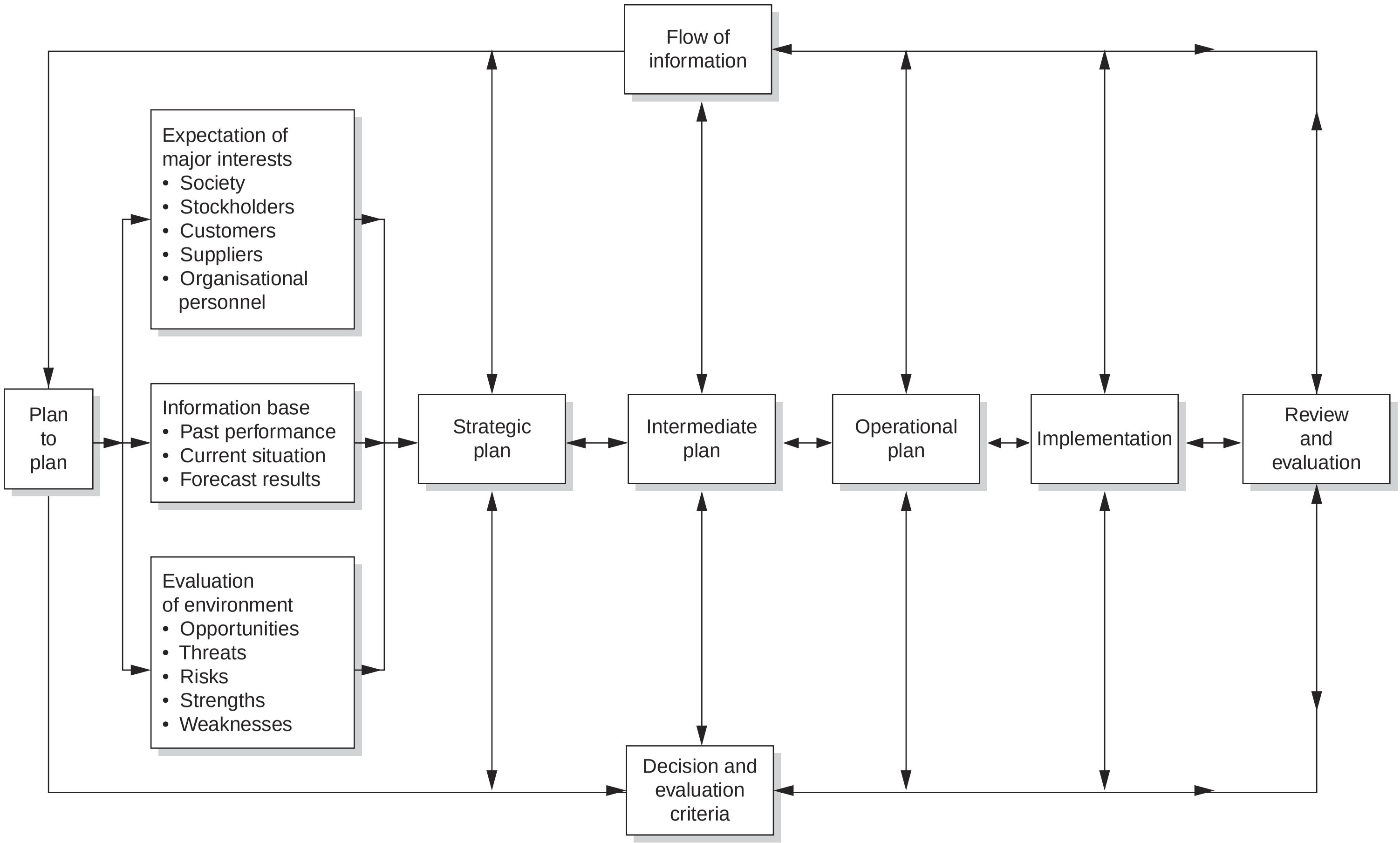
Company executives repeatedly make the effort to buckle down behind closed doors once a year to pump out an operational plan to satisfy shareholders and investors. They take a snapshot of the business and put their projections on paper, but fail to follow up or use those projections as a benchmark throughout the year at hand. When done right, using strategic planning to support an operational plan provides a corporate weapon, positioning the company to overcome obstacles and succeed at their annual plan.

At Springfield Remanufacturing Corporation, strategic planning is a year-round practice. Around April, sales and marketing leaders receive outlines requesting certain information that they must compile and present to company leaders and board members in early summer. Following are the requirements that keep this company on track and employees involved throughout the year.

- **Market analysis:** Current business conditions are laid out. New government regulations and technological advancements are addressed if they pertain to the operation and performance of the company.
- **Year-to-date performance:** The first half of the year is reviewed, comparing original unit and dollar projections with actual numbers and deviations are discussed.
- **May–December projections:** Sales are projected for the remainder of the year and compared to the original second-half projections. Any deviations are once again discussed, as they are usually attributed to changes in the external or internal environment.
- **Price increases and decreases:** Planned price changes are explained and justified.
- **Promotions/advertising:** The success of executed programs and the potential of future plans are presented. The expenditure budget is also reviewed.
- **Budget review:** Actual sales expenses are compared to planned sales expenses. The year-end status is altered or projected based on the current figures.
- **Competitive data:** Detailed information about competitors' product lines and marketing programs is identified. SWOT analyses are discussed.
- **Contingency planning:** Contingency plans, in the event of unexpected occurrences, are reviewed and summarized.

Source: Karen Carney, 'Mid-year planning made easy', *Open-Book Management: Bulletin* (May 1999).

FIGURE 15.8 THE OVERALL PLANNING PROCESS FOR A VENTURE



Source: Richard M. Hodgetts and Donald F. Kuratko, *Management*, 3rd edn (San Diego: Harcourt Brace Jovanovich, 1991), 171.

finance, marketing, production and management, functional policies need to be established in order to implement the goals determined in the strategy.

Research shows that small-business managers more commonly perform operational planning than strategic planning. In addition, operational planning has been established as a critical component in the overall planning process of a small firm.[27]

Operational planning process

The overall planning process incorporates all of the factors involved in strategic planning and the implementation tools of operational planning (see figure 15.8). Specifically, the tools applied in the functional areas of the business will be a key to implementation of the planning process. Some of the tools most widely known and used are budgets, policies and procedures.

Budgets are planning devices used to establish future plans in financial terms. They are valuable tools in the operational sense, because they provide a set of measuring points by which the implemented plans can be evaluated. Effective budgeting is based on realistic estimates and appropriate allocations.

Policies are the fundamental guides for the venture as a whole. Each department or functional area needs to establish the policies that will guide its operations on a day-to-day basis. For example, sales policies, financial policies, credit policies and manufacturing policies determine the daily course of business. Established policies allow entrepreneurs the freedom to work more on strategy since each specific functional problem does not have to be analysed. Policies are guidelines to decision making and action. They delimit the area a decision is made in and ensure that the decision is consistent with objectives.[28]

Although procedures are similar to policies, they are usually policies that have been standardised as a continuing method. For example, credit approval may follow specific credit policies, but eventually the steps that are followed can be completely standardised. Thus procedures are often referred to as *standard operating procedures*.

Each of these operating tools represents methods for implementing and evaluating the goals of strategic planning. Thus operational planning becomes the ongoing phase that brings a venture's strategic plan to action.

SUMMARY

Two fields – strategic management and entrepreneurship – have quite different origins. But today strategists must take advantage of the entrepreneurial mindset and entrepreneurs must take a strategic approach to how they perceive opportunities, mobilise their resources and exploit opportunity.

Although many ways of strategically planning a venture exist, all have one common element: each is an extension of the entrepreneur's vision – each takes the owner's concept of the business and puts it into action.

Entrepreneurs do not use strategic planning for many reasons, among them scarcity of time, lack of knowledge about how to plan, lack of expertise in the planning process and lack of trust in others.

A number of benefits to strategic planning exist. In particular, studies have shown that small firms that use this process tend to have better financial performance than those that do not.

Four ways to carry out a strategic plan exist. The opportunity management approach relies heavily on environmental analysis. When using this approach, the entrepreneur will make an evaluation of the firm's internal resources, a forecast of external market conditions and an evaluation of the company's strengths and weaknesses. Based on the results, objectives will be formulated and then pursued. The milestone planning approach is based on the use of incremental goal attainment that takes a new venture from start-up through strategy reformulation. Each major step is completed before moving on to the next one and all are linked together in an overall strategic plan. The entrepreneurial strategy matrix model measures innovation and risk through a matrix that allows entrepreneurs to characterise their new or existing venture situations and identify appropriate strategies. Finally, the multistage contingency approach combines the stages of a venture with distinct variables that must be continually assessed for proper planning.

The operational plan is the implementation phase that includes specific tools for proper action. Sometimes referred to as functional planning, the operational plan uses budgets, policies and procedures as methods for carrying out the objectives established in the strategic plan.

KEY TERMS AND CONCEPTS

entrepreneurial actions
entrepreneurial strategy matrix
milestone planning approach
multistage contingency approach
operational planning
opportunity management approach
policies
Strategic actions
strategic planning
strategic positionings
sustainable competitive advantage
SWOT analysis

REVIEW AND DISCUSSION QUESTIONS

1. How are strategic planning and entrepreneurial thinking related?
2. In what way does an entrepreneur's vision affect the company's strategic plan?
3. How is the strategic plan of an engineer/scientist entrepreneur likely to be different from that of an entrepreneur whose primary strength is in the manufacturing area?
4. What are the three basic steps involved in transforming entrepreneurial vision and ideas into action?
5. Give three reasons why many entrepreneurs do not like to formulate strategic plans.
6. Describe five difficulties entrepreneurs face in long-range planning.
7. Does strategic planning really pay off for small ventures? Why or why not?
8. A new-venture entrepreneur is considering formulation of a strategic plan. However, she is concerned this effort will have little value for her. Is she right or wrong?
9. How can an entrepreneur use an opportunity management approach when formulating and implementing a strategic plan?
10. What are the advantages of an opportunity management approach to strategic planning?
11. What types of ventures are most likely to profit from an opportunity management approach to strategic planning?
12. How does the milestone planning approach to strategic planning work?
13. What type of venture might profit from the use of a milestone planning approach? Defend your answer.
14. Describe the entrepreneurial strategy matrix and explain why it is effective for entrepreneurs.
15. What benefits does the multistage contingency approach offer to new-venture entrepreneurs?
16. What is operational planning? What specific tools are used?
17. How does operational planning fit with strategic planning?

EXPERIENTIAL EXERCISE

STRATEGIC PLANNING IN ACTION

Go to the library and look through the past issues of your local magazine for entrepreneurs. Pick out two stories about new or growing ventures that have been involved in formulating a strategic plan. Gather as much information as you can and then for each firm answer the following questions:

1. What did the company's strategic plan involve?
2. How successful was the plan?
3. What conclusions can you draw regarding the value of strategic planning to this company?

EXPERIENTIAL EXERCISE
SWOT ANALYSIS

Take your own company or a company with which you are familiar and conduct a SWOT analysis. Here is a simple 2 x 2 matrix that can be used to analyse your company:

STRENGTHS: Potentially positive *internal* factors • • • • • • • • • • • •	OPPORTUNITIES: Potentially positive *external* factors • • • • • • • • • • • •
WEAKNESSES (FLAWS): Potentially negative *internal* factors • • • • • • • • • • • •	THREATS: Potentially negative *external* factors • • • • • • • • • • • •

EXPERIENTIAL EXERCISE
MILESTONE PLANNING

You can use this blank form to break down your own new business into measurable phases. Each phase culminates with a milestone event. Start with 'Milestone 3' and describe your status quo. Then go to the two previous lines and describe the two 'most major' prior milestone events that you have already achieved. Finally, continue to the bottom.

MILESTONE PLANNING MATRIX

MILESTONE NO.	WHAT EVENT WILL HAVE ALREADY OCCURRED?	WHAT IS THE SIGNIFICANCE OF ACHIEVING THIS MILESTONE?	WHAT RESOURCES OR OTHER INPUTS DO YOU NEED TO ACHIEVE THIS MILESTONE?	MONTH 200X
Milestone 1				
Milestone 2				
Milestone 3 (current situation)				
Milestone 4				
Milestone 5				
Milestone 6				
Milestone 7				

CASE 15.1:
THE BANKER'S REQUEST

Elizabeth Edwards opened her first restaurant three years ago. Since then she has opened two more. Elizabeth caters to family dining and has developed a loyal following. Many families come to her restaurant on a weekly basis. Friday, Saturday and Sunday evenings are so popular that reservations are not accepted.

Last year Elizabeth's three units grossed $1.2 million. Her accountant estimates that this year the combined total will be in the neighbourhood of $1.45 million.

The first restaurant was started with funds from her grandfather. Since then, internal profits have been sufficient to handle most of her operating needs. However, her expansion costs for the second and third restaurants were taken care of through a bank loan.

Elizabeth is now thinking of opening a fourth restaurant. Her banker is willing to lend her the necessary funds but thinks this would also be a good time for her to draw up a strategic plan. 'You are getting too big to operate on a day-to-day basis', her banker said. 'You need a long-range plan that will help you manage your overall operations. You need to start putting more focus on where you want to be in five years and how you are going to get there'. Her banker would like Elizabeth to submit this plan with her new loan application. 'With this plan and your excellent record here at the bank', she assured her, 'I am sure your application will fly through the loan committee'.

Elizabeth is not pleased with her banker's suggestion. First, she is unsure of how to draw up a strategic plan. It seems to her it would take a great deal of effort and probably not have any real value for her business. Second, she sees the banker's suggestion as nothing more than an attempt to cover herself should the loan fall into default. 'I suppose when they lend you money they have to be able to justify the loan. In my case, they will have loaned me a substantial amount of money, so they want to cover their actions with the board of directors by showing that I have not only provided collateral for the loan but also provided them a detailed plan regarding the future operations of the enterprise. I can't say that I blame them, but I really don't think that plan has any practical value for me. Mostly it will be used to support the loan. Nevertheless, I want the loan, so I'll write the plan.'

Elizabeth has tentatively scheduled construction of the new restaurant to begin in 90 days. She would like to have all of the paperwork associated with the application completed within 30 days. 'I don't think it will be too difficult to write a strategic plan. I'll just pull together some of my current financial statements, write a brief description of the firm and its long-run objectives and submit the plan along with the loan application sometime early next month.'

QUESTIONS

1 In Elizabeth's case, what approach would you recommend she use for writing her plan? Why?
2 What specific steps should Elizabeth take for writing the plan? Will her current idea of what to include in the plan be of any value?
3 What benefits would a strategic plan have for Elizabeth's firm? Be complete in your answer.

CASE 15.2:
A TWO-PHASE APPROACH

Since its founding six months ago, Abdul Reezal's electronics repair shop in Kuala Lumpur has been booming. Abdul repairs electronic household appliances, including portable telephones, VCRs, televisions, radios and stereo equipment. Usually it does not take a great deal of time to make the repairs. For example, most portable phones have battery-related problems. All the repairer has to do is replace the battery and recharge the unit. The cost of a battery is around 15 Malaysian ringgit and the service charge is MYT135. So despite the fact the rent is high and the store has to keep a large supply of inventory on hand, profits are well over 40 per cent.

Abdul has been doing so well he has been thinking about opening a second store. However, he realises that if this new venture does not pay off, he could be in financial straits. Before going any further, he has decided to sit down and plan his moves. The plan is going to have two major phases. The first phase will focus on areas such as the direction in which the store currently is heading, projected sales for the next two years, competitive countermoves, responses to these countermoves and overall financial performance. Abdul believes it will not be long before competitors begin to move into his market niche. 'You can't make tremendous return on investment without attracting serious competition', he has told his wife. 'If I want to continue being successful, I have to figure out how to stop these guys from invading my market. I have to have a game plan.' The second phase of the plan will incorporate the new store and will examine the impact of this expansion on overall operations.

Abdul believes this two-phase approach will help him plan for current operations and future expansion. He also feels it will be easier to plan for the expansion if he first lays the groundwork with a basic strategic plan. Abdul's biggest problem right now is that he does not know much about strategic planning for new ventures. He is thinking he might drop by the local university and talk to one of the professors who teaches entrepreneurship or business strategy and get some advice on how to proceed.

QUESTIONS

1. If you were advising Abdul, what approach would you recommend he use for putting together his strategic plan? Why?
2. What advantages would your proposed approach have over other approaches? Compare and contrast at least three approaches.
3. How would your approach allow Abdul to incorporate expansion planning into the overall plan?

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Publication date: 22 January 2002
Revision date: 21 June 2002
Author(s): Allen Grossman, James E. Austin, Daniel F. Curran
Product number: 9-302-002

The National Foundation for Teaching Entrepreneurship (NFTE), is a successful non-profit organisation poised on the verge of explosive growth. For NFTE to go to the next step of its development, it must radically change the organisation and introduce both structure and discipline to themselves and others. This will require a number of difficult choices and behavioural changes. Was this a good partnership? Can NFTE succeed in making the necessary changes? Is the plan appropriate for the organisation?

Strategy as Simple Rules

Publication date: 1 January 2001
Author(s): Kathleen M. Eisenhardt, Donald Sull
Product number: 5858

In this article – the third in an HBR series by Kathleen Eisenhardt and Donald Sull on strategy in the new economy – the authors ask, what are the sources of competitive advantage in high-velocity markets? The secret, they say, is strategy as simple rules. In strategy as simple rules, advantage comes from successfully seizing fleeting opportunities. Simple rules fall into five broad categories: how-to rules, boundary conditions, priority rules, timing rules and exit rules. Companies must follow the rules religiously and avoid the temptation to change them too frequently. A consistent strategy helps managers sort through opportunities and gain short-term advantage by exploiting the attractive ones.

Go2Xpert Ltd: Finding the Right China Strategy

Publication date: 11 August 2004
Author(s): Ali Simon Lam, Vincent Mak, Pauline Ng
Product number: HKU285

Illustrates how Hong Kong SME entrepreneurs can find the right opportunities offered by the Chinese market. Sheds light on how SMEs need to change their strategy, manage their operations and market their business to make the best use of a rapidly changing business environment.

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16

MANAGING ENTREPRENEURIAL GROWTH

> In tomorrow's entrepreneurial economy, managers and their companies are likely to face important but exciting challenges. Innovation will become even more important in tomorrow's economy than it already is today. Innovation in every part of the firm's systems, operations, culture and organisation will gain greater importance. Process innovation, too, will increase in importance. Managing and fostering these innovations will continue to be a key managerial challenge.
>
> Shaker A. Zahra, 'The changing rules of global competitiveness in the 21st century'[1]

CHAPTER OBJECTIVES

1. To discuss the five stages of a typical venture life cycle – development, start-up, growth, stabilisation and innovation or decline
2. To explore the elements involved with an entrepreneurial firm
3. To survey the ways entrepreneurs build adaptive firms
4. To examine the transition that occurs in the movement from an entrepreneurial style to a managerial approach
5. To examine the five types of risks that growing entrepreneurs face – growth, technology and production, marketability and competing, financial, and team and management
6. To identify the key factors that play a major role during the growth stage
7. To discuss the complex management of paradox and contradiction
8. To introduce the steps useful for breaking through the growth wall

INTRODUCTION

A defining characteristic of an entrepreneurial venture is its motivation to grow. Managing entrepreneurial growth may be the most critical tactic for the future success of business enterprises. After initiation of a new venture, the entrepreneur needs to develop an understanding of management change. This is a great challenge, because it often encompasses the art of balancing mobile and dynamic factors.[2]

Thus, the survival and growth of a new venture require that the entrepreneur possess both strategic and tactical skills and abilities. Which specific skills and abilities are needed depend in part on the venture's current development. Figure 16.1 illustrates the typical venture life cycle.

The purpose of this chapter is to examine the venture characteristics, managerial abilities and entrepreneurial needs and drives in relation to the stages of the venture's development. Specifically, attention is concentrated on the **growth stage**, since this is the phase during which a venture usually reaches major crossroads in the decisions that affect its future. Managing growth can be a formidable challenge to the successful development of any venture.

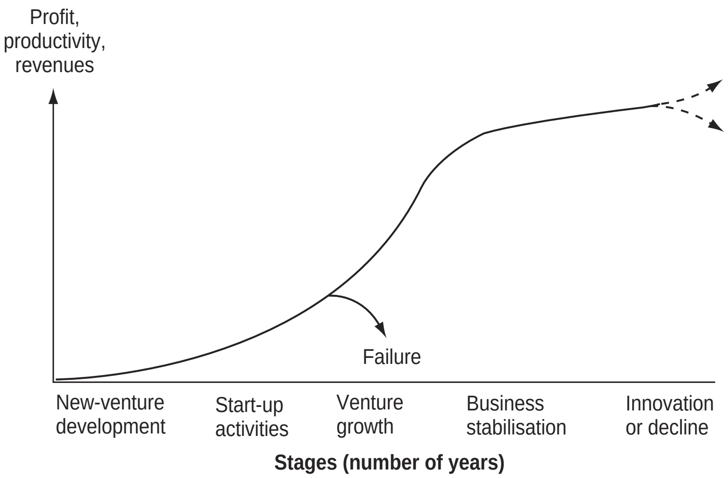
VENTURE DEVELOPMENT STAGES

As noted, figure 16.1 presents the traditional **life cycle stages** of an enterprise. These stages include new-venture development, start-up activities, growth, stabilisation and innovation or decline. Other authors have described these stages in different terms. For example, Alfred Chandler has presented a firm's evolution in the following stages:

- initial expansion and accumulation of resources
- rationalisation of the use of resources
- expansion into new markets to assure the continued use of resources
- development of new structures to ensure continuing mobilisation of resources.[3]

These four phases are, in effect, the same major stages illustrated in figure 16.1, with the exception of stabilisation. In short, authors generally agree regarding a venture's life cycle. Presented next are the five major stages.

FIGURE 16.1 A VENTURE'S TYPICAL LIFE CYCLE



New-venture development

The first stage, **new-venture development**, consists of activities associated with the initial formulation of the venture. This initial phase is the foundation of the entrepreneurial process and requires creativity and assessment. In addition to the accumulation and expansion of resources, this is a creativity, assessment and networking stage for initial entrepreneurial strategy formulation. The enterprise's general philosophy, mission, scope and direction are determined during this stage.

Start-up activities

The second stage, **start-up activities**, encompasses the foundation work needed for creating a formal business plan, searching for capital, carrying out marketing activities and developing an effective entrepreneurial team. These activities typically demand an aggressive entrepreneurial strategy with maximum effort devoted to launching the venture. It is typified by strategic and operational planning steps designed to identify the firm's competitive advantage and to uncover funding sources. Marketing and financial considerations tend to be paramount during this stage.[4]

Growth stage

The growth stage often requires major changes in entrepreneurial strategy. Competition and other market forces call for the reformulation of strategies. For example, some firms find themselves 'growing out' of business because they are unable to cope with the growth of their ventures.[5] Highly creative entrepreneurs sometimes are unable, or unwilling, to meet the administrative challenges that accompany this growth stage. As a result, they leave the enterprise and move on to other ventures. Steven Jobs of Apple Computer was forced out of his firm during this stage. His creative ideas were detrimental to the growth of the venture. The firm needed a managerial entrepreneur to run the operation; Jobs had neither the expertise nor the desire to assume this role.[6]

This growth stage presents newer and more substantial problems than those the entrepreneur faced during the start-up stage.[7] These newer challenges force the entrepreneur into developing a different set of skills while maintaining an 'entrepreneurial perspective' for the organisation.[8] The growth stage is a transition from entrepreneurial one-person leadership to managerial team-oriented leadership.

Business stabilisation

The **stabilisation stage** is a result of both market conditions and the entrepreneur's efforts. During this stage a number of developments commonly occur, including increased competition, consumer indifference to the entrepreneur's good(s) or service(s) and saturation of the market with a host of 'me too' look-alikes. Sales often begin to stabilise and the entrepreneur must begin thinking about where the enterprise will go over the next three to five years. This stage is often a 'swing' stage in that it precedes the period when the firm either swings into higher gear and greater profitability or swings toward decline and failure. During this stage innovation is often critical to future success.

Innovation or decline

Firms that fail to innovate will die. Financially successful enterprises often will try to acquire other innovative firms, thereby ensuring their own growth. Also, many firms will work on new product/service development in order to complement current offerings.

All of a venture's life cycle stages are important strategic points and each requires a different set of strategies. However, this chapter concentrates specifically on the growth stage since entrepreneurs need it most. We shall now examine the key factors affecting the ability to manage this stage.

THE ENTREPRENEURIAL COMPANY IN THE TWENTY-FIRST CENTURY

It's 15 May 2017. It's dawn in Sydney. While you yawn and express your coffee, you see that your partners have been busy in time zones all over the world from Brazil to Turkey. You went to bed four hours ago tired from responding to your video-mails. Working with people of different cultures and trying to achieve a consensus can be aggravating.

You check your decision support robot (DSR) to see that your operations are rolling smoothly. Then you are shocked to find an order from China through your California agent that could double yesterday's production. You suspect something and on intuition you don't increase production, in fact you scale it back. Better safe than sorry – in a just-in-time world, no one can afford to be stuck with excess inventory for a whole day.

You sit down to write a presentation to your banker in London that you have to give this afternoon – well, his afternoon. Better for you to do it than to delegate it, as vision and mission are your baby.

Then all hell breaks loose. Your partner – better said, a well-paid spy – in Hong Kong alerts you that a competitor is about to launch a copycat of your foundation product. You tell DSR to organise a video conference of managers ASAP. Then a pop-up on your screen flashes that the Chinese yuan is revaluing – again. Can you ramp up enough production in Brazil to take advantage of the currency wrinkle?

Breathless? The pace and magnitude of change will continue to accelerate in the new millennium. It is critical that entrepreneurial firms are able to evolve and transform to match this pace.

Growing firms that seek to adapt to the changing landscape must meet the challenge by building dynamic capabilities that are differentiated from those of the emerging competitors.[9]

There are really only two ways of building dynamic capabilities.

- One is *internal* – utilisation of the creativity and knowledge from inside the company. But there is often a limit to this growth, as no firm is capable of generating internally driven expansion indefinitely.
- The other is *external* – the search for external competencies such as joint ventures and strategic alliances to complement the firm's existing capabilities.

The trend toward globalisation, the advent of new technology and the information movement are all examples of forces in this new millennium that are causing firms to examine their culture, structure and systems for flexibility and adaptability. Innovation and entrepreneurial thinking are essential elements in the strategies of growing ventures.

Entrepreneurs perceive and pursue an opportunity. They also believe with all their heart that success is possible. This belief is often due to the uniqueness of the idea, the strength of the product, or some special knowledge or skill the entrepreneur possesses. These same factors must be translated into the organisation itself as the venture grows.

The entrepreneurial mindset

It is important for the growth-oriented entrepreneur to keep the entrepreneurial frame of mind and not relapse into being a manager or bureaucrat who stifles innovation (see figure 16.2). Table 16.1 provides a delineation of the differences between a managerial mindset versus an entrepreneurial mindset from the perspective of decision-making assumptions, values, beliefs and approaches to problems.

In some cases, success will affect an entrepreneur's willingness to change and innovate. This is particularly true when the enterprise has developed a sense of complacency or lifestyle and the entrepreneur likes this environment. The person does not want to change. In fact, some entrepreneurs will create a bureaucratic environment where orders are issued from the top down and change initiated at the lower levels is not tolerated.[10] As a result, no one in the venture is

FIGURE 16.2 THE ENTREPRENEURIAL MINDSET

		Future goals	
		Change	Status quo
Perceived capability	Possible	Entrepreneur	Satisfied manager
	Blocked	Frustrated manager	Classic bureaucrat

TABLE 16.1: THE MANAGERIAL VERSUS THE ENTREPRENEURIAL MINDSET

	MANAGERIAL MINDSET	ENTREPRENEURIAL MINDSET
Decision-making assumptions	The past is the best predictor of the future Most business decisions can be quantified	A new idea or an insight from a unique experience is likely to provide the best estimate of emerging trends
Values	The best decisions are those based on quantitative analyses Rigorous analyses are highly valued for making critical decisions	New insights and real-world experiences are more highly valued than results based on historical data
Beliefs	Law of large numbers: Chaos and uncertainty can be resolved by systematically analysing the right data	Law of small numbers: A single incident or several isolated incidents quickly become pivotal for making decisions regarding future trends
Approach to problems	Problems represent an unfortunate turn of events that threaten financial projections Problems must be resolved with substantiated analyses	Problems represent an opportunity to detect emerging changes and possibly new business opportunities

Source: Mike Wright, Robert E. Hoskisson and Lowell W. Busenitz, 'Firm rebirth: Buyouts as facilitators of strategic growth and entrepreneurship', *Academy of Management Executive* 15(1): 114.

willing (or encouraged) to become innovative or entrepreneurial because the owner–founder stifles such activity.

The solution is a haughty growth attitude. How to define this? It is a combination of skill, experience and judgement plus a dash of courage and a dose of arrogance. The growth attitude is essential in order to overcome the stagnation of operations and the complacency that naturally occurs as firms age. The spirit of relentless growth keeps fresh ideas flowing and reinvigorates the company. Here are the five guiding principles that leaders employ to spread the relentless growth attitude:

- generating and spreading a positive paranoia about the need for forward movement and change
- focusing externally – getting everyone looking out rather than looking in
- flattening the organisation and blurring boundaries with open, high-velocity information
- promoting people with passion and motivating them through a significant stake in the game
- setting stretch goals, making a decision and making it work by taking action and learning from both successes and failures.[11]

If the entrepreneur hopes to maintain the creative climate that helped launch the venture in the first place, specific steps or measures must be taken.

ENTREPRENEURIAL EDGE

MANAGING GROWTH AT EBAY

Business 2.0: eBay is an amazing growth machine. What were the key decisions you made that set up the company for this kind of hyperthyroidism?

Meg Whitman, CEO, eBay: The key decisions can all be characterised by focus, focus, focus. Back in March 1998, we were faced with a decision on what categories we wanted to focus on. We decided to really be a collectibles company. The heaviest users were collectors, the heaviest sellers were collectors. It was a very explicit strategic decision, because part of the group wanted to go into consumer electronics and all of these other categories we are in today. And we answered, 'We have only a limited number of resources. What is the best focus that we can have?'

How did you get from collectibles-only to we'll-sell-anything?

Our users took us there. You have to remember that we don't sell anything. We provide the trading platform. Our community of users is our R and D department. We enable, not direct. We help our users be successful utilising the platform in ways that they would like to use it.

As the CEO of an Internet company, do you motivate employees any differently than you would at an old-school Fortune 500 company?

I think at all good companies employees are excited by the mission of the company. And at eBay the mission is about creating this global online marketplace where your next-door neighbour's chance of success is equal to a large corporation's. We look for people who are energised by the mission of the company. Once they're here, we want to make sure that they have a chance to understand the company in a really deep way. I said to our head of strategy when he came to work for us: 'Don't do anything for three months. Just absorb, understand and get the counterintuitive nature of the business'. We give people a chance to settle in and then we make sure that they are well managed, that they are focused on high-impact projects and that they understand the results that they are going to be accountable for.

Given how much the company has grown, is it hard to keep people focused on the category or function that they are personally responsible for?

To keep up with our growth over the last seven years, we have reorganised early and often. That keeps people fresh; it brings a new set of eyes to problems. It keeps people excited because they get reposted into new opportunities. That's something we've done since the beginning of the company. Over the last seven years, we've probably made about 10 to 12 changes in how we have structured the organisation. Some were major, some were more evolutionary.

What about the other folks who work for youth entrepreneurs who tap into your software platform and innovate on top of it? How important is that to your future growth?

It's central to our strategy. We'll come up with a lot of good ideas, but we will not be the fountain of all good

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ideas. Users that have good ideas about how to make the platform more effective can tap into it through our API [application programming interface]. We now have 10 000 outside developers; 18 months ago it was just 400. We think it's important to open up the platform because it makes eBay better; it makes eBay stronger, as other people develop applications to the platform.

And it's not only software. It's also businesses that grow up to support eBay, like AuctionDrop here in the Bay Area. That is another way of supporting and extending the platform in a way that we will probably never get to, at least not in the foreseeable future.

That's a new management challenge. How do you motivate people who aren't on the payroll?

Again, it's enable, not direct. If we open the platform, enable buyers and sellers to be successful, enable entrepreneurs to be successful, then I think the company, by derivative, is successful.

I think we are one of the pioneers of a different kind of business model. And I think the Web has certainly made self-organising and empowerment of different groups far easier than it was prior to the Internet. But I think we are still at the earliest stages. So we're watching it very carefully. We know it is central to our business. Enabling our customers and our partners to be successful is critical.

Source: Erick Schonfeld with Meg Whitman, 'How to manage growth', *Business 2.0*, 5(11) (2004): 98.

BUILDING THE ADAPTIVE FIRM

Sometimes as an entrepreneurial firm grows, the seeds of its own destruction are sown for the very entrepreneurial impulses that were responsible for success in the first place. The transition from an entrepreneurial growth firm to a well-managed business often is accompanied by a decreasing ability to perceive and pursue opportunities. It is important for entrepreneurs to establish a business that remains flexible beyond start-up. An **adaptive firm** increases opportunity for its employees, initiates change and instils a desire to be innovative. Entrepreneurs can build an adaptive firm in several ways.[12] The following six methods are not inflexible rules, but they do enhance a venture's chance of remaining adaptive and innovative both through and beyond the growth stage.[13]

Share the entrepreneur's vision

The entrepreneur's vision must be permeated throughout the organisation in order for employees to understand the company's direction and share in the responsibility for its growth. The entrepreneur can communicate the vision directly to the employees through meetings, conversations, or seminars. It also can be shared through symbolic events or activities such as social gatherings, recognition events and displays. Whatever the format, having shared vision allows the venture's personnel to catch the dream and become an integral part of creating the future.[14]

Increase the perception of opportunity

This can be accomplished with careful job design. The work should have defined objectives for which people will be responsible. Each level of the hierarchy should be kept informed of its role in producing the final output of the product or service. This is often known as 'staying close to the customer.'[15] Another way to increase the perception of opportunity is through a careful coordination and integration of the functional areas. This allows employees in different functional areas to work together as a cohesive whole.

Continuous 'morphing'

Hypercompetition is a key feature of a new economy. In hypercompetitive environments, traditional paradigms of competitive advantage may have limited applicability. **Morphing** means

‘comprehensive ongoing transformations through which the focal firms sought to regenerate their transient competitive advantage’, particularly for firms on the Internet. This means that firms can change their functions often, even to the point of changing their organisational form. For example, a firm could change from a search engine to a media company. ‘Shifting competitive and resource conditions required them to continuously alter their form and function.’[16]

Institutionalise change as the venture’s goal

This entails a preference for innovation and change rather than preservation of the status quo. If opportunity is to be perceived, the environment of the enterprise must not only encourage it but also establish it as a goal. Within this context, a desire for opportunity can exist if resources are made available and departmental barriers are reduced.

Expanding strategic frontiers

Innovative new business opportunities found on the **strategic frontier** can provide firms at this threshold of expansion with the entrepreneurial growth they need. For example, Apple, with their iPod technology, discovered an innovative new business on the frontier of portable music. Bate and Johnston suggest five phases:

- **Staging:** In this phase, the discovery team is selected, key roles are identified, the objectives of the initiative are established and the team is prepared for the process.
- **Aligning:** The discovery team and senior management align themselves on the focus and scope of the initiative, agreeing on the ‘strategic frontier(s)’ to be explored.
- **Exploring:** The goal of this phase is the collection of new insights on the strategic frontier that can form the basis of new, value-producing business opportunities in the future. Depending on the strategic frontier and the scope of the initiative, teams will explore insights related to different exploration ‘vectors’, including *customer value*, *market dynamics* and/or *business model* innovation.
- **Creating:** Using the new insight gained, the discovery team will create, refine and develop a portfolio of new business opportunities for the future.
- **Mapping:** In this final phase the team will create a strategic roadmap outlining key events, trends, market discontinuities and milestones to move the company into its new strategic future.[17]

Instil the desire to be innovative

The desire of personnel to pursue opportunity must be carefully nurtured. Words alone will not create the innovative climate.[18] Specific steps such as the following should be taken.

- **A reward system:** Explicit forms of recognition should be given to individuals who pursue innovative opportunities. For example, bonuses, awards, salary advances and promotions should be tied directly to the innovative attempts of personnel.
- **An environment that allows for failure:** The fear of failure must be minimised by the general recognition that often many attempts are needed before a success is achieved. This does not imply that failure is sought or desired. However, learning from failure, as opposed to expecting punishment for it, is promoted. When this type of environment exists, people become willing to accept the challenge of change and innovation.
- **Flexible operations:** Flexibility creates the possibility of change taking place and having a positive effect. If a venture remains too rigidly tied to plans or strategies, it will not be

responsive to new technologies, customer changes, or environmental shifts. Innovation will not take place because it will not ‘fit in’.

- **The development of venture teams:** In order for the environment to foster innovation, venture teams and team performance goals need to be established. These must be not just work groups but visionary, committed teams that have the authority to create new directions, set new standards and challenge the status quo.[19]

ENTREPRENEURSHIP IN PRACTICE

SIGNS YOUR COMPANY IS GROWING OUT OF CONTROL

Your company has innovative products, great people and a track record of top-notch service. Best of all, you’re growing faster than ever. But is that really a good thing? During periods of rapid growth, it’s easy to lose control of what made your firm successful in the first place. If you’ve noticed any of these warning signs at your firm, it’s time to slow down and take stock.

- Your marketing materials are older than your kids.

  Next time you put off updating your marketing materials, remember this – ineffective marketing is expensive marketing. ‘As your company grows, marketing spin invariably becomes less effective’, says Maneesh Mehta, partner at Deloitte and Touche in Toronto, ‘either because your market is tapped out, or the message is stale’. Invest in fresh marketing today, or sacrifice sales tomorrow.

- ‘Crying breaks’ replace coffee breaks.

  ‘Uncontrolled growth will put enormous stress on your people and it can show up in many ways’, warns Ian MacFadden, VP of the Business Development Bank of Canada’s Atlantic-region consulting group. ‘If you’re paying huge amounts of overtime, you have too much pressure on your staff.’ Ease up or they could crack. That means they might make costly mistakes, fall ill or simply quit.

- Discussing your business is like playing ‘broken telephone’.

  ‘If you hear four or five different stories of what the company you founded is trying to do’, says Mehta, ‘you’re in trouble’. Everyone should know where the company is headed.

  ‘When you grow rapidly, changes must be communicated to everyone in your organisation’, says Darcy Amendt, president and CEO of Bluefalls Manufacturing Ltd in Thorsby, Alta. ‘Communicating is a big challenge.’ That’s why Amendt holds twice-weekly meetings with management and alerts staff to change, via the company website.

- You offer to design a website for a client – even though you run a landscaping firm.

  ‘When you have too many initiatives on the go, senior people are spread too thin and core issues are not addressed’, says David Zimmel, partner at Deloitte and Touche in Edmonton. Unless there’s a compelling reason to jump on an opportunity, take a pass.

  When you do seize an opportunity, make sure you have an off-ramp. ‘You can have seven or eight successful streams of business’, says Zimmel, ‘but it’s the one that isn’t successful that will drag you down and hurt you’. To protect yourself, ‘come up with a point where you have to break even or bail’, he says. ‘Then with some very simple metrics, everyone in the organisation will understand where they need to be.’

- You don’t talk to customers.

  ‘If you lose customer contact, it’s a scary thing’, says Doug Young, CEO of Cygnal Technologies, Canada’s Fastest-Growing Company in 2001. ‘It’s a sure sign you’re focusing on the wrong thing.’ After all, he says, ‘dealing with customers is generally how entrepreneurs become successful’. When customers feel neglected or fed up, they will go elsewhere, cautions MacFadden: ‘If you’re doing wrong, God bless ’em, customers will tell you soon enough.’

- You’re the new CFO: Chief Firefighting Officer.

  ‘If you’re caught up doing operating work to get product out the door, you aren’t doing your core job’, says Glen Hodgson, chief economist at Export Development Canada in Ottawa. Your job, he says, is to evolve the business model and tend to the supply chain. That means taking the time to delegate or hire someone to do the firefighting.

- You pay your bills – when you can find them.

  Neglecting internal systems is a recipe for disaster. ‘They’re always going to stretch, but periodically you have to catch up’, says Young. ‘If you

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grow out of them, you're really in the glue.' As your firm grows, you must invest in new inventory-control, payroll and financial-reporting systems. And when you adopt new systems, cautions Young, make sure to implement them slowly and with proper training.

- 'Profit' is just a magazine you read.

'Once you know how good it feels to be growing quickly, it's tough to have the discipline to rein it in', says MacFadden. 'But profits are essential to long-term growth.'

Although many successful companies sacrifice short-term profit to invest in systems and new-product development, it can't go on forever. 'Eventually you will melt', says Mehta. 'You won't be able to afford your own success.'

- You only see your family when you open your wallet.

Many of these signs are hard to see, so here's one that's easy – your family will tell you if you're growing too fast. Take it from Neil McDonnell, founder of Intrinsyc Software (No. 4 on this year's PROFIT 100). 'My son had a hockey tournament two weeks ago. He scored a hat trick, but I didn't see it because I was working. My son was not happy with me', says McDonnell. 'The next morning I was working downstairs and my son came in and he didn't say good morning. He said, "how's the stock price doing today, Dad?" It put it in perspective that I've spent a lot of time and a lot of grief worrying about something that I really couldn't control and I didn't take the time for something that is important to me.' Now that things are in perspective, go play with your kids.

Source: Kali Pearson, 'Too big, too fast: 9 signs your company is growing out of control', *Profit* (Toronto), 1 June 2002, 79.

THE TRANSITION FROM ENTREPRENEUR TO MANAGER The transitions between stages of a venture are complemented (or in some cases retarded) by the entrepreneur's ability to make a transition in style. Here's how it works in a sales-based start-up: Sales effort is high as the entrepreneur enters the growth phase. Then there is a crisis of falling or stagnating sales. To get back on the upward sales curve, the entrepreneur needs to hire more staff for a renewed sales focus and effort. But a few months down the road another crisis occurs. Higher costs of managing more sales staff means more human resources staff, which requires more executive oversight. The entrepreneurial spirit begins to disappear.[20]

A key transition occurs during the growth stage of a venture when the entrepreneur shifts into a managerial style. This is not easy to do. As Hofer and Charan have noted:

> Among the different transitions that are possible, probably the most difficult to achieve and also perhaps the most important for organisational development is that of moving from a one-person, entrepreneurially managed firm to one run by a functionally organised, professional management team.[21]

A number of problems can occur during this transition, especially if the enterprise is characterised by factors such as:

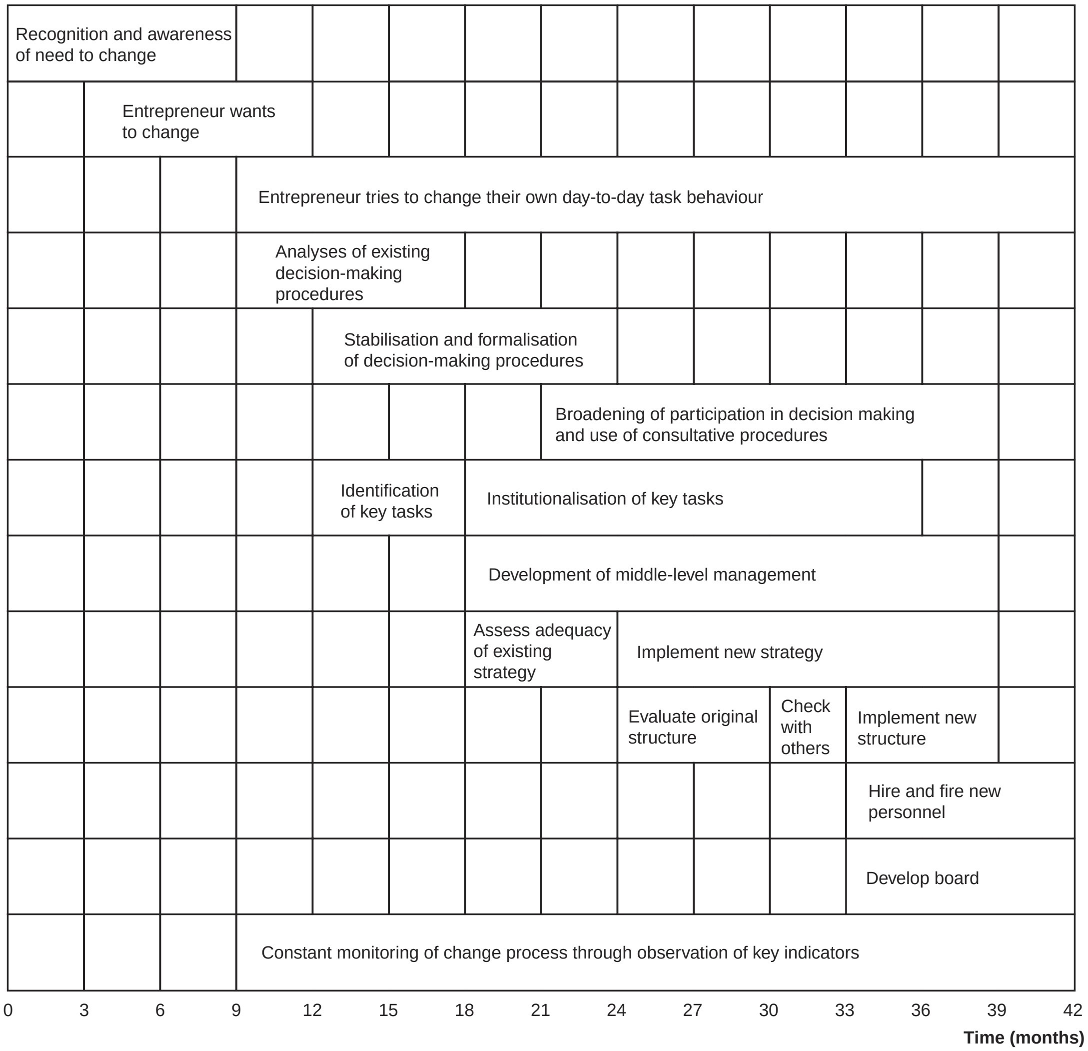
- a highly centralised decision-making system
- an over-dependence on one or two key individuals
- an inadequate repertoire of managerial skills and training
- a paternalistic atmosphere.[22]

These characteristics, although often effective in the new venture's start-up and initial survival, pose a threat to the firm's development during the growth stage. Quite often these characteristics inhibit development by detracting from the entrepreneur's ability to manage the growth stage successfully.

In order to bring about the necessary transition, the entrepreneur must carefully plan and then gradually implement the process. Hofer and Charan have suggested a seven-step process (see figure 16.3):

- **Step 1:** The entrepreneur must want to make the change and must want it strongly enough to undertake major modifications in their own task behaviour.

FIGURE 16.3 A SCHEMATIC PRESENTATION OF THE TRANSITION PROCESS SHOWING ITS RELATIVE TIME DIMENSIONS



Source: Charles W. Hofer and Ram Charan, 'The transition to professional management: Mission impossible?' *American Journal of Small Business* (Summer 1984): 11. Reprinted with permission.

- **Step 2:** The day-to-day decision-making procedures of the organisation must be changed. Specifically, participation in this process must be expanded. Greater emphasis also should be placed on the use of formal decision techniques.
- **Step 3:** The two or three key operating tasks that are primarily responsible for the organisation's success must be institutionalised. This may involve the selection of new people to supplement or replace 'indispensable' individuals who have performed these tasks in the past.
- **Step 4:** Middle-level management must be developed. Specialists must learn to become functional managers, while functional managers must learn to become general managers.

- **Step 5:** The firm's strategy should be evaluated and modified, if necessary, to achieve growth.
- **Step 6:** The organisational structure and its management systems and procedures must be slowly modified to fit the company's new strategy and senior managers.
- **Step 7:** The firm must develop a professional board of directors.[23]

The key factor in this process is found in the first step: the entrepreneur. Entrepreneurial self-management is the major area of concern.

Balancing the focus (entrepreneur and manager)

In managing the growth stage, entrepreneurs must remember two important points. First, an adaptive firm needs to retain certain entrepreneurial characteristics in order to encourage innovation and creativity. Second, the entrepreneur needs to translate this spirit of innovation and creativity to their personnel while personally making a transition toward a more managerial style.[24] This critical entrepreneur/manager balance is extremely difficult to achieve. As Stevenson and Gumpert have noted:

> Everybody wants to be innovative, flexible and creative. But for every Apple, Domino's and Lotus, there are thousands of new restaurants, clothing stores and consulting firms that presumably have tried to be innovative, to grow and to show other characteristics that are entrepreneurial in the dynamic sense – but have failed.[25]

Remaining entrepreneurial while making the transition to some of the more administrative traits is vital to the successful growth of a venture. Table 16.2 provides a framework for comparing the entrepreneurial and administrative characteristics and pressures relative to five major factors – strategic orientation, commitment to seize opportunities, commitment of resources, control of resources and management structure. Each of these five areas is critical to the balance needed for managing entrepreneurially. At the two ends of the continuum (from entrepreneurial focus to administrative focus) are specific points of view. Stevenson and Gumpert have characterised these in question format.

ENTREPRENEURIAL EDGE

FROM ENTREPRENEUR TO MANAGER

Charles Schwab, chairman and CEO of Charles Schwab, talks about the transition from entrepreneur to manager.

There were four or five of us working out of a small office at the very beginning. Early on, I recognized what I was good at and what I wasn't good at. And that, sometimes, is an awful realization, because you'd like to think you're great at everything. I was fortunate to see that I needed some people to help me in all the operational things. I knew what we wanted to do and where we wanted to go and I brought in people who were good at operations and others who were good at systems, to help us get there. I considered myself good at marketing and understanding what customers wanted. So I stayed focused on that and brought in people to do everything else. I've tried to surround myself with talented, smart people who take concepts and turn them into products.

This clear delegation of authority is important. Countless company founders don't make the necessary transition from entrepreneur to manager as their company grows. Invariably, this failure limits what their firm becomes. From the beginning, I accepted my limitations. I'm not as focused on implementing business strategies as I should be. I am always focused on our mission and where we are going. But the grinding away, the day-to-day stuff, is difficult for me. So I like to delegate that to other talented people.

Source: Charles Schwab, 'What's best for your customers?', *Executive Excellence* (Provo) 17(2) (2000): 20.

TABLE 16.2: THE ENTREPRENEURIAL CULTURE VERSUS THE ADMINISTRATIVE CULTURE

	ENTREPRENEURIAL FOCUS		ADMINISTRATIVE FOCUS	
	CHARACTERISTICS	PRESSURES	CHARACTERISTICS	PRESSURES
Strategic orientation	Driven by perception of opportunity	Diminishing opportunities	Driven by controlled resources	Social contracts
		Rapidly changing technology, consumer economics, social values and political rules		Performance measurement criteria
				Planning systems and cycles
Commitment to seize opportunities	Revolutionary, with short duration	Action orientation	Evolutionary, with long duration	Acknowledgement of multiple constituencies
	Narrow decision windows			Negotiation about strategic course
	Acceptance of reasonable risks			Risk reduction
	Few decision constituencies			Coordination with existing resource base
Commitment of resources	Many stages, with minimal exposure at each stage	Lack of predictable resource needs	A single stage, with complete commitment out of decision	Need to reduce risk
		Lack of control over the environment		Incentive compensation
		Social demands for appropriate use of resources		Turnover in managers
		Foreign competition		Capital budgeting systems
		Demands for more efficient use		Formal planning systems
Control of resources	Episodic use or rent of required resources	Increased resource specialisation	Ownership or employment of required resources	Power, status and financial rewards
		Long resource life compared with need		Coordination of activity
		Risk of obsolescence		Efficiency measures
		Risk inherent in the identified opportunity		Inertia and cost of change
		Inflexibility of permanent commitment to resources		Industry structures
Management structure	Flat, with multiple informal networks	Coordination of key non-controlled resources	Hierarchy	Need for clearly defined authority and responsibility
		Challenge to hierarchy		Organisational culture
		Employees' desire for independence		Reward systems
				Management theory

Source: Reprinted by permission of the *Harvard Business Review*. An exhibit from Howard H. Stevenson and David E. Gumpert, 'The Heart of Entrepreneurship', (March/April 1985): 89.

- **The entrepreneur's point of view:**
  - Where is the opportunity?
  - How do I capitalise on it?
  - What resources do I need?
  - How do I gain control over them?
  - What structure is best?
- **The administrative point of view:**
  - What resources do I control?
  - What structure determines our organisation's relationship to its market?
  - How can I minimise the impact of others on my ability to perform?
  - What opportunity is appropriate?[26]

The logic behind the variance in the direction of these questions can be presented in a number of different ways. For example, the commitment of resources in the entrepreneurial frame of mind responds to changing environmental needs, whereas the managerial point of view is focused on the reduction of risk. In the control of resources, entrepreneurs will avoid ownership because of the risk of obsolescence and the need for more flexibility, whereas managers will view ownership as a means to accomplish efficiency and stability. In terms of structure, the entrepreneurial emphasis is placed on a need for flexibility and independence, whereas the administrative focus is placed on ensuring integration with a complexity of tasks, a desire for order and controlled reward systems.

These examples of differences in focus help establish the important issues involved at both ends of the managerial spectrum. Each point of view – entrepreneurial and administrative – has important considerations that need to be balanced if effective growth is going to take place.

UNDERSTANDING THE GROWTH STAGE

The growth stage often signals the beginning of a metamorphosis from a personal venture to a group-structured operation. Domination by the lead entrepreneur gives way to a team approach based heavily on coordination and flexibility.

Key factors during the growth stage

Entrepreneurs must understand four key factors about the specific managerial actions necessary during the growth stage. These factors are control, responsibility, tolerance of failure and change.

Control

Growth creates problems in command and control. When dealing with them, entrepreneurs need to answer three critical questions: Does the control system imply trust? Does the resource allocation system imply trust? Is it easier to ask permission than to ask forgiveness? These questions reveal a great deal about the control of a venture. If they are answered with 'yes', the venture is moving toward a good blend of control and participation. If they are answered with 'no', the reasons for each negative response should be closely examined.

Responsibility

As the company grows, the distinction between authority and responsibility becomes more apparent. This is because authority always can be delegated, but it is most important to create a sense of responsibility. This action establishes flexibility, innovation and a supportive environment. People tend to look beyond the job alone if a sense of responsibility is developed, so the growth stage is better served by the innovative activity and shared responsibility of all of the firm's members.

Tolerance of failure

Even though a venture has avoided the initial start-up pitfalls and has expanded to the growth stage, it is still important to maintain a tolerance of failure. The same level of failure the entrepreneur experienced and learned from at the start of the venture should be the same level expected in the growth stage. Although no firm should seek failure, to continually innovate and grow it should tolerate a certain degree of failure as opposed to punishment for failure.

Three distinct forms of failure should be distinguished:

- **Moral failure:** This form of failure is a violation of internal trust. Since the firm is based on mutual expectations and trust, this violation is a serious failure that can result in negative consequences.
- **Personal failure:** This form of failure is brought about by a lack of skill or application. Usually responsibility for this form of failure is shared by the firm and the individual. Normally, therefore, an attempt is made to remedy the situation in a mutually beneficial way.
- **Uncontrollable failure:** This form of failure is caused by external factors and is the most difficult to prepare for or deal with. Resource limitations, strategic direction and market changes are examples of forces outside the control of employees. Top management must carefully analyse the context of this form of failure and work to prevent its recurrence.

Change

Planning, operations and implementation are all subject to continual changes as the venture moves through the growth stage and beyond. Retaining an innovative and opportunistic posture during growth requires a sense of change and variation from the norm. It should be realised, however, that change holds many implications for the enterprise in terms of resources, people and structure. It is therefore important during growth that the flexibility regarding change be preserved. This allows for faster managerial response to environmental conditions.

Managing paradox and contradiction

When a venture experiences surges in growth, a number of structural factors begin to present multiple challenges. These include cultural elements, staffing and development of personnel and appraisal and rewards. Entrepreneurs constantly struggle over whether to organise these factors in a rigid, bureaucratic design or a flexible, organic design. Table 16.3 depicts the conflicting designs for each element.

TABLE 16.3: CONFLICTING DESIGNS OF STRUCTURAL FACTORS

	FLEXIBLE DESIGN	BUREAUCRATIC DESIGN
CULTURAL ELEMENTS	Autonomous	Formalised
	Risk taking	Risk averse
	Entrepreneurial	Bureaucratic
STAFFING AND DEVELOPMENT	Technical skills	Administrative skills
	Specialists	Generalists
	External hiring	Internal hiring
APPRAISAL AND REWARDS	Participative	Formalised
	Subjective	Objective
	Equity based	Incentive based

Source: Charles J. Fombrun and Stefan Wally, 'Structuring small firms for rapid growth', *Journal of Business Venturing* (March 1989): 109.

Research has shown that new-venture managers experiencing growth, particularly in emerging industries, need to adopt flexible, organic structures.[27] Rigid, bureaucratic structures are best suited for mature, stabilised companies. Thus, the cultural elements need to follow a flexible design of autonomy, risk taking and entrepreneurship. This type of culture is a renewal of the entrepreneur's original force that created the venture. Although the entrepreneur's focus makes a transition toward a more administrative style, as mentioned earlier, the culture of the organisation must be permeated with a constant renewal of the virtues of innovation and entrepreneurship.[28]

When designing a flexible structure for high growth, entrepreneurs must realise that a number of contradictory forces are at work in certain other structural factors. Consider the following.

Bureaucratisation versus decentralisation

Increased hiring stimulates bureaucracy. Firms formalise procedures as staffing doubles and triples. Employee participation and autonomy decline and internal labour markets develop. Tied to growth, however, is also an increased diversity in product offering. This favours less formalised decision processes, greater decentralisation and the recognition that the firm's existing human resources lack the necessary skills to manage the broadening portfolio.

Environment versus strategy

High environmental turbulence and competitive conditions favour company cultures that support risk taking, autonomy and employee participation in decision making. Firms confront competitors, however, through strategies which depend on the design of formal systems that inhibit risk taking and autonomy.

Strategic emphases: Quality versus cost versus innovation

Rapidly growing firms strive to simultaneously control costs, enhance product quality and improve product offerings. Minimising costs and undercutting competitors' product prices, however, are best achieved by traditional hierarchical systems of decision making and evaluations. Yet these strategies conflict with the kinds of autonomous processes most likely to encourage the pursuit of product quality and innovation.[29]

These factors emphasise the importance of managing paradox and contradiction. Growth involves the multiple challenges of:

- the stresses and strains induced by attempts to control costs while simultaneously enhancing quality and creating new products to maintain competitive parity
- centralising to retain control while simultaneously decentralising to encourage the contributions of autonomous, self-managed professionals to the embryonic corporate culture.

Rapidly growing firms are challenged to strike a balance among these multiple pulls when designing their managerial systems.

Confronting the growth wall

Vadim Kotelnikov of Ten3 says that the entrepreneur faces five types of risk as the firm moves across the life cycle and confronts the **growth wall**:

- **growth risk**
- **technology and production risk**
- **marketability and competing risk**
- **financial risk**
- **team and management risk**.

They are outlined in table 16.4

TABLE 16.4: RISKS THAT GROWTH ENTREPRENEURS MUST FACE

PROBLEM: GROWTH RISK	SOLUTION	ACTION
Your capabilities in maintaining perspective (reality versus euphoria), balancing today's and tomorrow's needs and coordinating resources are being tested The original route to success works for some time, but then it stops working so well and hits diminishing returns; it is not easy to keep a great new venture growing at its original rate for more than three to five years; if you continue doing the same things that made you successful during the start-up stage you are almost certain to fail	Thinking about your second stage of growth before the first has happened. Reinventing your business model, experimenting extensively to find a successful new model and get to the second stage of growth Besides creating a viable model, a critical factor in the ultimate success is how well and fast your company integrates Development of a flexible and responsive company structure adaptable to changing internal and external conditions Development of an effective and flexible production system responsive to change Building strategic alliances and business partnerships	Develop sustainable growth strategies Reinvent your competitive and differentiation strategy Master company integration and build a new organisation that works Maintain a purposeful and organised search for new opportunities Inject the relentless growth attitude into your company Build a coaching organisation Keep flexible – spot what goes wrong and turn error to advantage Identify people (values, skills, expertise) and resources needed Develop a business plan for your company growth stage Develop strategic alliances and business partnerships Lead the team, create roadmaps – market opportunities; positioning; sales, distribution, operations; continuous innovation; people Develop innovative value chain management system Develop effective reward system – people are reinventing the wheel

PROBLEM: TECHNOLOGY AND PRODUCTION RISK	SOLUTION	ACTION
Early success with a single application or product line does not translate into long-term viability in the face of well-capitalised, entrenched competitors with strong customer relationships New technology and product development draws significant resources from the fast growing business operations	Identification of strategic market intervention areas Development of the business and technology strategy to achieve this goal Top management participation Development of strategic technology development partnerships	Reinvent your intellectual property management system and develop an intellectual property strategy Develop licensing strategy, protect your trade secrets Identify competitive factors and critical technologies and formulate your technology strategy Set strategic priorities and actions and develop your business strategy Develop your diversification strategy and launch differentiated produce Harness the power of innovation – search continuously for new opportunities

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		Develop flexible lean production systems responsive to change Establish a technology intelligence system Explore opportunities for a joint venture or a merger with a strategic partner to best exploit your short-term technologic advantage and realise the full potential of the company's entrepreneurial vision; transfer technology and establish strategic alliances to stay technologically competitive; winning is not necessarily achieved without partners and parents

PROBLEM: MARKETABILITY AND COMPETING RISK	SOLUTION	ACTION
Poor market feedback Poor strategic marketing plan Growing backorders Competitors' 'knockoffs' Customer complaints; product returns or write-offs	While managing growing complexity, it is essential to remain focused on how the business provides value to its customers Fighting fires Research into the market and its trends Reinventing market development strategy	Develop your competitive strategy – defend your markets from competitors, explore new markets to penetrate Revisit continuously the laws of marketing and reinvent your marketing strategy Critically revise your marketing approach Develop a realistic marketing concept Reinvent your competitive strategy Reinvent your marketing, advertising and selling strategy Develop a strategic marketing plan Gain repeated customers; retain customers – unleash the power of your service–profit chain to gain more loyal customers Partner with your customers to create a future for both parties that is better than either could have developed alone Develop innovative product selling and customer relationship chain Develop marketing partnerships

PROBLEM: FINANCIAL RISK	SOLUTION	ACTION
High leverage Short-term financing Inventory shortages or imbalances Poor financial and tax strategy for generating cash Excessive increases in overhead and personnel	Operating costs reduction through optimisation of production systems Raising of working capital (second round) to support strategic growth plans	Look at several measures of capital employment – not just one Work back to costs from what customers are prepared to pay Select type of finance you require to implement your growth strategy and develop your fund raising strategy Study investment opportunity selection criteria of different types of investors Enhance shareholder value by adopting a leading-edge reporting model

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PROBLEM: TEAM AND MANAGEMENT RISK	SOLUTION	ACTION
Start-up spirit begins to fade Organisational boundaries are mounting; employees gradually lose perspective on each other's jobs People lose the big picture – they can no longer see how the various tasks, activities and functions fit together to achieve the organisation's overall purpose Employees start to identify more with their own unit or work group than with the company as a whole As boundaries become more rigid, the company loses its elasticity – its ability to change in response to (or anticipation of) changes in the external environment No strategic and contingency planning Shifting priorities in response to opportunities Resisting development of structure, processes and controls Hiring people who are no smarter than you are Key people leaving Others don't share your urgency Poor decision support systems Overridden and inadequate internal systems, non-responsive to customers and employees Conflict between formal and informal Emergence of the 'Peter principle' Difficult decisions about roles, authority and responsibility	Keeping pace with an increasingly complex business environment requires proper delegation, better communication and cross-pollination of perspectives from outside advisers and peers Managing as a team Addressing the problem of 'good people' who can't keep up Establishment of management systems enabling better control, transparency and customer relationships Development of employee empowerment mechanisms Development of formal professional management structures	Learn to do less and manage more; practise the art of effective leadership, management and coaching Practise effective self-management Manage by objectives Start with yourself – know your own values, strengths, weaknesses and use them effectively To be a successful manager, learn how to innovate Build an innovation-friendly organisation If you cannot afford top management, build your management team from within and develop their management skills Change from reactive to proactive style Do the feedback analysis as a matter of course to build on your strengths Gain really effective control by completing a comprehensive business audit Develop plans for the future Don't over-respond to opportunities to avoid fragmentation and burn-out Micro-management de-motivates people – concentrate on the activities that bring the most value to the organisation and delegate other responsibilities and tasks Make sure you communicate clearly and often with colleagues, superiors and subordinates Talk less and listen more and actively to associates, advisers, customers, suppliers and vendors; cross-pollinate solutions and ideas with peers and advisers outside the business Don't assume that everyone in the company thinks like you do; that you have all the answers; that things won't get done without you; and that your direct reports will automatically function as a team Play the role of the team builder, coach, strategic planner and communicator; communicate critical and actionable information Require top managers to operate as a 'team' Help team manage the plan by group discussion of progress; measuring results with key metrics; communicating progress and results; and adjusting plans to market shifts Manage organisational misfits, malcontents and non-performers

Source: Vadim Kotelnikov, 'High-growth business development' [www.1000ventures.com/business_guide/psa_bcoach_growth.html]

Growth and decision making

Following on from the different risks that an entrepreneur faces, the decision-making process is a critical issue in the growth stage of emerging ventures. Entrepreneurs differ in their decision making and management styles. There are four kinds of entrepreneurs:

- **Entrepreneurial genius:** The company is new, the entrepreneur is fired up with enthusiasm, products and services are online and expectations for future success are unbridled. It is common for entrepreneurs to view the future with a simple, one-dimensional plan – create the commodity and sell it. During this initial phase, entrepreneurs have little patience, time, or energy for anything except the pursuit of more sales.
- **Benevolent dictator:** In this phase of development, entrepreneurs act like parents who tell their children – employees and franchisees – what to do and when and how to do it. As more force is used to bring everyone into conformity, employees – and franchisees – often rebel.
- **Dissociated director:** This phase of entrepreneurial development is confusing and frustrating for everyone in the company. Entrepreneurs learn that the company does not want to be dependent on them for every decision. Their egos suffer and they feel alienated. Dissociated directors often claim they will remove themselves from the day-to-day running of the company and bring in professional managers. They can't resist meddling, however and many of them soon go back to running the company 'their' way.
- **Visionary leader:** Leadership and management processes are used to position the company for sustainable long-term growth. Visionary leaders live within identified values, think before acting, are consistent and they communicate openly, honestly and directly. They exhibit patience and develop a participatory style of management and decision making.[30]

The focus and style of decision making are distinctive from the earlier or later stages that a venture goes through.[31] Table 16.5 illustrates the primary decision-making focus for the growth stage compared to the early and later stages. Also, as depicted in the table, the organisational characteristics of successful early-stage firms and of successful mature firms are quite different, as indicated by differences in the problems they face. Early-stage firms usually face undefined tasks, such as technology or market development, characterised by high levels of uncertainty. As a result, their organisations typically demonstrate little structure in the form of job specialisation, rules,

TABLE 16.5: DECISION-MAKING CHARACTERISTICS AND GROWTH STAGES

	EARLY STAGE(S)	GROWTH STAGE	LATER STAGE(S)
PRIMARY FOCUS	Product business	Volume production	Cost control
	Definition	Market share	Profitability
	Acquisition of resources	Viability	Future growth opportunity
	Development of market position		
DECISION-MAKING CHARACTERISTICS	Informal	Transitional	Formal
	Centralised		Decentralised
	Non-specialised		Specialised
	Short time horizon		Long and short time horizon

Source: Thomas N. Gilmore and Robert K. Kazanjian, 'Clarifying decision making in high growth ventures: The use of responsibility charting', *Journal of Business Venturing* (January 1989): 71.

or formality. Decision making is, in many instances, based solely on the owner communicating informally and face-to-face. The owner-founder integrates people, functions and tasks in many instances through their own direct contact.

In contrast, mature firms that have attained a size of several hundred employees can no longer manage in such a fashion. They require some elements of formality, structure and specialisation to control and direct their organisation effectively and efficiently. The transition of the decision-making process from that described for early-stage firms to that of later-stage firms must be effected during the growth stage. Timing is critical. Premature introduction of structure and formalities may dampen the venture's creative, entrepreneurial climate. However, if formality and structure are not adopted soon enough, management may lose control of the organisation as its size increases, leading to major dislocations of the firm and even failure.[32]

Therefore, entrepreneurs need to recognise the important transition of decision-making style during growth and to learn to authorise others to make necessary decisions in order to address the simultaneous challenges of rapid growth. Methods for entrepreneurs to consider when handling decisions during growth have been suggested.

One method concentrates on the use of **external resources** through networking.[33] In other words, networking entails the establishment of external personal relationships that the entrepreneur may use for professional assistance. The idea is to gain a competitive advantage by extending decision making and resource availability beyond the assets under the domain and control of the venture. One example of such resource use is a firm that obtains a licence to use a well-known name to market a product that could not achieve recognition otherwise and that does so by promising a royalty on future sales. This is obviously taking advantage of a series of resources – all the resources normally needed to create a national brand – that it does not own. 'External resources' are assets – physical or otherwise – a firm uses in its pursuit of growth and over which it has no direct ownership.[34] Another example would be the use of outside consulting assistance in the areas of administrative or operating problems. Strategic planning, security financing, marketing and day-to-day operational assistance are all areas in which emerging firms may seek outside assistance.[35]

Another method suggested to entrepreneurs for consideration when handling decisions during growth is **responsibility charting**.[36] The process assumes that decision making involves multiple roles that come into play in various ways at different points of time. Therefore, its three major components are decisions, roles and types of participation. These three components are combined to form a matrix, so a respondent can assign a type of participation to each of the roles (at the top) for a specific decision (on the left). Responses are then analysed either in a group setting with all participants present or by a facilitator alone when group size makes processing of the data unwieldy. The steps of responsibility charting are listed in table 16.6.

TABLE 16.6: STEPS OF RESPONSIBILITY CHARTING

1	Establishment of initial parameters:
	Decision rules
	Common language
	Creating the matrix of key decisions and roles
2	Individual balloting and tabulation of patterns
3	Discussion, clarification, negotiation
4	Agreement on allocation of responsibility
5	Monitoring and renegotiation as needed

Source: Gilmore and Kazanjian, 'Clarifying decision making in high growth ventures', 73.

When reporting the value of this process, Gilmore and Kazanjian stated:

> Responsibility charting enables better discussions of power and authority because it allows a rich range of potential solutions, rather than the win–lose dynamics that result from discussing these issues in terms of boxes and lines of a new structure.
>
> In growth-stage ventures, team building often fails because of the influx of new executives. Once responsibility charting has been used to clarify major decisions, the results are a powerful way to orient new executives who step into key roles. Unlike a job description that only communicates one's duties, the chart shows how the role fits into many critical processes.[37]

Whether it's networking or responsibility charting, entrepreneurs need to develop methods for handling the increasing complexities of decision making in the growth stage. The key to any system may be the ability of the entrepreneur to delegate.

Effective delegation

For making the transition from owner dominance of an entrepreneurial venture to the diversity of operations in a growth stage, **effective delegation** is a key component of success. This process entails three steps:

- assigning specific duties
- granting authority to carry out these duties
- creating the obligation of responsibility for necessary action.[38]

Why is delegation so essential to growth-oriented ventures? Because to continue growth and innovation, the entrepreneur needs to free up their time and to rely on others in the enterprise to carry on the day-to-day activities.[39] Timothy W. Firnstahl, an executive with a small growth-oriented firm, states:

> In start-up companies, the visions are usually the entrepreneurs' – they have the clear ideas about the product or service they plan to offer. Moreover, they often have to be in all places at all times, taking care of every detail. Unfortunately, this 100 percent hands-on management does not permit an entrepreneur's staff to mature. Why think, if the boss has all the answers? Inadvertently, an entrepreneur usurps employees' responsibilities. Worse, people often perform well because they know the owner is right there.[40]

ACHIEVING ENTREPRENEURIAL LEADERSHIP IN THE NEW MILLENNIUM

Entrepreneurial leadership may be the most critical element in the management of high growth ventures. Terms such as 'visionary' and 'strategic' have been used when describing different types of leaders. Table 16.7 provides a comprehensive description of strategic leaders, visionary leaders and managerial leaders. It is the concept behind strategic leadership that research has demonstrated to be the most effective in growing organisations.[41] Researchers Ireland and Hitt identified some of the most important concepts in effective strategic leadership.[42] This type of leadership can be classified as entrepreneurial leadership, which arises when an entrepreneur attempts to manage the fast-paced, growth-oriented company.[43]

Entrepreneurial leadership can be defined as the entrepreneur's ability to anticipate, envision, maintain flexibility, think strategically and work with others to initiate changes that

TABLE 16.7: STRATEGIC, VISIONARY AND MANAGERIAL LEADERSHIP

STRATEGIC LEADERS	VISIONARY LEADERS	MANAGERIAL LEADERS
Synergistic combination of managerial and visionary leadership Emphasis on ethical behaviour and value-based decisions Oversee operating (day-to-day) and strategic (long-term) responsibilities Formulate and implement strategies for immediate impact and preservation of long-term goals to enhance organisational survival, growth and long-term viability Have strong, positive expectations of the performance they expect from their superiors, peers, subordinates and themselves Use strategic controls and financial controls, with emphasis on strategic controls Use and interchange, tacit and explicit knowledge on individual and organisational levels Use linear and non-linear thinking patterns Believe in strategic choice, that is, their choices make a difference in their organisations and environment	Are proactive, shape ideas, change the way people think about what is Desirable, possible and necessary Work to develop choices, fresh approaches to long standing problems; work from high-risk positions Are concerned with ideas; relate to people in intuitive and empathetic ways Feel separate from their environment; work in, but do not belong to, organisations; sense of who they are does not depend on work Influence attitudes and opinions of others within the organisation Concerned with ensuring future of organisation, especially through development and management of people More embedded in complexity, ambiguity and information overload; engage in multifunctional, integrative tasks Know less than their functional area experts More likely to make decisions based on values More willing to invest in innovation, human capital and creating and maintaining an effective culture to ensure long-term viability Focus on tacit knowledge and develop strategies as communal forms of tacit knowledge that promote enactment of a vision Utilise non-linear thinking Believe in strategic choice, that is, their choices make a difference in their organisations and environment	View work as an enabling process involving some combination of ideas and people interacting to establish strategies Are reactive; adopt passive attitudes towards goals; goals arise out of necessities, not desires and dreams; goals based on past Relate to people according to their roles in the decision-making process See themselves as conservators and regulators of existing order; sense of who they are depends on their role in organisation Influence actions and decisions of those with whom they work Involved in situations and contexts characteristic of day-to-day activities Concerned with and more comfortable in, functional areas of responsibilities Expert in their functional area Less likely to make value-based decisions Engage in and support, short-term, least-cost behaviour to enhance financial performance figures Focus on managing the exchange and combination of explicit knowledge and ensuring compliance to standard operating procedures Utilise linear thinking Believe in determinism, that is, the choices they make are determined by their internal and external environments

Source: W. Glenn Rowe, 'Creating wealth in organisations: The role of strategic leadership', *Academy of Management Executive* 15(1) (2001): 82.

will create a viable future for the organisation.[44] If these leadership processes are difficult for competitors to understand and imitate, the firm will create a competitive advantage.

Today's fast-paced economy has created a new competitive landscape – one in which events change constantly and unpredictably. These changes are revolutionary in nature – that is, they happen swiftly and are relentless in their frequency, affecting virtually all parts of an organisation simultaneously. The ambiguity resulting from revolutionary changes challenges firms and their strategic abilities to increase the speed of the decision-making processes through which strategies are formulated and implemented.[45]

Growth-oriented firms need to adopt a new competitive mindset – one in which flexibility, speed, innovation and strategic leadership are valued highly. With this mindset, firms can identify and completely exploit opportunities that emerge in the new competitive landscape. These opportunities surface primarily because of the disequilibrium that is created by continuous changes (especially technological changes). More specifically, although uncertainty and disequilibrium often result in seemingly hostile and intensely rivalrous conditions, these conditions may simultaneously yield significant product-driven growth opportunities. Through effective entrepreneurial leadership, growth firms can adapt their behaviours and exploit such opportunities.[46]

SUMMARY

A typical life cycle of a venture has five stages: development, start-up, growth, stabilisation and innovation or decline. This chapter focused on ways to maintain an entrepreneurial frame of mind while making the necessary adjustments for dealing with the growth phase.

Entrepreneurs need to build internal and external capabilities that are differentiated from competitors. They also need to keep the entrepreneurial frame of mind and not relapse into being a manager or bureaucrat. They need to keep or develop a growth attitude to overcome stagnation and complacency. The entrepreneurial mindset is quite different to that of a manager.

In building the desired adaptive firm, entrepreneurs can call upon different processes: increasing the perception of opportunity; continuous 'morphing'; institutionalising change as the venture's goals; expanding strategic frontiers; and instilling the desire to be innovative.

The transition from an entrepreneurial style to a managerial approach was reviewed. A seven-step process for achieving this transition was described. The balance between the entrepreneurial focus and the administrative focus was then considered. This balance was demonstrated by considering five major factors: strategic orientation, commitment to seize opportunities, commitment of resources, control of resources and management structure. This differentiation of major factors is important for analysing aspects of the venture that need either more administrative or more entrepreneurial emphasis.

The chapter then examined the importance of a venture's growth stage. Underscoring the metamorphosis a venture goes through, four factors were discussed: control, responsibility, tolerance of failure and change.

Next were the five types of risk that a young firm faces: growth risk, technology and production risk, marketability and competing risk, financial risk, team and management risk. Each was described and then solutions and actions were explained.

One of the key skills for growth entrepreneurs is effective decision making. Decision making differs between the types of entrepreneurs. Four types were identified: entrepreneurial genius, benevolent dictator, dissociated director and visionary leader. Techniques were described that help move the firm forward.

Finally, the concept of entrepreneurial leadership was introduced as a way for entrepreneurs to anticipate, envision, maintain flexibility, think strategically and work with others. This style enables the entrepreneurs to initiate changes that will create a viable future for the growth-oriented venture.

KEY TERMS AND CONCEPTS

adaptive firm
effective delegation
entrepreneurial leadership
external resources
financial risk
growth risk
growth stage
growth wall
life cycle stages
marketability and competing risk
morphing
new-venture development
responsibility charting
stabilisation stage
start-up activities
strategic frontier
team and management risk
technology and production risk

REVIEW AND DISCUSSION QUESTIONS

1. Briefly identify and describe the stages of development for a new venture.
2. Firms that fail to innovate will die. What does this statement mean in the context of new ventures?
3. What are the dangers of an entrepreneur evolving into a bureaucrat?
4. How can entrepreneurs build an adaptive firm?
5. Successful ventures balance entrepreneurial characteristics with managerial style. What does this statement mean?
6. Comparing the entrepreneurial focus with the administrative focus involves five major areas of consideration. What are these areas?

7 Identify and describe the four key factors that need to be considered during the growth stage.
8 Which will you be – entrepreneurial genius, benevolent dictator, dissociated director, visionary leader?
9 Describe the concepts of networking and responsibility charting and explain their potential for improving entrepreneurs' decision-making abilities.
10 What are the types of entrepreneurial risk that a firm faces as it moves through the life cycle stages?
11 Why is delegation so important to entrepreneurs who are making the transition from an entrepreneurial venture to the diversified operations of the growth stage?
12 Explain the concept of entrepreneurial leadership and list some of its key components.

EXPERIENTIAL EXERCISE

THE VENTURE LIFE CYCLE

Listed below are the five basic phases or stages of the typical life cycle of a venture, labelled (A) to (E). Rank these from 1 to 5, beginning with the first phase and continuing to the last. Then examine the list of activities (a) to (j) and place a 1 next to those that happen during the first phase of the venture, on down to a 5 next to those that occur during the last phase. Answers are provided at the end of the chapter.

A Growth
B Innovation or decline
C Start-up
D Stabilisation
E New-venture development

a Transition from one-person leadership to team management leadership
b New-product development
c Search for capital
d Increased competition
e Venture assessment
f Attempts to acquire other firms
g Consumer indifference to the entrepreneur's goods or services
h Accumulation of resources
i Major changes in entrepreneurial strategy
j Development of an effective entrepreneurial team

CASE 16.1:

HENDRICK'S WAY

When Hendrick Harding started his consumer products firm, he was convinced he had a winning product. His small, compact industrial drill was easier to use than any others on the market and cost 30 per cent less than any of the competitors' drills. The orders began to pour in and within six months Hendrick's sales surpassed his first year's estimate. At the end of the first 12 months of operation his firm was grossing more than $50 000 a month and he had a six-week backlog in filling orders.

The rapid growth of the firm continued for two years. Beginning about four months ago, however, Hendrick began to notice a dip in sales. The major reason appeared to be a competitive product that cost 10 per cent less than Hendrick's drill and offered all the same benefits and features. Hendrick believes that with a couple of minor adjustments he can improve his product and continue to dominate the market.

On the other hand, Hendrick is somewhat disturbed by the comments of one of his salespeople, George Simonds. George spends most of his time on the road and gets to talk to a great many customers. Here is what he had to say to Hendrick: 'Your industrial drill has really set the market on its ear. And we should be able to sell a modified version of it for at least another 36 months before making any additional changes. However, you need to start thinking about adding other products to the line. Let's face it; we are a one-product company. That's not good. We have to expand our product line if we are to grow. Otherwise, I can't see much future for us.'

The problem with this advice is that Hendrick does not want to grow larger. He is happy selling just the industrial drill. He believes that if he continues to modify and change the drill, he can maintain a large market share and the company will continue to be profitable. As he explained to George, 'I see the future as more of the past. I really don't think there will be a great many changes in this product. There will be modifications, sure, but nothing other than that. I think this firm can live off the industrial drill for at least the next 25 years. We've got a great thing going. I don't see any reason for change. And I certainly don't want to come out with a second product. There's no need for it.'

1 What is the danger in Hendrick's thinking?
2 Using Table 16.2 as your point of reference, how would you describe Hendrick's focus?
3 Based on your evaluation, what recommendations would you make to him?

CASE 16.2: KEEPING THINGS GOING

Because a surge in outsourcing contracts coming in from the United States the Wadhwani Company of Hyderbad has grown 115 per cent in the past year and 600-plus per cent in the past three years. A large portion of this growth is attributable to Sharma Subramonia's philosophy of hiring the best possible computer systems people and giving them the freedom they need to do their jobs.

Most of Sharma's personnel operate as part of work teams that analyse, design and implement computer systems for clients. The way the process works is this: First, the company will get a call from a potential client indicating that it needs to have a computer system installed or special software written for its operations. Sharma will send over one of his people to talk to the client and analyse the situation. If it turns out that the Wadhwani Company has the expertise and personnel to handle the job, the client will be quoted a price. If this price is acceptable, a Wadhwani work group will be assigned the project.

An example of a typical project is the manufacturing client who called three weeks ago and wanted to purchase five personal computers for the firm's engineering staff. The company wanted these machines hooked up to the main computer and to have a dedicated connection to their Houston, Texas Office. Additionally, the firm wanted its computer-aided design software to be modified so the engineers could see their computer-generated drawings in a variety of colours, not just in monochrome. The Wadhwani group installed the entire system and modified the software in 10 working days.

Sharma realises that the growth of his enterprise will be determined by two factors. One is the creativity and ingenuity of his workforce. The other is the ability to attract talented personnel. 'This business is heavily labour intensive', he explained. 'If someone wants a computer system installation, that may take 100 labour hours. If I don't have the people to handle the project, I have to turn it down. My expansion is heavily dependent on hiring and training talented people. Additionally, I need more than just hard workers. I need creative people who can figure out new approaches to handling complex problems. If I can do these two things, I can stay a jump ahead of the competition. Otherwise, I won't be able to survive.'

In dealing with these key factors for success, Sharma has initiated three changes. First, he has instituted a bonus system tied to sales; these bonuses are shared by all of the personnel. Second, he gives quarterly salary increases, with the greatest percentages going to employees who are most active in developing new programs and procedures for handling client problems. Third, he has retreats every six months in which the entire staff goes for a long weekend to a mountain area where they spend three days discussing current work-related problems and ways of dealing with them. Time is also devoted to social events and to working on developing an esprit de corps among the personnel.

QUESTIONS

1 In what phase of the venture life cycle is Sharma's firm currently operating?
2 How are Sharma's actions helping to build an adaptive firm? Give three specific examples.
3 If Sharma's firm continues to grow, what recommendations would you make for future action? What else should Sharma be thinking about doing in order to keep things moving smoothly?
4 Do you have ideas about how Sharma could acquire more of the US outsourcing business?

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A Note on Managing the Growing Venture

Publication date: 31 January 2005
Revision date: 23 August 2005
Author(s): Richard G. Hamermesh, James L. Heskett, Michael J. Roberts
Product number: 9-805-092

Focuses on the strategic and organisational challenges that confront growing enterprises and the entrepreneurs who lead them. Provides an overview of how a new venture needs to change as it passes from the initial start-up to the growth phase. Explores how a venture's leadership, strategy and execution need to evolve to deal with rapid growth. A rewritten version of an earlier note.

Innocent Drinks

Publication date: 24 November 2004
Author(s): William A. Sahlman, Dan Heath
Product number: 9-805-031

The three founders of a London-based, start-up smoothie company must decide between three growth options: expansion of the existing product line into Europe, extension of the brand into other product categories, or continued organic growth within the United Kingdom.

The Five Stages of Small Business Growth

Publication date: 1 May 1983
Author(s): Neil C. Churchill, Virginia L. Lewis
Product number: 83301

A five-stage framework will help owners to determine their company's stage of development and how to ensure a profitable future. It is also useful to consultants and accountants in diagnosing problems and matching solutions to smaller organisations. The five stages are existence, survival, success (with the substages of disengagement and growth), take-off and resource maturity. Each stage has an index of size, diversity and complexity.

Charles Schwab Strategic Differentiation, Exercise

Publication date: 25 June 2003
Revision date: 20 January 2004
Author(s): Lynda M. Applegate
Product number: 9-803-207

Enables students to apply the tools of strategy to an analysis of Charles Schwab's strategy in 2002.

Lark International Entertainment Ltd

Publication date: 10 August 1998
Revision date: 2 October 1998
Author(s): Linda A. Hill, Jennifer M. Suesse
Product number: 9-499-023

Two HBS MBAs leave McKinsey and Morgan Stanley to become entrepreneurs in Hong Kong. Together they start up a cinema chain throughout Asia. This case describes the experiences of managing a team in their Wuhan, China cinema. Looks at the challenges of managing growth in an entrepreneurial venture in an emerging market; leading a multicultural team; and coping with headquarter-field relationships.

ANSWERS

A	3
B	5
C	2
D	4
E	1
a	3
b	5
c	2
d	4
e	1
f	5
g	4
h	1
i	3
j	2

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GLOBAL OPPORTUNITIES FOR ENTREPRENEURS

17

> Today, thanks to a thriving world economy, global telecommunications and expanding travel, exchange among Europe, North America and the Pacific Rim is happening at an unparalleled pace. In the urban centres of the developing world signs of the international youth culture are almost everywhere … For the companies that sell these new international products, that understand the world as one single market, it is an economic bonanza.
>
> John Naisbitt and Patricia Aburdene, *Megatrends 2000*[1]

CHAPTER OBJECTIVES

1

To introduce the new international developments that have expanded opportunities for the global market

2

To examine how entrepreneurs can take advantage of importing opportunities

3

To explore the entrepreneurial benefits of exporting

4

To discuss the advantages and disadvantages of entrepreneurial joint ventures

5

To examine the benefits of direct foreign investment by entrepreneurs

6

To explain how licensing arrangements work and to review their advantages and disadvantages

7

To set forth the five key steps for entering the international marketplace

THE ASIA–PACIFIC ENTREPRENEURIAL ECONOMY

In the last two hundred years, the world has experienced one revolution after another: First an Industrial Revolution, then a Technological Revolution and now a Knowledge Revolution. Global entrepreneurs don't just sit back and react to emerging challenges. They see scientific and technological progress as the primary engines of change and exploit them. Entrepreneurs create economic activity by commercialising new ideas, products and services. Air travel, modern communications, Internet and advanced software make it possible for the global entrepreneur to act almost easily and seamlessly anywhere in the world. The entire world has become the entrepreneur's play pen.

This is nowhere truer than in economies of the Asia–Pacific region. As the global economic recovery gathers pace, businesses and investors in our region are set to benefit. The outlook for the region looks promising. The strong performances of the US, Japanese and Chinese economies have set the stage for acceleration in gross domestic product (GDP) growth in most of the Asia–Pacific. All the pieces seem to be in place to ensure entrepreneurial prosperity around the region. Overall growth is expected to accelerate slightly over the 2005–06 period from 4.5 to 4.7 per cent. Japan is enjoying an economic revival; its best performance in 14 years. But this growth is still insignificant and dilutes the overall growth average of the Asia–Pacific. If we exclude Japan, the growth numbers are impressive. By that standard, the International Monetary Fund (IMF) forecasts economic growth of 4.9 per cent for 2006. If we also exclude the bottom countries US, Australia and New Zealand, the rest are looking at a respectable 5.5 per cent growth rate in 2006. Challenges do exist, including a weak US dollar and rising interest rates, high oil prices, continuing youth unemployment, a rising elderly population and pressure to pursue environmentally friendly growth practices. But prognosis is good.

Two of the primary reasons for this emerging opportunity are the decline in trade barriers and the rise of free trade agreements as well as the emergence of major trading blocs. In addition, over the past decade the Asia–Pacific has become a hotbed for business opportunity.[2]

There are more than 300 worldwide regional trade agreements accounting for more than 50 per cent of the total global trade volume. **Free trade agreements (FTAs)** benefit entrepreneurs by improving access to foreign markets and liberalising trade. The least complicated way to conduct

TABLE 17.1: **ASIA–PACIFIC GROWTH RATES, 2004–06**

COUNTRY	2004	2005	2006
China	9.5	9.0	8.2
Vietnam	7.7	7.5	7.0
Malaysia	7.1	5.5	6.0
Indonesia	5.1	5.8	5.8
Korea	4.6	3.8	5.0
Thailand	6.1	3.5	5.0
Philippines	6.0	4.7	4.8
Hong Kong	8.1	6.3	4.5
Singapore	8.4	3.9	4.5
Taiwan	5.7	3.4	4.3
United States	4.2	3.5	3.3
Australia	3.2	2.2	3.2
New Zealand	4.8	2.5	2.5
Japan	2.7	2.0	2.0
Average	5.9	4.5	4.7

Source: 'International Monetary Fund', World Economic Outlook Database. [www.imf.org/external/pubs/ft/weo/2005/02/data/index.htm] accessed July 2005.

TABLE 17.2: FREE TRADE AGREEMENTS IN THE ASIA–PACIFIC

	IN FORCE	UNDER NEGOTIATION OR DISCUSSION
Australia	New Zealand, Singapore, Thailand, United States	Australia-ASEAN-New Zealand, China, Indonesia, Japan, Malaysia
China	Chile, Hong Kong, Japan, Macau, South Korea, Thailand	Australia, Japan, Korea, New Zealand
Indonesia		Australia, China, Japan, New Zealand
Japan	Korea, Mexico, Philippines, Singapore	ASEAN, Australia, China, Indonesia, Malaysia, Australia, Philippines, Thailand
Korea	Chile, Singapore	ASEAN, Canada, China, India, Japan, Philippines
Malaysia		Australia, Japan, Korea, New Zealand, Pakistan
New Zealand	Australia, Brunei, Chile, Singapore, Thailand	ASEAN-Australia/NZ, China, Hong Kong, Malaysia
Singapore	ASEAN, Australia, Japan, Korea, New Zealand, Trans-Pacific SEP (Brunei New Zealand Chile Singapore), United States	China
Thailand	Australia, China, New Zealand	China, India, Japan, Peru, United States
United States	Australia, Chile, Singapore	Korea, Taiwan, Thailand

Source: Most of these data come from ministry sources and [www.bilaterals.org].

global business is in countries with common free trade agreements, where they have agreed to eliminate tariffs, quotas and preferences on most goods traded between them. Singapore has been the most active 'free trader'. China has fast-tracked its first free trade agreement with New Zealand in 2007.

'Global thinking' is important because today's consumers can select products, ideas and services from many nations and cultures. Entrepreneurs who expand into foreign markets must be global thinkers in order to design and adopt strategies for different countries. World exports and world imports were each about $8.8 trillion in 2004. Table 17.3 presents the Asia–Pacific countries, their world ranks and total amounts. The region amounts to 36.6 per cent of world exports and 41.6 per cent of world imports.

The impact can be clearly seen by looking at the top import and export partners of leading economies in the Asia–Pacific. In figure 17.1 we look at the direction of those export and import relations. One thing is immediately clear: Japan and the United States play a huge role in the region. The United States is the biggest exporter to Australia and the Philippines, while Japan serves that role for China, Korea, Taiwan, Malaysia and Thailand. As far as the other direction is concerned, the United States is the importer from Malaysia, Thailand, China and Japan. For Australia, Indonesia and the Philippines, Japan is the biggest importer.

What this means for Asia–Pacific entrepreneurs is that potential markets are increasingly overseas. The most profitable firms will increasingly be those who can provide higher quality and lower prices than their competitors and who have the broadest global markets.

In this chapter we discuss new developments in the global marketplace that directly affect entrepreneurial opportunities. We also examine the various methods of international participation. Finally, we consider the steps to be taken when going international – the required research, feasibility analysis and implementation plan.

MULTILATERAL INSTITUTIONS

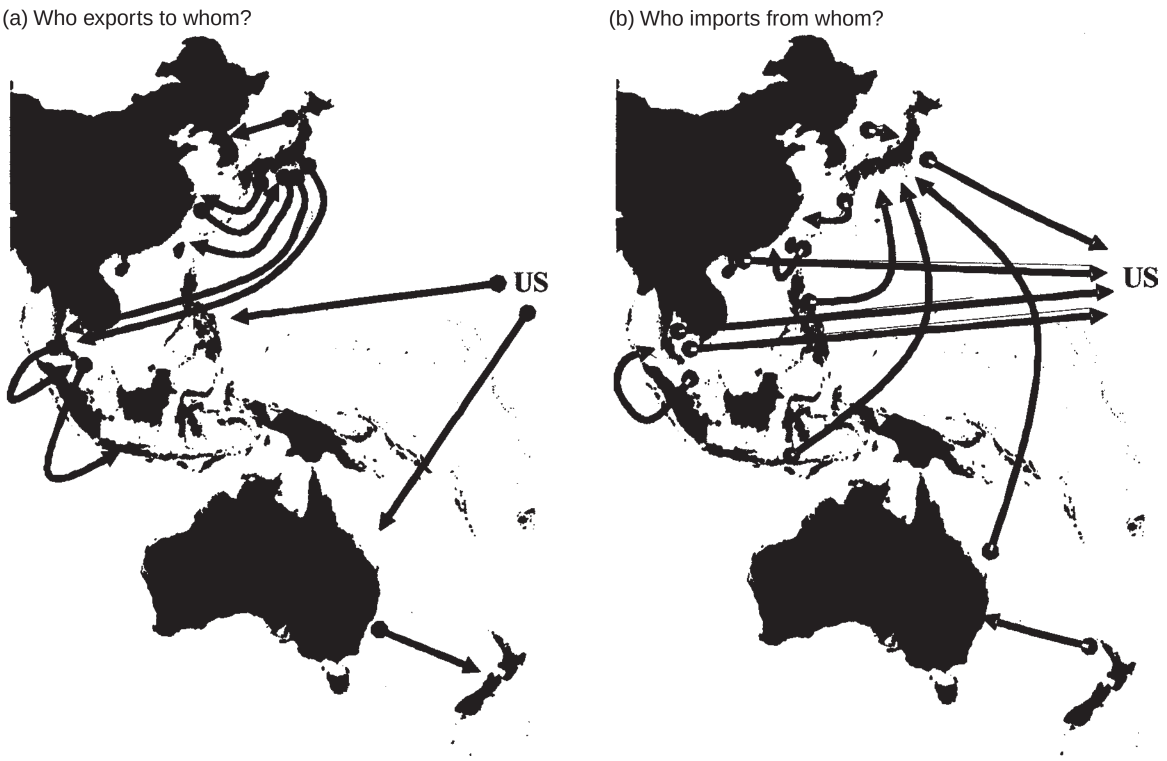
Which institutions are influencing the Asia–Pacific entrepreneurial economy and pushing the increasing number of small ventures participating in the

TABLE 17.3: **WORLD EXPORTS AND IMPORTS, 2004**

RANK	COUNTRY	EXPORTS	RANK	COUNTRY	IMPORTS
1	World	$8 819 000 000 000	1	World	$8 754 000 000 000
4	United States	$795 000 000 000	2	United States	$1 476 000 000 000
5	China	$583 100 000 000	5	China	$552 400 000 000
6	Japan	$538 800 000 000	8	Japan	$401 800 000 000
12	Hong Kong	$268 100 000 000	10	Hong Kong	$275 900 000 000
14	Korea, South	$250 600 000 000	15	Korea, South	$214 200 000 000
16	Singapore	$174 000 000 000	17	Taiwan	$165 400 000 000
18	Taiwan	$170 500 000 000	18	Singapore	$155 200 000 000
21	Malaysia	$123 500 000 000	21	Malaysia	$99 300 000 000
27	Thailand	$87 910 000 000	22	Australia	$98 100 000 000
28	Australia	$86 890 000 000	28	Thailand	$80 840 000 000
32	Indonesia	$69 860 000 000	39	Indonesia	$45 070 000 000
42	Philippines	$38 630 000 000	41	Philippines	$37 500 000 000
53	Vietnam	$23 720 000 000	49	Vietnam	$26 310 000 000
55	New Zealand	$19 850 000 000	52	New Zealand	$19 770 000 000
	Asia–Pacific	$3 230 460 000 000		Asia–Pacific	$3 647 790 000 000
	% of world exports	36.6%		% of world imports	41.6%

Source: 'CIA World Factbook 2005', Washington [www.cia.gov] 2005.

FIGURE 17.1 **EXPORT AND IMPORT DIRECTIONS, 2004**



(a) Who exports to whom?

(b) Who imports from whom?

TABLE 17.4: ASIA–PACIFIC ECONOMIES AND THEIR TOP TRADING PARTNERS, 2004

COUNTRY	EXPORTS	% OF TOTAL	IMPORTS	% OF TOTAL
Australia	Japan	18.60	United States	14.80
	China	9.20	China	12.70
	United States	8.10	Japan	11.80
	Korea	7.70	Germany	5.80
	New Zealand	7.40	Singapore	4.40
	India	4.60	United Kingdom	4.10
	United Kingdom	4.20		
Brunei	Japan	38.10	Singapore	32.70
	Korea	14	Malaysia	21.20
	Australia	11.20	United Kingdom	8.30
	United States	8.60	Japan	7.20
	Thailand	7.90		
	Indonesia	5.90		
	China	4.50		
China	United States	21.10	Japan	16.80
	Hong Kong	17.00	Taiwan	11.40
	Japan	12.40	Korea	11.10
	Korea	4.70	United States	8
	Germany	4	Germany	5.40
Hong Kong	China	44	China	43.50
	United States	17	Japan	12.10
	Japan	5.30	Taiwan	7.30
			United States	5.30
			Singapore	5.30
			Korea	4.80
Indonesia	Japan	22.30	Singapore	13.10
	United States	12.30	Japan	13.10
	Singapore	8.40	China	8.80
	Korea	6.80	United States	7
	China	6.40	Thailand	6
	Malaysia	4.20	Australia	4.80
			Saudi	4.20
			Korea	4.20
Japan	United States	22.70	China	20.70
	China	13.10	United States	14
	Korea	7.80	Korea	4.90
	Taiwan	7.40	Australia	4.30
	Hong Kong	6.30	Indonesia	4.10
			Saudi	4.10
			UAE‡	4
Korea	China	19.70	Japan	20.60
	United States	17	China	13.20
	Japan	8.60	United States	12.90
	Hong Kong	7.20	Saudi	5.30

>>

COUNTRY	EXPORTS	% OF TOTAL	IMPORTS	% OF TOTAL
Malaysia[†]	United States	18.80	Japan	16.10
	Singapore	15	United States	14.60
	Japan	10.10	Singapore	11.20
	China	6.70	China	9.90
	Hong Kong	6	Thailand	5.60
	Thailand	4.80	Taiwan	5.50
			Korea	5
			Germany	4.50
			Indonesia	4
New Zealand	Australia	21	Australia	22.40
	United States	14.40	United States	11.30
	Japan	11.30	Japan	11.20
	China	5.70	China	9.70
	United Kingdom	4.70	Germany	5.20
Philippines	Japan	20.10	United States	18.80
	United States	18.20	Japan	17.40
	Netherlands	9	Singapore	7.80
	Hong Kong	7.90	Taiwan	7.30
	China	6.70	Korea	6.20
	Singapore	6.60	China	6
			Malaysia	4.50
Singapore	Malaysia	15.20	Malaysia	15.30
	United States	13	United States	12.70
	Hong Kong	9.80	Japan	11.70
	China	8.60	China	9.90
	Japan	6.40	Taiwan	5.70
	Taiwan	4.60	Korea	4.30
	Thailand	4.30	Thailand	4.10
	Korea	4.10		
Taiwan	China*	37	Japan	26
	United States	16	United States	13
	Japan	7.70	China*	11
			Korea	6.90
Thailand	United States	15.90	Japan	23.60
	Japan	13.90	China	8.60
	China	7.30	United States	7.60
	Singapore	7.20	Malaysia	5.80
	Malaysia	5.40	Singapore	4.40
	Hong Kong	5.10	Taiwan	4.10
Vietnam[†]	United States	20.20	China	13.70
	Japan	13.60	Taiwan	11.30
	China	9	Korea	10.80
	Australia	7	Japan	10.50
	Germany	5.90	Singapore	10.50
	Singapore	4.80	Thailand	6.20
	United Kingdom	4.60	Hong Kong	4

[†] denotes 2003 figures
[‡] United Arab Emirates
* including Hong Kong

global marketplace? There are several **multilateral institutions** that warrant our attention. We briefly examine their objectives and their views on entrepreneurs.

Asia–Pacific Economic Cooperation (APEC)

Asia–Pacific Economic Cooperation (APEC) has 21 member economies.[3] The word 'economies' is used to describe APEC members because the APEC process is predominantly concerned with trade and economic issues and with members engaging with one another as economic entities. APEC was formed in 1989 to promote trade and economic cooperation among its members. The APEC countries account for approximately half of world exports. They work together to sustain this economic growth through a commitment to open trade, investment and economic reform.

In the 2004 Santiago Agenda on Entrepreneurship, APEC leaders have committed themselves to ensure entrepreneurship promotion policies are developed to promote growth and job creation as well as to encourage small and medium enterprise (SME) innovation. They called on governments to 'intervene' to promote new ventures and increase innovation. These interventions should correct market failures, unequal income distribution, economic instability, disadvantage based on ethnicity, imbalance between rural and urban development and gender inequity. 'The priority accorded to these objectives will vary between economies.'[4]

Organisation for Economic Cooperation and Development (OECD)

Organisation for Economic Cooperation and Development (OECD) is a multilateral organisation that provides a forum where representatives of industrialised countries develop and coordinate economic and social policies. Formed in 1961, its membership comprises the most economically advanced countries in the world.[5] OECD is one of the world's leading advocates of the new economy. Its Centre for Entrepreneurship, SMEs and Local Development, launched in 2004, disseminates best practices and fosters the development of the entrepreneurial society. OECD believes that entrepreneurship is central to the functioning of market economies.[6]

European Union (EU)

Entrepreneurship is now fundamental to **European Union (EU)** strategy. Smaller enterprises and entrepreneurs today play a central role in the EU economy. The EU is committed to boosting entrepreneurship as part of its strategy to transform its economy and build its future economic and competitive strength. To make progress on the entrepreneurship agenda, the European Commission published an action plan – strategic framework for boosting entrepreneurship.[7]

North American Free Trade Agreement (NAFTA)

The **North American Free Trade Agreement (NAFTA)** is an international agreement between Canada, Mexico and the United States whereby eventually no trade barriers will exist among the three nations. Additionally, it is likely that other countries such as Chile will join NAFTA. This has created the second-largest trading bloc in the world, after the EU. The present NAFTA market is composed of more than 400 million consumers and the total gross domestic product for the three countries is close to one trillion. Thus, new opportunities are occurring for entrepreneurs in these three countries. The former Canadian Prime Minister, Brian Mulroney, even suggested that New Zealand and Australia could become members of NAFTA.[8] In any case, Asia–Pacific entrepreneurs can use one country, for example, Mexico, as a base to reach the entire NAFTA market.

United Nations Development Program (UNDP)

The United Nations Development Program (UNDP) is working in areas to help break down the obstacles that prevent new entrepreneurs from getting started and the barriers that hinder the growth of SMEs. Secretary-General Kofi Annan initiated a UNDP-coordinated 'Commission on the private sector and development' by saying that 'entrepreneurs have the power to create the greatest change for their own countries.'[9] The Commission's report 'Unleashing entrepreneurship: Making business work for the poor' seeks to tap the power that can be drawn from engaging the private sector to unleash the entrepreneurial and creative potential of people.[10]

World Bank

The **World Bank** is actually a group of institutions that lend money to developing nations or encourage investment in various regions. They generally seek to contribute to economic growth in developing countries. More than just funding river diversions and petroleum-powered electric generators, the World Bank is increasingly funding the needs of local entrepreneurs. Through their programs they encourage governments to build a good investment climate in which private entrepreneurs can operate. The International Finance Corporation (IFC), a member of the World Bank group, believes that sound economic growth, grounded in the development of entrepreneurship and successful private investment, is key to reducing poverty.

World Trade Organization (WTO)

One of the most important bodies for global entrepreneurs, the **World Trade Organization (WTO)** had 149 members in 2006, collectively accounting for more than 90 per cent of the world's trade and virtually all of its investment. WTO has existed since 1995 and superseded the General Agreement on Tariffs and Trade (GATT). WTO is the only international body dealing with the rules of trade between nations. Its goals are to help trade flow as freely as possible, to promote the rules of free trade between the countries and to settle trade disputes. Whereas GATT had mainly dealt with trade in goods, the WTO covers also trade in services, creations and design. WTO brings the updated GATT, the new General Agreement on Trade in Services (GATS) and the Trade-Related Aspects of Intellectual Property Rights (TRIPS) together within a single organisation. WTO helps entrepreneurs because its members are not allowed to grant a special favour to one country (with some exceptions, such as the establishment of free trade areas). WTO aims to remove trade barriers, such as customs duties and to promote competition. In 2004, WTO found itself at the crossroads. World trade has grown significantly. Even as more and more countries appreciate the importance of trade, disputes have also become frequent. WTO has been set up to resolve these disputes amicably and to create an environment where trade can flourish.

ASIA–PACIFIC PROFILES IN ENTREPRENEURSHIP[11]

Australia

Level of entrepreneurial activity

Australia's early-stage entrepreneurship rate has fallen to 10.9 per cent (from 13.4 per cent in 2004). This decline coincides with decreased business confidence, although Australia still remains among the top 10 of Global Entrepreneur Monitor (GEM) participating nations when compared on this measure.

Reversing the trend of the last two years, female early-stage entrepreneurial activity has dropped markedly from 11 to 7.6 per cent. This means that for every 10 men there are a little less than five women.

Business angel activity has increased by 0.8 per cent this year. This coincides with an improvement in the ratio of activity motivated by opportunity and by necessity – this suggests that the quality of start-ups in 2005 may be better than in 2004.

Unique national features

The decline in the early-stage business participation rate is largely accounted for by a reduction in female participation. This suggests that the type of businesses being commenced by females may be more susceptible to changes in business confidence.

In Australia, the relative levels of full- and part-time participation on the part of business owners reflect the average score of this year's GEM nations. The nation's comfortable lifestyle is often said to be an inhibitor to the creation of high growth businesses. One may expect that part-time business ownership would feature more strongly in Australia – this was not the case.

On measures of innovation, Australia again displays a higher propensity toward competitor differentiation with 40 per cent of business owners falling into the medium category and 14 per cent indicating a high score. On measures of newness to customer and adoption of new technologies, more than 70 per cent of Australian business owners reported low scores in each area.

Key issues

Much of government policy on entrepreneurship centres on generating innovation through science and technology. There is little evidence of success in diffusion policies where start-ups, young and established businesses readily seek out and adopt new technologies or create new products and services for customers and markets.

Australia remains below the GEM average (on the reports of the key informants) on measures of education in entrepreneurship and the start-up and growth of new firms in all education sectors from primary through to higher education.

The sustained high levels of participation in entrepreneurship could be well supported by policy measures that not only encourage innovation in the business sector but drive ambitions and intentions beyond thinking domestically or even growing exports and toward the creation of a business environment that thinks and acts as global players on a world stage.

Japanese entrepreneurship

Level of entrepreneurial activity

Japan has the second lowest rate of entrepreneurial activity (3.5 per cent) among the GEM countries. About one-third of Japan's entrepreneurs are driven by necessity (in the ranks of South Africa and Argentina).

Consistent with the relatively low level of entrepreneurial activity, there are few business angels in Japan. Less than 1 per cent of the adult population invests in new business start-ups, compared with the GEM 2004 average of 3.9 per cent. The involvement of Japanese women in entrepreneurial activities is also low. The ratio of one woman to every three men is lower than the GEM average.

Unique national features

Japanese culture is generally not supportive of entrepreneurship. Recently, however, young people have been more motivated to start new businesses rather than opting to work in large established companies or in the public sector. Adverse market and share price developments have increased the level of risk for many young companies as a result of lower sales growth and stronger competition.

Key issues

Because of significant structural changes in the financial sector in Japan, many banks are reluctant to lend to entrepreneurs. In addition, banks often lack the capability to assess new business ventures. Japan's tax system and regulatory structure tend to discourage entrepreneurship. A high rate of taxation on capital gains and stock options penalises entrepreneurial success. Continued active involvement by government agencies in several business sectors, such as postal services, limits the opportunities for new business ventures in those sectors.

Korean entrepreneurship

Level of entrepreneurial activity

An entrepreneurial activity rate of 15 per cent puts Korea just ahead of New Zealand and just behind Chile. A relatively high proportion (40 per cent) of entrepreneurial activity is motivated by necessity. Entrepreneurial activity is particularly high among men. Only one in 10 entrepreneurs is female.

Unique national features

The Asian financial crisis of 1997 led to concerted efforts by the Korean government to overcome the country's foreign exchange problems and restructure the economy. It initiated reforms designed to instil market mechanisms throughout the economy and reduce reliance on the small number of large conglomerates. These included specific measures to promote new businesses and touched many areas from research and development to direct support for new businesses and tax concessions to investors.

Key issues

Falling interest rates have not improved the financial constraints faced by start-up businesses. Venture capital investment in new ventures has fallen sharply. In the current climate, banks are also showing a strong preference for lending to low-risk clients. Businesses with low credit ratings are expected to have difficulties in obtaining bank financing.

A strong university education system has left little room for entrepreneurship. The growing popularity of entrepreneurship among students has faltered, with employment in larger corporations or financial institutions now being preferred to new ventures as uncertainty continues and conditions in the labour market weaken.

New Zealand/Aotearoa

Levels of entrepreneurial activity

In terms of total early-stage entrepreneurial activity, Aotearoa (Māori New Zealand) at 17.7 per cent and New Zealand at 17.6 per cent were surpassed only by Thailand and Venezuela. But they significantly exceeded the United States and United Kingdom. About 25.0 per cent of Māori versus 13.1 per cent of the general population say they expect to launch a start-up in the next three years.

Māori experience some liabilities: 6.5 per cent of Māori own and operate established businesses compared to 10.8 per cent in the general population. Only 37 per cent of Māori entrepreneurs survive 42 months compared to 62 per cent in the general population. Māori entrepreneurs between 35 and 44 years old have some of the highest total entrepreneurial activity rates ever recorded in the GEM survey. About one in three between 35 and 44 years of age is an entrepreneur.

Unique national features

Approximately 83 per cent of Māori entrepreneurs are opportunity entrepreneurs, a value comparable to Canada, Austria and the United States. Māori have a higher rate of necessity entrepreneurship than the general population; however it is inaccurate to say that most Māori are necessity entrepreneurs.

For New Zealanders, both Māori and non-Māori, wealth creation is not as important as is independence. Māori have twice as many independence-driven entrepreneurs as wealth-driven entrepreneurs. The typical entrepreneur is an opportunity-based lifestyle entrepreneur, opting for work–life balance rather than wealth creation.

New Zealand entrepreneurs, both Māori and non-Māori, have twice the global rate of 'we face no direct competition' and are top-rank in business optimism. Māori are definitely not technology-shy. In terms of technology innovation, 18 per cent of Māori entrepreneurs claim to be using the very latest technology compared to 10 per cent of the New Zealand general population of entrepreneurs. Māori also have much higher growth expectations – 12.3 per cent of Māori entrepreneurs believe they will create 20 jobs in five years compared to 8.1 per cent of the general population.

Māori women have the world's third highest opportunity entrepreneurship rate and only a moderate rate of necessity entrepreneurship. Māori males have much higher rates of necessity entrepreneurship, about five times the rate of the general male population. Māori have the highest informal investment rate in the OECD and double the rate of informal investment of other GEM nations. More Māori (71.3 per cent) than other New Zealanders (60.5 per cent) say that starting a business is a good career choice.

Key issues

New Zealand in general has distinguished itself since 2001 as one of the world's most entrepreneurial countries. Surprisingly to some, the indigenous Polynesian population, the New Zealand Māori, are every bit as entrepreneurial as European New Zealanders. Nonetheless, the New Zealand government has largely ignored entrepreneurship policy while concentrating on innovation policy. Entrepreneurship as a concept does not fit the ideology of the Labour-led Coalition government. Big business and the chambers of commerce are largely uninterested in entrepreneurship and prefer to focus on small business policy and innovation funding. While the number of commercialisable ideas has increased, the supply of high-growth entrepreneurs has not. New Zealand is largely a country of lifestyle entrepreneurs with low horizons and ambitions. They would rather exploit existing equilibrium opportunities and optimise supply and demand in established markets than exploit innovative venture opportunities and create new markets at home and abroad.

Singapore

Level of entrepreneurial activity

Total early-stage entrepreneurial activity in Singapore has increased from a low of 4.2 per cent in 2000 to 7.2 per cent in 2005. Singapore's rate is now above the mean for OECD member states (6.8 per cent) and is also an increase from 5.7 per cent in 2004.

While men are still more likely to be involved in entrepreneurial activities than women, the gender gap has begun to narrow. The rate of female involvement has risen by 50 per cent from 3.4 per cent in 2004 to 5.1 per cent in 2005, while male overall involvement has risen by only 17 per cent from 8.2 per cent in 2004 to 9.6 per cent in 2005. Consistent with previous years, opportunity entrepreneurship accounts for the majority of entrepreneurial activities in 2005 (83.8 per cent). However, the rate of necessity entrepreneurship has doubled from 0.6 per cent of the general population in 2004 to 1.2 per cent in 2005.

Singapore ranks high globally in terms of start-ups with high growth potential. With about one in five new start-ups expecting to create high levels of employment, Singapore is among the top nations for high growth potential entrepreneurial activities.

Unique national features

The prevalence of informal investors has been an upward trend since 2003, with a rate of 3.5 per cent in 2005 compared to 2.7 per cent in 2004. In the last two years, Singapore's business angel prevalence rate has been above the GEM global average. Given the positive economic outlook and growth in the country's research and development (R&D) sectors, it likely that informal investments will continue to rise to provide financing support for the development of new start-ups. The key challenge for policy makers is to enhance the level of professionalism and expertise of the business angel community so that they are better equipped to invest in high-risk and high growth ventures.

Key issues

Experts rated cultural attitudes towards entrepreneurship slightly higher in 2005 than in previous years. This appears to reflect the success of efforts to leverage on education and training to foster entrepreneurial mindsets. Policymakers have made significant changes to the education curriculum at the primary, secondary and tertiary levels to mould the young generation to be less risk averse and more enterprising. However, it will take time for these policy changes to make a significant impact on society's attitudes towards entrepreneurship. As revealed in the 2005 survey, the prestige of entrepreneurship in Singapore is rated slightly below the GEM global average.

The effectiveness of R&D transfer is the third lowest rated entrepreneurship framework condition in Singapore. This concern is addressed by several recent policy initiatives that emphasise R&D as a national priority. The government recently announced an increase in total public sector R&D budget from just under S$5 billion for the financial years 2001–05 to almost S$12 billion for financial years 2006–10, including S$5 billion committed to the new National Research Foundation. A high-level Research, Innovation and Enterprise Council (RIEC) will also be set up to foster innovation for growth and job creation. These developments provide promising opportunities for high-tech start-ups and knowledge-based ventures. It will be important to ensure that these resources are channelled effectively to eligible recipients in order to boost their technological and internationalisation capabilities.

GOING GLOBAL

The first question the entrepreneur should ask is: Why should I go global in the first place? An entrepreneurial firm should be able to answer 'yes' to many of the following questions.

- **Profit maximisation:** Is the firm driven by a need to maximise profits? Are shareholders or investors expecting quick returns? This might mean adopting an 'opportunistic' strategy in which the company moves from market to market in search of the best possible returns, rather than slowly building a position in any particular market.

CHINESE ENTREPRENEURS

ENTREPRENEURSHIP IN PRACTICE

CHINA'S HOME-GROWN ENTREPRENEURS

Private business was gradually abolished following the 1949 Communist revolution, so that by the 1950s it had all but disappeared. It was first revived after the Cultural Revolution as a way to respond quickly to the mounting pressures of unemployment and economic stagnation. It was allowed on the fringes of the economy and was initially regarded as a supplement to the state and collective sectors. Private enterprise first took hold in the rural sector, as an outgrowth of the virtual privatisation of agriculture and in small-scale individual enterprises in the urban sector.

During the 1980s, larger private enterprises grew out of these rural and individual enterprises and out of collectives (enterprises with common ownership by the employees, under state supervision) and SOEs. Some were sole proprietorships (getihu) that grew and took on more employees. By 1988, when private firms were first officially recognised, China had 500 000 getihu that could be called private firms (siying qiye). Some larger private enterprises emerged from the leasing of state or collective enterprises to individuals. The private entrepreneur paid the collective a fixed rent and operated the firm as if it were his own – and in many cases accumulated considerable assets. These enabled him to reduce the share of collective ownership and gradually transform the enterprise into a solely owned firm.

Many large private firms disguised their true identities by maintaining the formal status of a collective or SOE, a process known as 'wearing the red hat'. Collective status allowed a degree of local government involvement in the enterprise. This could be helpful in obtaining access to land, bank loans, government contracts and tax breaks. On the other hand, wearing the red hat meant that enterprises could not operate on a fully commercial basis, but had to cooperate, to some degree, with the local government's wishes.

The change in political sentiment following the events of 1989 caused a temporary setback to the growth of private enterprise, but Deng Xiaoping's famous 'Southern Tour' in September 1992, during which he called for continuation of the reform effort, opened the way for renewed growth. During the 1990s, government encouraged the privatisation of smaller, non-strategic SOEs and allowed collectives to transform into private enterprises. As a result, the number of registered private firms (excluding sole proprietorships) rose from 108 000 in 1991 to 960 000 in 1997. In March 1998, the government issued a directive requiring all the red hat firms to 'take off the hat', or show their private ownership, by November 1998. In effect, government was playing catch-up with the reality of how these enterprises were operating. However, because of the advantages of maintaining connections to local government, many privately run enterprises have maintained their collective status.

ONE OUT OF EVERY 30 PEOPLE IN SHANGHAI OWNS A PRIVATE BUSINESS

In China's largest city Shanghai, there is one private business owner out of every 30 people of employable age, a recent survey among Shanghai's working population has found.

The survey, conducted by the Shanghai municipal labour and social security department, shows 3.1 per cent of the 25 000 citizens surveyed are operating their private business entities and hold stakes.

Meanwhile, an additional 1.8 per cent of the respondents said they are making concrete preparations for a private business, bringing the actual proportion of private entrepreneurs in the city to 4.9 per cent.

The percentage is higher than the 3.3 per cent reported in Hong Kong and 4.3 per cent in Taiwan, but lags behind the southern booming city Shenzhen, where 10.5 per cent of the working population are private business owners, said Sheng Zuhuan, a labour and social security official.

The survey also found an impressive 13.1 per cent of average Shanghai people plan to start up their own businesses in the coming year. The proportion is nearly 23 per cent among the unemployed respondents.

Men are more enthusiastic than women in starting up a business and those between 35 and 44 years old are keenest entrepreneurs, according to Sheng.

Most residents support enterprising endeavours and are tolerant of abortive business attempts, too. About 84 per cent of the parents surveyed said they approve of their children's private business plans and are ready to give a helping hand.

The respondents, aged between 16 and 64, were randomly picked by the labour and social security department to fill out a questionnaire.

Shanghai has been encouraging its unemployed population to start up their own businesses since 1996, with tax exemption policies, easier access to small loans and tailored logistic services for their convenience. About 20.5 per cent of the citizens have benefited from the preferential treatment in the past decade.

Source: Neil Gregory and Stoyan Tenev [www.chinabusinessreview.com/public/0101/gregory.html]; 'One out of every 30 people in Shanghai owns a private business: Survey', *Xinhua Economic News Service* (7 November 2005).

- **Market share:** Does the firm want to establish a strong position in an undeveloped market? Is it willing to charge less initially (penetration pricing) in order to get buyers to adopt? This may mean spending more on advertising and marketing and less concern with short-term profitability. This strategy works best in a market where demand is strong (or can be stimulated with appropriate marketing) and where competition, particularly from local suppliers, is weak.
- **Maximising cash flow:** Another strategy may be simply as a way of maximising cash flow. Firms strapped for cash may go abroad to bring in more revenue. This may be the case, for example, for companies that have large stocks of unsold or discontinued inventory or with idle production capacity.
- **Repositioning the business:** Global market entry may help an entrepreneurial firm reposition a business by developing new product lines and new capabilities. It may make sense to roll out a different product in a new market, where the company is relatively unknown, than attempt to change the company's image in its original market, possibly undermining its existing business in the process.
- **Domestic impact:** Aggressive firms may go overseas in order to acquire new knowledge, skills or technologies for their domestic operations. Such strategies are often pursued by companies in technology-intensive industries or in sectors undergoing rapid change.

The entrepreneur can actively engage in the international market in many ways:

- **importing**
- **exporting**
- **joint ventures**
- **direct foreign investment**
- **royalties and licensing**
- **franchising**
- **mergers and acquisitions**
- **greenfield investments**.

These are all becoming part of the extended enterprise. Each of these methods involves increasing levels of risk. The final choice will depend on the organisation's needs and the risk it is willing to take.

Importing and global sourcing

Importing is buying and shipping foreign-produced goods from foreign sources. Entrepreneurs trade because it enables them to acquire goods they cannot produce themselves. Today importing is called **global sourcing**. Entrepreneurs find market niches and fill them. Global sourcing makes it possible to meet an increase in product demand. Then there is the quality issue. Some countries have a reputation of producing high quality products with high reliability. Another reason is the penetration of growth markets. An entrepreneur can get a foothold in a new country by sourcing in that country. Last but not least, there is cost. Buying abroad is sometimes cheaper than domestic buying. Of course, there are disadvantages as well. There are extra cost factors and time factors, such as travel and communication. A foreign broker's and an agent's fees must be paid. Then there is the cost of distribution which adds hugely to the unit cost.

How does an entrepreneur become aware of import opportunities? Knowing where to look is sometimes the hardest part of importing. It is often indicated by your knowledge of world trends in your industry or existing market, or your intuition about likely new markets. The next stage is to test and confirm this. Some entrepreneurs use a formal market selection process, which considers a wide range of political, geographic, economic and other factors. Others use a less formal process, such as talking with business people and other importers. Another way is to attend trade shows and fairs where firms gather to display their products and services. Some of these shows are international in flavour, with firms from different countries exhibiting their products and services. Basically, the trade show gives the prospective customer the opportunity to window-shop. Another way is to monitor trade publications. Often, firms will advertise in trade publications to make themselves known to potential customers.

Exporting

On the flip side is exporting, shipping and selling of local-produced products and services abroad. Every globally active entrepreneurial seller is an exporter of some kind. This is particularly important for countries of the Asia–Pacific.

Exports can be commodities such as wood and meat products, manufactured goods such as electronics or automobiles, knowledge products such as software or video, services sold to foreigners or even education sold to international students. Exporting is important for entrepreneurs because it often means increased market potential. Instead of being limited to a small market, the firm now has a broader sales sphere.

Increased export sales volumes will lead to lower unit costs, which will lead to increased margins and profits. As more and more units are exported, the firm becomes more efficient at production of the units, thereby lowering the cost per unit. The lower unit cost thus enables the firm to compete more effectively in the marketplace.

Exporting has been increasing as a method for venture growth and increased profitability among entrepreneurial firms. One study identified four key competitive export strategies small firms can use to gain a competitive edge in their market:

- market differentiation through competitive pricing, through the development of brand identification or through innovation in marketing techniques
- focus strategy involving specialty products for particular customers or new-product development
- achieving technological superiority of certain products
- product-oriented emphasis using the elements of customer service and high quality.[12]

In order to pursue any of these strategies, entrepreneurs need to understand some of the ways to become involved in exporting that are presented in the following sections. Foreign market entry is a complex and sometimes lengthy process. Even if the firm is producing more units efficiently, it will take time to learn the intricacies of global entrepreneurial trade. There are lots of considerations when launching an entrepreneurial export business – from cultural issues in advertising, currency trading and hedges, to tariffs and taxes. Smaller companies can sometimes overcome this by entering into deals with companies abroad. That means shifting some of the risks to overseas firms. It also means relinquishing at least some power over how a transaction is made and its value captured. The bottom line question is: Are increased sales in an international market worth the loss of control and profit?

Large and frequent exporters can usually handle the challenges of international trade on their own. For smaller firms of the Asia–Pacific, diverse mechanisms can lead to benefit on both sides of the transaction through various types of alliance and partnering strategies. These can:

- take care of tricky distribution and delivery issues
- share risks and costs as well as the reward
- overcome the culture and distance barriers
- bring the exporter’s product or service more closely in line with the needs of the customer.

Some exporters do not actually export products themselves. Indirect exporters simply provide components to other companies who do. This way, small entrepreneurial firms can get a taste of the rigours of foreign exporting without all of the problems. For example, automobile manufacturers source components from a host of smaller suppliers. Many of the cars they assemble are destined for export. These suppliers – called indirect exporters – need not concern themselves with market entry barriers, logistics or international distribution. Yet they must continually produce their product with the ultimate foreign customers in mind.

Strategic alliances

All of the following methods comprise various forms of the strategic alliance. The term encompasses everything from informal agreements to share information all the way up to joint ventures. In short, a **strategic alliance** is any formal relationship, short of a merger or acquisition, between two companies, formed for the purpose of gaining synergies. In the new economy, strategic alliances enable business to gain competitive advantage through access to a partner's resources, including markets, technologies, capital and people.

Teaming up with others adds complementary resources and capabilities, enabling participants to grow and expand more quickly and efficiently. Especially fast-growing companies rely heavily on alliances to extend their technical and operational resources. In the process, they save time and boost productivity by not having to develop their own from scratch. They are thus freed to concentrate on innovation and their core business.[13]

Strategic alliances give firms access to additional resources and capabilities by sharing the high costs and risks of business, by participating in a division of labour appropriate to respective business strengths and by better-leveraging financial resources.

Alliance patterns differ from one industry to the next. Companies in the biotechnology sector tend to seek out alliances for joint R&D. Alliances in the information technology sector tend to favour marketing agreements and those in the materials industry tend to be production-oriented. By using these various forms of alliance, small entrepreneurial firms can compete effectively in the global economy. The linkages formed are restricted primarily by a company's ability to manage its relationships.

Before entering into a strategic alliance, enough thought is to be placed behind the structure of the relationship and the details of how it will be managed. Consider the following in your planning process:

- define expected outcomes from the relationship for all the parties in the strategic alliance
- define and document the elements provided by each party and the benefits a successful alliance brings to each
- identify the results that will cause the alliance to be most beneficial for your business and define the structure and operating issues that need to be addressed to achieve these results
- protect your company's intellectual property rights through legal agreements and restrictions when transferring proprietary information
- define the basics of how you will operate
- be certain that the company cultures are compatible and the parties can operate with an acceptable level of trust.[14]

Export management company

Another way to get into export is through an **export management company**, also known as a trading house. An export management company is a private firm that serves as an export department for several manufacturers. The company solicits and transacts export business on behalf of its clients in return for a commission, salary, or retainer plus commission. In addition, some export management companies will purchase the product and sell it themselves to foreign customers. Export management companies can facilitate the export process by handling all of the details – from making the shipping arrangements to locating the customers.

When approaching an export management company, however, entrepreneurs should exercise caution. Questions to ask include:

- What is the reputation of the firm?
- What expertise does the firm have in the specific product line?
- What is its track record?
- Does it have an adequate number of staff?
- Will it accept a non-exclusive contract?
- Can it handle documentation and shipping requirements?
- Is the company familiar with selling in areas of the world where you want to go?
- Will it accept a performance clause in the contract?

On the positive side, the small entrepreneurial firm doesn't have to find foreign buyers and deliver the goods. It can also add synergies and broader markets to sales volumes since many trading houses specialise in specific types of goods and can offer larger catalogues of, say, electronic parts, clothing or food products. The producer would then see the benefits of higher volumes or higher prices. On the minus side, the producer loses control over pricing, positioning, marketing and delivery. This strategy would not be appropriate for a company trying to establish a brand reputation abroad.

One form of export management is the freight forwarder. A freight forwarder is an independent business that handles export shipments in return for compensation. This does not cost as much as the services offered by an export management company. That is because an export management company handles all of the export-related activities, whereas the freight forwarder simply arranges for product shipment.

Foreign distributors

There are quite a few similarities with **foreign distributors** and the trading house. The distributor takes title to the goods and has to re-sell them down the distribution chain. The big difference is that transaction (transfer of ownership) may take place in the home country of the distributor. What this means is that the entrepreneur producer must do the packaging and delivery. The producer assumes more risk but is in a better position to capture more value from the transaction. The producer also has to take care of all of the barriers to market entry before the products arrive at the distributor. Of course, this can be arranged differently. Apprehensive exporters can offer their products 'ex works' – in effect selling them at their factory gate. That means all of the formalities fall to the distributor. On the negative side, the distributor relationship means the producing firm can lose control over marketing, sale and delivery. The goods may even be totally repackaged, relabelled, or repositioned to suit the distributor rather than the exporter (unless specific provisions are included in the agreement). This means that a fruitful and productive foreign distributorship can have some characteristics of a strategic alliance or even a partnership.

Foreign agents

An 'agency agreement' with a **foreign agent** is a step forward from these previous forms of market entry. Here the producer retains title until the goods are delivered to the buyer or even to the consumer. The agent merely 'represents' the producer but never takes ownership of the goods. Motivated agents like to work on a commission basis because they capture an agreed-upon percentage of every transaction – oftentimes even with an escalator clause for great sales. That gives them the incentive to maximise sales volumes. Usually a new agent starts out on a low salary

and commission. As sales increase, so do commissions. It is generally the exporter's responsibility to pack and ship the goods, clear them through customs and deliver them to the agent. This means that the producer/exporter assumes direct responsibility for most of the steps in the distribution chain. A good agent can also be extremely helpful in dealing with some of the procedures involved and is better placed to understand any duties, taxes or 'tips' owing on the shipment. In rare instances the exporter may deal directly with a foreign customs broker – usually if the goods must be stored for future distribution.

Setting up a local office

Beyond agents, the next route to global market entry is setting up a small office in the country. Usually firms send over one or two people with specialist language or cultural expertise to set up a small office, gather local intelligence, set up a contact network, trial-test new opportunities and carry out marketing and public relations. If things go well, then the staff move from information gathering to deal-making and order-processing. This could lead to setting up a full-scale subsidiary in the new market. It is important to work with trade delegations from the home country that have offices abroad. They have experience, specialist expertise and, most importantly, the contact network to help the venture along.

Contract manufacturing

Contract manufacturing means that a contractee-manufacturer assembles the product under a contract arrangement. The manufacturer often charges on a per-piece or per-lot basis for the labour required for their services while using components or materials, moulds or detailed manufacturing instructions supplied by the entrepreneur. Sales and marketing of the finished product remains the responsibility of the contractor, not the manufacturer. The greatest potential for contract manufacture offshore lies not in being a substitute for local manufacture and export but as a means of achieving strategic advantages in the target country.

Co-production

Under **co-production** agreements, companies agree to manufacture each other's products. Co-manufacturing may be combined with co-promotion or **co-marketing** agreements (see below). Most such agreements do not involve licences or royalties, but some rights to the product may be worked into the agreement.

Joint production

In a **joint production** agreement, companies cooperate to produce goods. These agreements enable firms to optimise the use of their own resources, to share complementary resources and to take advantage of economies of scale. Companies may cooperate to make components or even entire products. Many foreign engineering firms have entered joint production agreements with domestic firms that have manufacturing expertise. In the automobile and telecommunications industries, competing firms often form an alliance to make components that they all need and use.

Retail outlet

Beyond this comes the network of **retail outlets** as volume increases. Some are owned and operated (O-and-O) by the parent firm or could be dealerships that have an exclusive relationship to the parent. This gives the parent company direct control over the whole distribution chain from initial production to final sale. One of the huge additional benefits is that the parent company can monitor customer behaviour. On the negative side, though, it means hiring, training and firing sales staff, managing inventory, navigating local laws and operating the outlets.

Co-marketing

Co-marketing, also known as co-promotion, means two or more companies cooperating to market or promote each other's products. This type of alliance can involve cross-licensing a shared promotion campaign, or even the formation of a joint venture to market products. For a firm wanting to enter a new market, a co-marketing agreement is an effective way to take advantage of existing distribution networks and an ally's knowledge of local markets. It allows firms whose products complement each other to fill out a product line while avoiding expensive and time-consuming development.

Export consortium

The most common form of an **export consortium** might involve a joint bid by several small firms to bid on a foreign project. For a large-scale project, this is the only way that small firms can reach a threshold of size and credibility to complete the assigned task. Much smaller ventures might also require a diversity of skills. Consortia can be fairly informal, but they work better if there is some common agreement that defines the group's objectives.

Joint venture

A joint venture (JV) is an international business collaboration in which two or more parties establish a new business enterprise to which each contributes and in which ownership and control are shared. There are good business and accounting reasons such as distribution, technology, or finance to create a joint venture. One is that the firm would be able to gain an intimate knowledge of the local conditions and government where the facility is located. It provides the opportunity to obtain new capacity and expertise. Another benefit is that each participant would be able to use the resources of the other firms involved in the venture. This allows participating firms a chance to compensate for weaknesses they may possess.

It is important to consider certain important factors before forming a joint venture. These include:

- prospective partners should be screened
- joint development of a detailed business plan and a short-list of a set of prospective partners based on their contribution to developing a business plan
- due diligence – checking the credentials of the other party ('trust and verify' – trust the information you receive from the prospective partner, but it's good business practice to verify the facts through interviews with third parties)
- development of an exit strategy and terms of dissolution of the joint venture
- most appropriate structure (for example, most joint ventures involving fast growing companies are structured as strategic corporate partnerships)
- availability of appreciated or depreciated property being contributed to the joint venture (by misunderstanding the significance of appreciated property, companies can fundamentally weaken the economics of the deal for themselves and their partners)
- special allocations of income, gain, loss or deduction to be made among the partners
- compensation to the members that provide services.[15]

The central characteristic of a joint venture is that it is an equity-based relationship. In a joint venture, two or more 'parent' companies agree to share capital, technology, human resources, risks and rewards in the formation of a new entity under shared control. Each parent owns a part of the joint venture and is represented on its board of directors or other governing body.

If the ownership of the joint venture is split 50–50, it is usually because the partners are about the same size and both want a large say in the company. A different split usually reflects a difference in the resources committed by each parent. Here are three possible joint venture governance arrangements:

- full equality – the parents decide policy and operating matters together
- policy equality – the parents must concur on joint venture policy terms, while one takes the lead in operating matters
- lead parent arrangement – one parent has the lead on policy as well as operating questions.[16]

One of the disadvantages associated with joint ventures is the problem of fragmented control.[17] For example, a carefully planned logistics flow may be hampered if one of the firms decides to block the acquisition of new equipment. This type of problem can be avoided or diminished in several ways:

- One party can control more than 50 per cent of the voting rights. This will normally give formal control; however, even a minority opposing view can carry considerable influence. This can be particularly true if the differences of opinion reflect different nationalities.
- Only one of the parties is made responsible for the actual management of the venture. This may be complemented by a buyout clause. In case of a disagreement among the owners, one party can purchase the equity of the other.
- One of the parties can control either the input or the output, exerting significant control over the venture decisions, despite voting and ownership rights.

Direct foreign investment

A direct foreign investment is a domestically controlled foreign production facility. This does not mean the firm owns a majority of the operation. In some cases, less than 50 per cent ownership can constitute effective control because the stock ownership is widely dispersed. On the other hand, the entrepreneur may own 100 per cent of the stock and not have control over the company. In some instances the government may dictate whom a firm may hire, what pricing structure the firm must use and how earnings will be distributed. This causes some concern about exactly who is in control of the organisation. Because of the difficulty of identifying direct investments, governmental agencies have had to establish arbitrary definitions of the term. A direct foreign investment typically involves ownership of 10 to 25 per cent of the voting stock in a foreign enterprise.

A firm can make a direct foreign investment by several methods. One is to acquire an interest in an ongoing foreign operation. This initially may be a minority interest in the firm but enough to exert influence on the management of the operation. A second method is to obtain a majority interest in a foreign company. In this case the company becomes a subsidiary of the acquiring firm. Third, the acquiring firm may simply purchase part of the assets of a foreign concern in order to establish a direct investment. An additional alternative is to build a facility in a foreign country.

An entrepreneur may want to make a direct foreign investment for several reasons. One is the possibility of trade restrictions. Some countries have prohibitions or restrictive trade barriers on imports of certain products. These barriers can make exporting costly or impossible. In addition, foreign governments may grant tax incentives to a firm seeking direct investment in that country. These incentives can be attractive if the anticipated rate of return is estimated to be higher at the foreign location than domestically.

Direct investment can be an exciting venture for small firms making efforts to increase their sales and their competitive positions in the marketplace. However, it is sometimes not practical for a firm to make a direct investment in a foreign location. If the firm has a unique or proprietary product or manufacturing process, it may want to consider the concept of licensing.

ENTREPRENEURSHIP IN PRACTICE

JOINT VENTURE AGREEMENT CHECKLIST

- Legal structure of the new business
- Scope of business
- Governing structure: Percentage ownership; cooperation at the policy and operating level
- Investment: Form of investment (know-how, technology, brand equity, equipment, land, cash and so on); total investment and/or capital contribution
- Production: Goods and/or services to be produced and/or provided; location of production facilities; required production capacity; required office space; R&D budget; quality management and standards
- Management and staffing: The CEO (should come from one of the parents but be able to win both parents' confidence); board of directors (total number, number of appointees of each parent, frequency of meetings); governance policies (regulatory compliance, board policies); other key positions (who appoints what members of the management team and responsibilities for each position); expatriates (legal, living and working arrangements); delegation of authority, reporting structure
- Technology and intellectual property transfer: Technology transfer (patents, copyrights, know-how, trade secrets); specifics on technology to be transferred; training and technical assistance
- Marketing: Marketing strategy; office space required for and location of sales and branch offices; share or products/services to be sold at the local and international market; marketing budget
- International business procedures: Requirements for local or imported raw materials and components; foreign currency requirements; taxes and import duties; regulatory approval process (cost, timing requirements);
- Contracted services; Product/service development; marketing support
- Revenue sharing: Dividend policy, royalties or transfer fees
- Accounting and control methods: Level of detail in cost accounting required; information required for venture control; frequency and level of detail required for accounting reports; choice of auditor

Source: Ten3 East-West. 'Joint venture agreement: Checklist' [www.1000ventures.com/doc/legal/agr_jv_checklist_byten3ew.html].

Royalties and licensing

Royalty is a payment made in return for being permitted to exercise a right owned by another person. Most commonly it is allied to the payment made by a publisher or record producer to the author of a book or performer of a piece of music, but it can apply equally to a payment made for producing something by a patented process. This method of distribution is usually entered into when the developer of a product or component does not have the capital, time or commitment to manufacture and market the product/component themselves, or there are substantial tariff barriers to imports in the market of interest. You effectively sell your intellectual property to someone else to manufacture on your behalf, or to incorporate into a product they are already manufacturing. You then receive an agreed amount – a royalty – every time they make a sale. This method is often entered into when a small component has been developed that can be used in other processes – for example, a micro-chip that can be used in computers.

Licensing is a global market-entry tool in which the company enters into an agreement with a licensee in the foreign market, offering the right to use a manufacturing process, trademark, patent, trade secret, or other item of value for a fee or royalty. Licensing can cover inventions, technologies, software, manufacturing systems and processes, products, and artistic and literary material. The entrepreneur need not make an extensive capital outlay to participate in the international market. Nor does the licensor have to be concerned with the daily production, marketing, technical, or management requirements; the licensee will handle all of this. Due to the high cost of manufacture and the comparatively small investment of a licensing program, many of the risks that a company would otherwise face in exploiting its intellectual property are transferred to the licensee. Depending on the exclusivity of the licence, there are varying degrees of risk involved for the licensee and licensor; however, an effective licence strategy will minimise risk for both parties.[18]

For developing an international licensing program, three basic types of programs are available:

- **Patents:** If the entrepreneur decides to use the patent approach, they should begin with a valid US patent. Within one year, the entrepreneur should then file for patents in the countries where business will be transacted. Although this step can be expensive, it is essential because this action will give them a stronger bargaining position. Keep in mind that the United States is trying to adjust its patent system from 'first to invent' to the international system of 'first to file'. It's being referred to as 'patent harmonisation' in order to be compatible with the international marketplace. The new system includes safeguards for small inventors, such as an inexpensive system for provisional patents. The goals are to make the patent process more efficient and to offer better foreign protection for inventors.[19]

  Currently, a single patent filing could cost tens of thousands of dollars in fees if you include all the lawyers' fees. The entrepreneur must file multiple applications as a defence against competitors – particularly in a global economy. A rule of thumb is that gaining sufficient protection for a patent internationally could cost about $100 000. Filing 10 related patents to create a protective 'picket fence' around an invention could cost the entrepreneur $1 million. Self-defence has increased the cost of international patent protection.[20]
- **Trademarks:** Due to the difficulties that can occur in direct translations, it may be advisable for the entrepreneur to have more than one trademark licensed for the same product. The entrepreneur should keep in mind, however, that if the product is not well recognised in the international market, they will not be able to use it as a major incentive in the bargaining phase. Sometimes, licensees will want the patent rights but prefer to use their own trademarks. This can be particularly true if the foreign firm is well established.
- **Technical know-how:** This type of licensing is often the hardest to enforce since it depends on the security of secrecy agreements. (The licensor should sign an agreement to prevent the licensee from legally revealing trade secrets.) In some localities, governments have strict regulations governing the use of technical know-how licensing. Frequently, one may protect the technical capabilities for only five years before the licensee is free to use this know-how without paying royalties. However, keep in mind that this may differ from country to country, depending on the particular regulations. Because this is a complex process, the entrepreneur must continue to develop their technical capabilities to ensure an ongoing international need for the company's services.[21]
- Advantages of licensing:
  - It can be an extremely attractive way to enter the international arena. It requires a minimal capital outlay and can generate savings in tariffs and transportation costs.
  - It is a more realistic means of expansion than exporting, particularly for the high-tech firm.
  - Access to the market is easier in comparison with equity investments and foreign governments are more likely to give their approval because technology is being brought into the country.

  - A potential exists for the licensees to become partners and contributors in improving the 'learning curve' of technology.
- Disadvantages to licensing also exist:
  - It is possible that the licensee will become a competitor after the contract expires.
  - The licensor must get the licensee to meet contractual obligations and to adjust products or services to fit the licensee's market.
  - The licensing entrepreneur must manage the relationship's conditions and circumstances, as well as resolve conflicts or misunderstandings as they occur.
  - The integrity and independence of both the licensor and licensee must be maintained.

To be competitive with larger firms, small businesses have to be on the cutting edge of bringing in new and innovative technology. Moreover, some small firms may not have the financial resources available to participate in the international marketplace by exporting, joint venture, or direct investment. For many of these firms, international licensing is a viable and exciting method of expanding operations.[22]

Before a company considers licensing out its technology, however, it should consider whether other ways of taking advantage of its property, such as joint ventures and strategic alliances with other companies, would better complement its economic position. Once licensing is decided on, the nature of the company, as well as the particular property it wishes to utilise, should be carefully considered before deciding the architecture of the licence.[23]

Franchising

Franchising is a specific form of licensing that involves selling the rights to a complete package of trademarks, processes, technologies, designs and copyrights, as they are all involved in the operation of a specific business. Perhaps the best known franchises are in the fast-food business, with the world leader probably being McDonald's. Whether it is in North America or Russia, a McDonald's restaurant promises the same food, the same quality and the same level of service to customers. Moreover, its business formula involves service standards (quick service, a standard menu), an approach to employment (hiring younger people), technology (high-tech ovens, foolproof cash registers), marketing (Ronald McDonald, frequent promotions) and a common 'look' that is reinforced by logos and other symbols. In selling its franchise, McDonald's provides an entire process, employee training, monitoring of performance, quality control and marketing support as part of the package.

Generally, with franchising, though terms of the arrangement vary, the purchaser usually pays a lump sum for the franchise and then remits a percentage of all subsequent profits. The sale of a franchise marks the beginning of an ongoing partnership between the franchise owner and the purchaser that apportions responsibilities in both directions. That partnership may include an agreement that the purchaser buy specific products or supplies from the franchise owner on an exclusive basis. The franchise owner will certainly provide ongoing training and marketing support to the purchaser.

Even though franchising has been growing rapidly, problems are often encountered in international markets:

- host government regulations and red tape
- high import duties and taxes in foreign environment
- monetary uncertainties and royalty retribution to franchiser
- logistical problems in operation of international franchise system
- control of franchisees

- location problems and real estate costs
- patent, trademark and copyright protection
- recruitment of franchisees
- training of foreign franchisee personnel
- language and cultural barriers
- availability of raw materials for company product
- foreign ownership limitations
- competition in foreign market areas
- adaptation of franchise packages to local markets.

Mergers and acquisitions

Mergers and acquisitions are another way for companies to position themselves in a new market. They can also be important for companies seeking to develop greater economies of scale or to acquire new capabilities. A merger occurs when two corporations join together into one, with one corporation surviving and the other corporation disappearing. An acquisition is one company taking control of another, often through an 'unfriendly' or 'hostile' acquisition. A prospective exporter interested in acquiring a foreign firm would do well to develop a cooperative business relationship with it first. This gives both companies a chance to work out an effective relationship, develop trust and assess the real advantages and disadvantages of a merger or acquisition.

The four main reasons for making an acquisition include:

- to acquire complementary products, in order to broaden the line
- to acquire new markets or distribution channels
- to acquire additional mass and benefit from economies of scale
- to acquire technology, to complement or replace the currently used one.[24]

Greenfield investment

Building everything from the ground up may be the ultimate international market entry strategy. Greenfield investment involves building everything the foreign subsidiary might need. In the past, this was a good way to get around protectionist barriers or to acquire an idle production plant cheaply. These days, this strategy is less popular for two reasons: expense and risk. It's also much cheaper to outsource the services needed. It also means tying up scarce capital and thus being inflexible and less strategically agile.

FIVE STEPS TO THE INTERNATIONAL MARKETPLACE

Figure 17.2 illustrates the process for an entrepreneur to follow when deciding whether to pursue a global expansion. The following pages summarise the process into five distinct steps. This five-step process begins with research and moves into a feasibility study. From this point the financial arrangements are secured, the necessary documentation is prepared and, finally, the plan is implemented.

Conduct research

One of the most difficult phases of entering the international arena is that of conducting research on the market. Compounding this problem is the fact that the entrepreneur may be thousands of kilometres away from this market. As a result, the entrepreneur must often turn to methods and techniques other than marketing research to determine the most profitable markets.

HARDWARE VERSUS 'HEARTWARE' IN SINGAPORE

ENTREPRENEURIAL EDGE

The lesson learnt is that globalisation and cross borders mergers and acquisitions are not about acquiring the hardware and the infrastructure. It is equally important to acquire the 'heartware' of the local people. Without that, the acquisition will be very costly and it would be doomed to fail.

In the early nineties, a listed and well known US company acquired a listed Asia company that had built a highly successful electronics distribution business in key markets in Asia. Soon after the acquisition, the US company introduced many drastic changes, including strict internal control compliance procedures and structured financial reporting. While these were good practices, they were not executed with a sound integration strategy, which provided time and buy-in from local management. As a result, there were clashes in management style and the key local managers left.

Soon after their departures, these key managers joined their competitors and started to dismantle the highly successful distribution network that the US company thought it now owned. The consequences were dire. The US company had to write off millions of dollars of bad debts as many distributors defaulted. They had to rebuild their distribution channels from scratch, which was a very costly exercise. The lesson learnt is that buying and owning the hardware does not automatically mean owning the 'heartware', i.e., the loyalty of the local team.

On the other hand, a local contracting company that provided services to major telecommunication companies in the region was successful in acquiring both the hardware and the 'heartware'. Rather than acquiring the local contracting company in each country, a new company was incorporated, with the Singapore side controlling 70 per cent. However, in the shareholders' agreement the local partner was entitled to 50 per cent profit-sharing. Key guiding principles were established, but the local partners were allowed to manage the business.

As the local partners were treated like partners, not employees, their mindsets and attitudes were different. They worked harder, solved teething problems, secured local working capital financing and made huge profits for the joint venture company. The lesson learnt is that globalisation and cross border mergers and acquisitions are not about acquiring the hardware and the infrastructure. It is equally important to acquire the 'heartware' of the local people. Without that, the acquisition will be very costly and it would be doomed to fail.

Source: Stone Forest, 'Financing mergers and acquisitions: Growth strategies of successful Singapore companies', *International Enterprise Singapore, Financing Internationalisation: Growth Strategies for Successful Companies* (Singapore: Singapore Information Services, 2004), 129.

Any company seeking to enter foreign markets needs to evaluate the opportunity. This means in the first instance developing a general understanding of the characteristics, pressures, trends and requirements in the target countries being considered. It is important to flag and eliminate unattractive options which do not meet the company's basic objectives, either in performance potential or operating requirements. Beyond that, the researcher helps identify the preliminary priorities and risks associated with the trade opportunity. The Internet is a cornucopia for trade researchers. One can also acquire proprietary research undertaken by survey and market researchers in target countries. Here are key elements that have to be addressed in any foreign market entry plan:

- **Macro-level market attractiveness:**
  - Which markets should be given further attention?
  - Is there a basic need for the company's product/service?
  - Are business conditions suitable for the firm's risk profile and capabilities?
- **Basic fit:**
  - Is the country receptive to imports of products or services such as those provided by the company?
  - Are there reasons why the product would not be right for this market (for example, climate – sending snowsuits to the tropics), infrastructure (for example, reliability

ENTREPRENEURSHIP IN PRACTICE

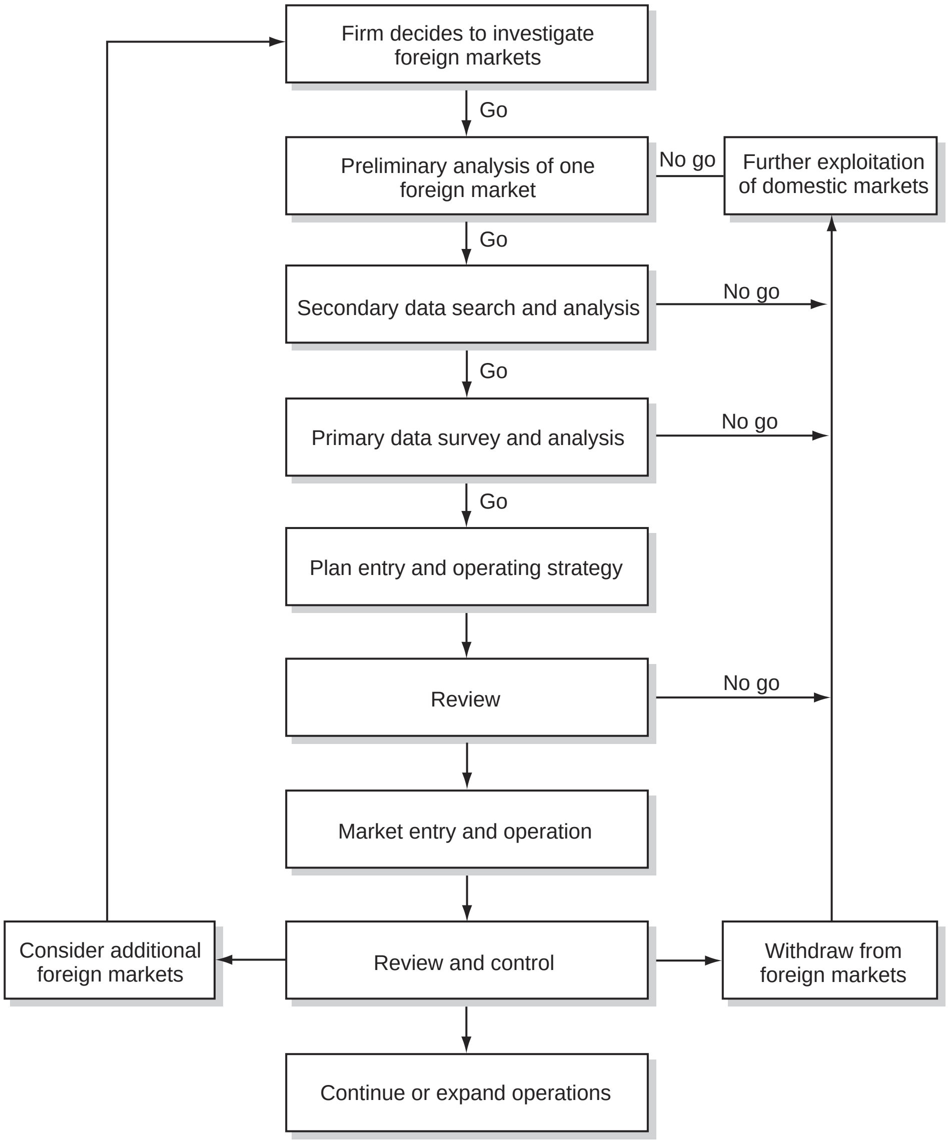
WHERE TO FIND GOOD FOREIGN MARKET RESEARCH

Acton Institute, International Trade: Research Resources	[www.acton.org/ppolicy/trade/resources.html]
Australian Bureau of Statistics	[www.abs.gov.au]
California Association for Local Economic Development, International Trade links	[www.caled.org]
eMarketer	[www.idcresearch.com]
Exporting Guide	[exportsource.ca/gol/exportsource/interface.nsf/engdocBasic/0.html]
Federation of International Trade Associations, Web Resources for International Trade	[www.fita.org/webindex/index.html]
Government trade agencies	[dir.yahoo.com/Business_and_Economy/Trade/Government_Agencies]
International Data Corporation	[www.idcresearch.com]
International Economics	[netec.wustl.edu/WebEc/webecf.html]
International trade agencies	[dir.yahoo.com/Business_and_Economy/Trade/International_Trade_Organizations]
International Trade Data Network	[www.itdn.net]
Jupiter Research	[www.jup.com]
Lex Mercatoria	[www.lexmercatoria.org]
List of Central Banks around the world	[www.bis.org/cbanks.htm]
Michigan State University, Global Edge	[globaledge.msu.edu/ibrd/ibrd.asp]
National Trade Databank	[www.stat-usa.gov/tradtest.nsf] [iserve.wtca.org/intro_ntdb.html]
Philadelphia University, Everything International	[faculty.philau.edu/russowl/russow.html]
The Art Of Business Web Site Promotion	[www.deadlock.com/promote]
The United Nations national and international data sources	[unstats.un.org/unsd/methods/inter-natlinks/sd_natstat.htm]
US Commercial Service About Market Research	[www.export.gov/marketresearch.html]
University of Tennessee, International Trade links	[www.lib.utk.edu/refs/business/international.html]
US Census Bureau	[www.census.gov]
Virtual International Business & Economic Sources	[library.uncc.edu/display/?dept=reference&format=open&page=68]
World Bank, Major Research Activities in Progress	[www.worldbank.org/research/trade/majoract.htm]
Yahoo's Internet Statistics and Demographics Surveys	[dir.yahoo.com/Computers_and_Internet/internet/statistics_and_demographics/surveys]

of power for electronic goods) and related products (for example, computer software requires an installed base of computer hardware)?

- **Economic environment (market indicators):**
  – What is the relative overall market size (gross national product (GNP), population)?

FIGURE 17.2 **ANALYSIS OF GLOBAL EXPANSION DECISIONS**



Source: Roger D. Blackwell and Kristina Stephan, 'Growing profits for small business through global expansion', *Small Business Forum* (Winter 1990): 55.

- How strong/concentrated is the consumer or industrial purchasing power (income distribution, capital expenditures)?
- How rapid is overall growth in the market (GNP **growth rates**, per capita income growth)?

- **Political/legal environment (risk, requirements, regulations):**
  - How stable/risky is the political situation/level of civil unrest and how would this affect trade?
  - Would government regulations restrict access to certain types of trade, or create excessive burdens for the firm's entry plans (for example, do they require a certain level of local production)?
  - Are there tariffs, entry barriers or non-tariff barriers which would either hamper or help market entry of a product from your country (for example, a special trade arrangement such as a free trade agreement could help market entry to the United States)?
  - Are there legal restrictions which would require excessive modification to the product (for example, restrictions on the use or protection of a trademark or brand name, labelling requirements)?
- **Financial environment:**
  - How stable/volatile is the overall economy (for example, inflation, interest rates)?
  - Are there restrictions on exchanging foreign currency (can the firm be paid in a suitable currency)?
  - What is the level of general credit availability and payment reliability?
- **Socio-cultural environment:**
  - To what degree is language a factor in the company's ability to do business in foreign markets?
  - To what degree would the social structure affect/alter the way the firm does business?
- **Market potential/ industry attractiveness:**
  - Is there sufficient demand in the latter for the firm's product or service?
  - How much adaptation would be needed?
  - Will demand exceed the cost of doing business?
- **Economic/market considerations:**
  - How will economic factors affect the standardisation of the product or the marketing mix (for example, will product sizes need to be reduced or less choice need to be provided at the premium end, to accommodate lower purchasing power)?
  - How strong is the current and potential demand for this product (for example, what is the market size and growth trend)?
  - What market segments exist that could create opportunities?
  - What stage of the product life cycle would the firm's export be entering?
- **Socio-cultural considerations:**
  - Will cultural factors require the firm to change features of its marketing mix?
  - Will language affect the company's marketing efforts in the target market? Is there more than one language that must be considered?
- **Competitive considerations:**
  - How strong is the current competition (their size and market share, the quality levels of their product, level of after-sales service, intangible advantages – member of a favoured nation)?
  - What is the source of the competitors' products (for example, imported or locally produced?)
- **Political/legal considerations:**
  - Are there specific tariffs, taxes, duties and/or permits which apply to the firm's product?
  - If permits are necessary, would they be difficult or costly to obtain?

- **Infrastructure considerations:**
  - What are the characteristics of the shipping, transportation, warehousing, distribution facilities and the general level of access to the markets?
- **Physical/geographic considerations:**
  - Are there specific characteristics that would affect the marketing mix and require adaptation?
  - What is the internal suitability like? How it will affect the firm's other operations?
  - What form of business should the firm adopt (internal/external exporting, indirect or direct exporting, licence or franchise, technology transfer)?
  - If the company adopts an external form of exporting (for example, through an agent, distributor, trading house), how does it select the best representative?
  - How will it manage the representative? What relationship will it have with the representative? What are the legal implications of the relationship?
  - If it licenses, franchises or transfers technology, how does it find and select the right partner?
  - What type of payment/credit arrangements would be most suitable?
  - Is there a solid chance for product acceptance to compensate for the cost of entry and ongoing support?

Prepare a feasibility study

A feasibility study should be undertaken to determine if the proposed project is capable of being carried out. Figure 17.3 illustrates a format the study can take. The feasibility study is a critical document of the entry procedure in that it helps demonstrate how realistic the project is. Because the first few years in the international markets typically will be non-profitable, it is imperative the entrepreneur have sufficient foresight to look at both the long-term and the short-term prospects of the proposal.

Secure adequate financing

Exporters naturally want to get paid as quickly as possible, while importers usually prefer to delay payment until they have received or resold the goods. Because of the intense competition for export markets, being able to offer attractive payment terms customary in the trade is often necessary to make a sale.[25]

The following factors are important to consider in making decisions about financing:

- the need for financing to make the sale – in some cases, favourable payment terms make a product more competitive
- the length of time the product is being financed – this determines how long the exporter will have to wait before payment is received and influences the choice of how the transaction is financed
- the cost of different methods of financing – interest rates and fees vary; where an exporter can expect to assume some or all of the financing costs, the effect of costs on price and profit should be well understood before a pro forma invoice is submitted to the buyer
- the risks associated with financing the transaction – the riskier the transaction, the harder and more costly it will be to finance; the political and economic stability of the buyer's country can also be an issue.[26]

Once it has been determined the project is feasible, arrangements should be made to secure proper financing. Quite often payments from overseas customers require special attention.

FIGURE 17.3 **FEASIBILITY STUDY OUTLINE FOR GLOBAL MARKET ENTRY**

- I Identification of international project
- II Statement of feasibility
- III Summary and/or conclusion
- IV Entry selection (select one method and develop complete program)
  - A Methods of entry
    - 1 Exporting
      - a Pros
      - b Cons
    - 2 Joint venturing
      - a Pros
      - b Cons
    - 3 Direct investment
      - a Pros
      - b Cons
    - 4 Licensing
      - a Pros
      - b Cons
  - B Other considerations
    - 1 Financial considerations
      - a Raw materials
      - b Labour
      - c Tax incentive and allowance
    - 2 Governmental considerations
      - a Stability
      - b Regulations
    - 3 Distribution
      - a Modes of transportation
      - b Channels
- V Market profile
  - A Overview: target market
    - 1 Population
    - 2 Major cities
    - 3 Language
    - 4 Climate
    - 5 Geography
    - 6 Imports
    - 7 Exports
    - 8 Exchange rate
    - 9 Transportation
    - 10 Communication
    - 11 Business practices
    - 12 Business hours
  - B Society/culture: Background of society
  - C Major demographic factors
    - 1 Income
    - 2 Occupation
    - 3 Education
    - 4 Religion
  - D Political climate: Background
  - E Economic climate
  - F Outlook for trade
  - G Opportunities and restraints
- VI Targeted consumer analysis
- VII Legal considerations
  - A Trade policy
  - B Registration of company
  - C Ownership of the business entity
  - D Governmental policy on foreign investment
  - E Industrial property protection
- VIII Risk identification and analysis
  - A Financial risk and property/business seizure
  - B Repatriation of capital
  - C Political risk
    - 1 Foreign relations with the United States
    - 2 Governmental stability
- IX Financial considerations
  - A Type of financing for proposed project
  - B Source of financing
    - 1 Internal
    - 2 World Bank
    - 3 Other
  - C Break-even analysis
    - 1 Return on investment
    - 2 Return on total assets employed
    - 3 Sales forecast
  - D Taxation considerations (US and foreign)
  - E Policy on repatriation of profits
- X Labour and managerial considerations
  - A Organised labour
    - 1 Description
    - 2 Bargaining tools
  - B Work characteristics
    - 1 Hours worked
    - 2 Pay rates
  - C Recruitment
    - 1 Local
    - 2 Expatriate
    - 3 Third country
  - D Management
    - 1 Local
    - 2 Expatriate
    - 3 Compensation
- XI Control strategies
  - A Difficulty of international control
    - 1 Distance
    - 2 Diversity
    - 3 Degree of certainty
  - B Centralised versus decentralised
  - C Policy
- XII Timetable for implementation

Of course, if the customer has an excellent credit history, the entrepreneur may be willing to establish an open account with the business. If this is not the case, however, the seller may have to rely on an irrevocable letter of credit. This is a document the bank prepares, on the buyer's instructions, authorising the seller to draw a specified sum of money under specified terms. This letter can be an extremely powerful form of financing since it guarantees payment of the account if all terms and conditions of the letter of credit are met.

Another source of financing is the local banker. Most large banks have international banking divisions that can help the entrepreneur in their efforts to go international. They can provide the names of freight forwarders, assistance with completing the necessary paperwork and credit references on potential foreign customers. In fact, the international banker can be one of the most useful contacts for the entrepreneur participating in the global arena.

File the proper documents

One of the most frustrating experiences for the exporter can be obtaining the documentation needed to export products to foreign countries. This task can be accomplished in several ways. One is to use Dun & Bradstreet's *Exporter's Encyclopedia* located in the reference section of many local libraries. This book lists all of the necessary documentation, as well as other vital information, for exporting to a particular country. National departments and chambers of commerce also can provide assistance in determining the required format and in completing the forms. In addition, several freight forwarders have programs wherein they help customers prepare the necessary documentation. Finally, some banks will provide similar assistance.

Draw up and implement the plan

The first step in implementing an international strategy is to define the firm's policy. A policy consists of guidelines for achieving the firm's objectives. The firm should define its international policy in accordance with its overall objectives. When it establishes these objectives, the company should ensure that they are realistic and attainable.

The next step is to ensure that the firm is efficiently organised for international operations. Normally with an exporting firm, the responsibility falls in two departments – marketing and finance. The marketing department is charged with creating export sales and the finance department assumes the responsibility of fulfilling the documentation requirements and ensuring that the firm gets paid for its product. In order to provide export training for the affected departments, most firms also will send personnel to a seminar covering the basic aspects of exporting. For example, in many US states the US Department of Commerce conducts several of these workshops each year to inform domestic businesses about opportunities in the international market.

Finally, after the plan has been drawn up, it must be put into effect. At the heart of this activity should be a timetable, or schedule, that indicates key tasks of the implementation process and who has responsibility for them. Many small firms use a Gantt chart to achieve this purpose. This chart displays the duration and timing of the activities related to a project – in this case, entering the international market.

SUMMARY

Doing business globally is a profitable and popular strategy for many entrepreneurial ventures. First we examined the Asia–Pacific from the perspective of comparative growth rates. Throughout the world today, multilateral and bilateral free trade agreements are powerful economic forces creating opportunities for entrepreneurs in the international marketplace. We compared and contrasted the entrepreneurial profiles of countries in the Asia–Pacific.

There are a variety of reasons for going global, each with associated risks and challenges. This chapter discussed several ways the entrepreneur can actively engage in the international market. One way is importing, which involves buying goods from other countries. A second way is exporting, which takes a variety of forms. All global strategies involve some form of strategic alliance. For exporters, the export management company, distributors abroad, foreign agents and setting up a local office are important foreign market entry strategies. The global entrepreneur may become involved in contract manufacturing, co-production, joint production, retail outlets, greenfields investments, or co-marketing.

Another way is through the use of joint ventures. These international arrangements offer many benefits for those looking to establish a presence in the international market. Beyond this is direct foreign investment. Before entrepreneurs take this step, however, it is important they carefully evaluate the associated risks. Royalties and licensing have both advantages and disadvantages. Franchising is an increasingly popular way of gaining a foot in an overseas market. Mergers and acquisitions were discussed for companies seeking to develop greater economies of scale or to acquire new capabilities.

The last part of the chapter examined the steps for entering the international marketplace: conduct research; prepare a feasibility study; secure adequate financing; file the proper documents; and draw up and implement the plan.

KEY TERMS AND CONCEPTS

acquisitions
Asia–Pacific Economic Cooperation (APEC)
co-marketing
contract manufacturing
co-production
direct foreign investment
European Union (EU)
export consortium
export management company
exporting
financial environment
foreign agents
foreign distributors
franchising
free trade agreements (FTAs)
global sourcing
greenfield investments
growth rates
importing
joint production
joint venture
licensing
mergers
multilateral institutions
North American Free Trade Agreement
Organisation for Economic Cooperation and Development (OECD)
retail outlet
royalties
strategic alliance
World Bank
World Trade Organization (WTO)

REVIEW AND DISCUSSION QUESTIONS

1. Describe some of the powerful economic forces that are creating global opportunities for entrepreneurs.
2. How can an entrepreneur become aware of import opportunities?
3. Of what value are an export management company and a freight forwarder to entrepreneurs who are seeking to export goods?
4. Before engaging the services of an export management company, an entrepreneur should ask what questions?
5. What is a foreign sales corporation? Of what value is it to entrepreneurs in the export business?

6 What are five of the most common mistakes potential exporters make?
7 How does a joint venture work? What are the advantages of this arrangement? What are the disadvantages?
8 How can a firm make a direct foreign investment?
9 How does a licensing arrangement work? What are the advantages and disadvantages of such an arrangement?
10 When entering the international marketplace, entrepreneurs should follow what five specific steps?

EXPERIENTIAL EXERCISE
GOING INTERNATIONAL

When entrepreneurs decide to go international, they must take steps in hiring people to help them out, entering into agreements with overseas partners and putting together a plan for conducting the venture. The following are nine groups or terms with which the entrepreneur should be familiar, labelled (A) to (I). Match each of these groups or terms with its correct definition or description (1) to (9). Answers are provided at the end of the chapter.

A Export management company
B Freight forwarder
C Foreign sales corporation
D Joint venture
E Licensing
F Direct foreign investment
G Patents
H Technical know-how
I Conduct research

1 The first step taken to go international
2 A business arrangement in which the manufacturer of a product gives permission to some group or individual to manufacture the product in return for specified royalties or other payments
3 Can handle all the details for shipping goods overseas, although the cost can be high
4 Some of its income is exempt from federal taxes
5 Foreign governments sometimes grant tax incentives for this
6 One of the basic types of international licensing programs
7 A company owned by two or more organisations
8 Another of the basic types of international licensing programs
9 Can arrange for shipment of the product to overseas markets

CASE 17.1:
HOME AGAIN

For Jamey Bennett, CEO of reading-lamp company LightWedge, the decision to start manufacturing in China was simple. It came down to money: Factories in the People's Republic could make his products for 30 per cent less than those in the US. Those bargain prices brought other problems, though. One year, two factories, two trading companies and countless headaches later, Bennett, 36, moved his company's production back to the States.

Sitting in his Nantucket, Massachusetts, office, Bennett recalls how his problems began immediately after he picked a trading company in Taiwan and a factory in Guangdong province back in 2002. The reading lamps were simple enough – a thin sheet of transparent acrylic, illuminated by two light-emitting diodes, that is placed over an open book – but the made-in-China versions never looked quite right; there were problems with the texture and the colour of the acrylic. Each lamp requires two LEDs of the same colour, but because the factory matched them by 'eye-balling', some lamps gave off an odd-coloured light.

Bennett, a serial entrepreneur who'd already founded two companies, BookWire.com and LendingTree.com, considered those the inevitable snags of a new venture. He wasn't thrilled, but he was comfortable enough to ship the $34.95 LightWedge Original to customers (and most didn't notice anything amiss). A few months later, however, when the factory shipped the products late and LightWedge almost missed its first holiday season, Bennett was less forgiving. 'We could have done 40 per cent more in sales for Christmas,' he says. 'We got clobbered.'

For the company's second product, a version designed for paperbacks, Bennett tried a different factory, in Shanghai. Unfortunately, he says, 'it was more of a disaster than the one in Guangdong'. The owners spoke little English and despite an $80 000 investment and months spent tweaking machinery, they never got the product right. The lenses arrived with scratches and a 'weird goopy material' on them, Bennett says. Worse, he had more shipping delays. One company that put LightWedges in its May 2003 catalogue couldn't ship them to customers until September.

Anand Sharma, CEO of TBM Consulting Group in Durham, NC, says, 'China works if you have a long lead time and need things that are very standard'. Bennett declined to say how much the experiment cost him, but LightWedge lost $1.5 million in sales in 2003 because of shipping delays alone. Of course, there were soft costs as well: The documentation and fees became burdensome for his three-person business, the weekly conference calls at 11 pm were trying and Bennett – halfway around the world – couldn't stop by to check on things. 'There was no way to stay on top of everything with so much other stuff to do,' he says. 'It just didn't work.' Finally he decided to bring production back home.

Today every LightWedge lamp is made in Newport News, Virginia, at a 1500-person plant run by Canon Virginia. (Yes, it's the US arm of Japanese Canon – welcome to the global marketplace.) Bennett's production outlays are 30 per cent higher than those in China and getting a US factory set up costs three times as much, but he says it's worth it – at present. 'We'd consider going back to China, but I think I made the right decision for now.'

Source: 'Home again', *Fortune Small Business* (New York) 14(2) (March 2004): 60.

QUESTIONS

1 What were the trade-offs when Jamey was considering a factory in China?
2 What could Jamey have done to prevent the problems?
3 What factors would he have to have in place to consider going back to China?

CASE 17.2:
'I DID IT BECAUSE I DIDN'T KNOW THAT I COULDN'T'

That might sound like the sort of line that could get someone in a good deal of trouble, but in the case of New Zealand vegetable exporters Lance and Kay Peterson it was exactly that attitude that got their bottled asparagus out of the warehouse and onto the shelves of every supermarket chain in Australia.

Lance explains, 'We'd had some problems getting the product out into the Australian market, so I went to talk to the category buyers themselves. Within six months every one of them was stocking it. When people asked me how I did it, I told them that it was because I didn't know I couldn't'.

If that makes it sound as if all you need is a gung-ho attitude to crack the export market, Lance will assure you that nothing could be further from the truth. What it does tell you however, is the importance of doing your homework, making the right contacts and knowing which approach is right in any particular market.

Another story from Lance about doing business in Japan exemplifies the very different approach required there. The Petersons' company, Circle Pacific, is a well established, very successful Hawkes Bay exporter of asparagus and frozen squash pumpkin – a Japanese diet staple. But cementing a business relationship in Japan can take years. 'You're wasting your time if you think you can rush into the Japanese market and score an overnight hit. My Japanese agent and I spent four years talking to one client before he did any business with us.'

'If there's one piece of advice I would give to new and potential exporters, it's to put the time, money and effort into finding the right agent in that market and work on building that relationship. It can take years, but once you are in, they are extremely loyal to you. I can't emphasise enough how important it is to show them that you are there for the long haul.'

After 30 years working to grow their family business and expand their markets around the world, Kay and Lance have recently handed over the reins to CEO, Jeannette Samundsen. Jeannette worked closely with Giles Pearson from PriceWaterhouseCoopers to put a new rigorous accounting and computing system in place which provides Circle Pacific with the quality of information they need to do business efficiently and profitably, here and around the world.

'The great thing about Giles is that he is never satisfied', says Jeannette. 'It's brilliant having someone who keeps asking us the hard questions and who keeps setting the hurdles a little higher. Giles reviews our results and, in particular our margins, every two to three months to ensure that we are actually making the margin that our costings tell us we should be making. In this business there are so many variables and price fluctuations – especially around foreign exchange, we have to have really robust policies and procedures in place to manage the risks and give us the quality of information we need. This last year has been about working with Giles to get our ducks in a row, this next year we're going to really begin to see the results of that.'

Source: PriceWaterhouseCoopers, 'I did it because I didn't know that I couldn't' [www.pwcgloba.com].

QUESTIONS

1 What does 'I didn't know that I couldn't' mean to an entrepreneur?

2 Would Circle Pacific have been able to succeed without the help of PriceWaterhouseCoopers?

3 What cultural problems do you think Circle Pacific had in Japan?

CASE 17.3:

A FOREIGN PROPOSAL

Australian Edgar Bruning left his job at a major computer manufacturing firm and started his own business, naming it Bruning Computer. Since then Edgar has secured five patents for computer-related equipment. His latest is a computer chip that can increase the speed of most personal computers by 35 per cent. The cost of one of these computer chips is only $8 and the unit wholesales for $135. As a result, Bruning's profits have mushroomed.

Realising that everything he developed can be copied by foreign competitors, Edgar entered into contractual arrangements with a firm each in Australia, Singapore and Dubai to market his product. Bruning ships 50 per cent of its production output to these three firms, while the rest is sold to companies in Australia and New Zealand. Edgar recently has been thinking about increasing his production facilities. He is certain he could sell 40 per cent more chips if he were able to make them.

Last week Edgar had a visit from the chief executive of a Chinese firm. The company has proposed a joint venture between itself and Bruning. The venture would work this way: Bruning would ship the company as many chips as are currently sent to the three other firms. These chips would be paid for on a 90-day basis. The Chinese firm would act as Bruning's Asia sales representative during this part of the agreement. Then within 90 days the Chinese firm would purchase manufacturing equipment that would allow it to make the chips in China. 'This will save us both labour and shipping costs', the Chinese executive pointed out. 'And all profits will be divided on a 50/50 basis. Your only expenses will be your share of the manufacturing equipment and we will apply your profits against those expenses. So you will have no out-of-pocket expenses.'

The idea sounds very profitable to Edgar, but he is not sure he wants to give someone else the right to produce his product. 'Technological secrecy is important in this business. It's the key to success', he noted to a colleague. On the other hand, Edgar realises that without having someone to sell his product in Asia, he is giving up a large potential market. Over the next 10 days Edgar intends to make a decision about what to do.

QUESTIONS

1 What type of arrangement is Edgar using in his business dealings with the firms in Australia, Singapore and Dubai? Be complete in your answer.

2 Is the Chinese business proposal a joint venture? Why or why not? Would you recommend that Edgar accept it? Why or why not?

3 Based on information in chapter 13, what concerns should Edgar have?

4 If Edgar were looking for an alternative approach to doing business with the Chinese, what would you suggest? Defend your answer.

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The Entrepreneur's Path to Global Expansion

Publication date: 1 January 2005
Author(s): Walter Kuemmerle
Product number: 9-SMR-160

Most start-up companies today consider overseas expansion from their inception. Yet, says the author, entrepreneurs and their managers often underestimate the cost of expansion and lack a clear conceptual framework for it. On the basis of studying 50 entrepreneurial ventures in more than 20 countries, the author concludes that such ventures follow a variety of different expansion paths. The most successful are those that best manage the constant tensions between resources and opportunities, each of which run the gamut from purely local to worldwide. Offers a framework that defines the choices a venture has at its inception and throughout its life and shows how to use the framework to assess and direct a venture and mitigate developing tensions by anticipating a variety of strategic, financial, organisational and regulatory factors. Uses case examples of a software company that took a balanced or 'diagonal' path (the most common), an air-freight delivery service that progressed from pursuing local opportunities with local resources to pursuing cross-border opportunities with local resources and a consumer-loan provider that began by pursuing a local opportunity with local resources, then added cross-border resources.

Dell Computer Corp.: Investment in Malaysia as a Global Strategic Tool

Publication date: 26 May 2003
Author(s): Justin Tan, Michael Young
Product number: 903M19

Dell Computer Corp. is one of the largest computer manufacturers in the world. The company's international business strategy has supported its global position and performance facing the Asian economic crisis. Its investment in Malaysia reduced its foreign exchange exposure and supported its low-cost advantage. Now Dell must decide whether to expand its commitment in Malaysia and/or other locations, such as China.

TCS: An Entrepreneurial Air-Express Company in Pakistan

Publication date: 6 November 2002
Revision date: 22 April 2004
Author(s): Walter Kuemmerle, Zahid Ahmed
Product number: 9-803-027

Distance Still Matters: The Hard Reality of Global Expansion

Publication date: 1 September 2001
Author(s): Pankaj Ghemawat
Product number: R0108K

Companies routinely over-estimate the attractiveness of foreign markets. Dazzled by the sheer size of untapped markets, they lose sight of the difficulties of pioneering new, often very different territories. The problem is rooted in the analytic tools (the most prominent being country portfolio analysis, or CPA) that managers use to judge international investments. By focusing on national wealth, consumer income and people's propensity to consume, CPA emphasises potential sales, ignoring the costs and risks of doing business in a new market. Most of these costs and risks result from the barriers created by distance. 'Distance', however, does not refer only to geography; its other dimensions can make foreign markets considerably more or less attractive. The CAGE framework of distance presented here considers four attributes: cultural distance (religious beliefs, race, social norms and language that are different for the target country and the country of the company considering expansion); administrative or political distance (colony-coloniser links, common currency and trade arrangements); geographic distance (the physical distance between the two countries, the size of the target country, access to waterways and the ocean, internal topography and transportation and communications infrastructures); and economic distance (disparities in the two countries' wealth or consumer income and variations in the cost and quality of financial and other resources). This framework can help to identify the ways in which potential markets may be distant from existing ones. The article explores how (and by how much) various types of distance can affect different types of industries and shows how dramatically an explicit consideration of distance can change a company's picture of its strategic options.

Jollibee Foods Corp. (A): International Expansion

Publication date: 7 July 1998
Revision date: 17 December 2001
Author(s): Christopher A. Bartlett, Jamie O'Connell
Product number: 9-399-007

Noli Tingzon, newly-appointed international division VP at Jollibee, the Philippines-based hamburger chain, is faced with the challenge of expanding fast food operations in Asia in the face of stiff competition. The case describes Jollibee's six-year international expansion history and the lessons the company has learned. Against this background, Noli must decide among expansion opportunities in New Guinea, Hong Kong and California.

ANSWERS

1 I
2 E
3 A
4 C
5 F
6 G or H
7 D
8 G or H
9 B

ENDNOTES

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11 Material with permission from Howard H. Frederick, *Global Entrepreneurship Monitor Aotearoa New Zealand 2005* (Auckland: New Zealand Centre for Innovation & Entrepreneurship, 2006); for Japan and Korea, material taken with permission from Mick Hancock and Paula Fitzsimmons, *Global Entrepreneurship Monitor 2004: National & Regional Summaries* (London: London Business School, 2005) available from [www.gemconsortium.org].

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part 5

ENTREPRENEURIAL CASE ANALYSIS

ARE JOINT VENTURES THE WAY TO GO?

Greg Boland, University of Canberra

All business structures in Australia are required by law to exist in some legal form. Basically there are three main forms and these include sole proprietorship; partnership and companies. Depending on which form an entrepreneur takes will depend on issues such as costs in establishment, taxation, ownership, relationships, management, control and duration of the business or project. The most common form of small business existing today is that of a sole trader. However, there are other legal forms that occur, including trusts and joint ventures. Like the three main legal forms these also have their advantages and disadvantages.

The following case study depicts an actual joint venture that recently occurred in Australia. It portrays the advantages of such a business structure but at the same time exposes traps for the unwary.

Andrew and Emma were a little concerned about how much funding the Australian government would have left in its 'kitty' to supplement their superannuation with their retirement plans in the form of social security pensions when they reach normal retirement age. They both expect to retire in 20 years time. They live in suburban Canberra with their three school-aged children and each have a secure public service position earning average salaries. To supplement their future financial needs they decided to look for an alternative but secure investment opportunity. After much soul searching, including reading newspaper reports, magazines and talking to friends, the very conservative couple decided that perhaps property might be the way ahead to achieve their goals.

By chance one of their relatives in Sydney was on the verge of forming a joint venture with his colleagues to develop a block of land into 15 new two- and three-bedroom townhouses in the middle class suburb of St Ives – located some 30 minutes west of the famous Sydney Harbour Bridge. As the group was looking for additional capital for their project Andrew and Emma were invited into the venture as the sixth joint venture member. Upon receiving this invitation they made a rushed trip to Sydney to investigate the proposal. Here they met with the other members of the proposed group that consisted of five business people (including a lawyer an accountant a builder, an architect and the relative who owned a very large new and used car sales business). They discussed the idea with these members and were told the following requirements were necessary for the project to take place:

- Each member (except for the architect) would contribute $20 000 of their own capital to commence the project.
- In lieu of the architect's contribution of $20 000, he would draw up plans and oversee the complete building phase of the venture.
- A loan of $1.2 million would be taken out with a non-bank financial intermediary (merchant bank) to be drawn down in stages throughout the building process. It was mentioned at the meeting that a traditional bank had been approached for finance but it had indicated that it would not be interested in financing such a venture.
- To secure the loan the builder would use his matrimonial home where he had sufficient equity as security for the merchant bank loan.
- The builder would be given one town house free upon completion in payment for his labour to build the townhouses.
- Upon completion of the project, which was expected to take 12 months, each member (except for the builder) would then be required to re-finance the $1.2 million loan in pro rata amounts based on whether they received a two- or three-bedroom townhouse and how many they received. Allocation of these would be via a simple ballot system.
- At this re-finance stage each member would then register their respective title(s) in their own names and would be free to either rent out, sell or live in their townhouse. At this final stage the joint venture would be dissolved and members would be in charge of their own destiny in relation to their entitlements.

The happy couple came away from this initial meeting very excited with the idea of being 'silent investors' and the

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fact that the project was in the form of a joint venture as opposed to a partnership or company. They also liked the idea that they would receive the benefits of experienced business professionals and the fact that the leverage for the venture was going to be a combination of both equity and debt from the parties. As both Andrew and Emma had tertiary training in the business area they were aware of potential risks but felt this project was certainly on the side of moderate risk undertaking.

They decided to go ahead with it and after approaching their friendly ANZ Bank manager were able to secure the required $20 000 by breaking a term deposit that they had previously invested with the bank. They then sent this down to the member overseeing the joint venture.

The project ran very smoothly and was completed within the expected 12 months. Andrew and Emma re-financed their share with a $220 000 loan from the ANZ Bank. They were now the proud owners of a brand new two-bedroom townhouse that they rented out for $330 per week and on their way to financial security.

All proceeded well until six months down the track when Andrew and Emma received a letter from the solicitors representing the wife of the project's builder. Andrew and Emma had never met the wife of the builder, and her name never appeared on any of the legal documents involving the joint venture. This letter informed them that the builder was now in the process of divorce proceedings. In fact, this divorce had started at about the same time as the joint venture. He had also been declared bankrupt. His wife was seeking her share of their matrimonial home that the builder (her now ex-husband) had used as security for the joint venture. This family home was now in the process of being repossessed by the merchant bank. Andrew and Emma then employed their own solicitor in Canberra to represent them after receiving this surprise. It emerged from subsequent investigations by their solicitor that the builder's wife had previously placed a caveat on the matrimonial home so that the ex-husband could not use it as security for a loan that would give benefit to any external parties. Unfortunately this caveat had not been registered in time for the merchant bank to have known and so the initial loan ($1.2 million) had been approved. These details had not been disclosed at any stage to the other members of the joint venture. The wife claimed that each member of the joint venture had taken advantage of her marriage predicament and together, as joint venturers, made substantial financial gains at her expense. As a result she was seeking compensation from each joint venture member.

After months of legal deliberations and spending substantial money on legal fees (legal costs for each of the defendants totalled approximately $90 000) this fiasco ended up in the Family Court of Australia. The joint venturers (excluding the project's builder) decided to employ a Queen's Counsel to try and contest their innocence. At all times Andrew and Emma, together with the other joint venturers, claimed that they were the innocent parties to this case and it should never have ended up in court. They all claimed they had no prior knowledge of the builder's marital problems or any hint of any complications that may arise from that initial security and loan being granted by the merchant bank.

DISCUSSION QUESTIONS

1. What is your understanding of a joint venture?
2. In table form, list the advantages and disadvantages of being a sole trader; a partnership; a company and a joint venture.
3. What is meant by the terms leverage; equity; debt and caveat?
4. The joint venture secured initial funding from a merchant bank. What is a merchant bank and why do you think that a normal bank was reluctant to finance a venture such as the one described in this case study?
5. What information do you think the ANZ Bank required from Andrew and Emma when they sought their $220 000 loan request?
6. Assume you are the Family Law Court judge presiding over this case. What would your decision be based on the facts you have in hand?

Note: The actual findings of this case in the family court were that Andrew and Emma (together with the other joint venturers) were the innocent parties. The builder's wife was advised to sue her original solicitor for failing to action the caveat on the matrimonial home before the loan was actually taken out. This was because it was discovered that there may be a negligence charge against her solicitor as it was found that there was a considerable time delay from when the wife applied for the caveat to when the title was accordingly stamped with it.

PART SIX: CONTEMPORARY CHALLENGES IN ENTREPRENEURSHIP

CHAPTER

18

BUYING AND SELLING BUSINESS VENTURES

I liked the shaver so much, I bought the company.

Victor Kiam, legendary CEO of Remington Shavers

CHAPTER OBJECTIVES

1 To explain the importance of valuation

2 To describe the basic elements of due diligence

3 To outline key questions to ask when buying an ongoing venture

4 To examine the underlying issues involved in the acquisition process

5 To outline the various aspects of analysing a business

6 To present the major points to consider when establishing a firm's value

7 To examine the principal methods currently used in business valuations

8 To consider additional factors affecting a venture's valuation

THE IMPORTANCE OF BUSINESS VALUATION

Every entrepreneur should be able to calculate the value of their business and also should be able to determine the value of a competitor's operation. Such **business valuation** is essential in these situations:

- buying or selling a business, division, or major asset
- establishing an employee stock option plan (ESOP) or profit-sharing plan for employees
- raising growth capital through stock warrants or convertible loans
- determining inheritance tax liability (potential estate tax liability)
- giving a gift of stock to family members
- structuring a buy/sell agreement with stockholders
- attempting to buy out a partner
- going public with the company or privately placing the stock.

Equally important is the entrepreneur's desire to know the real value of the venture. From the entrepreneur's point of view, merging with a larger company or being acquired makes perfect sense when it is found that the appropriate timing for capturing the value has been created through the venture. This valuation can provide a scorecard for periodically tracking the increases or decreases in the business's value.[1]

BUYING OR SELLING A BUSINESS VENTURE

A prospective entrepreneur may seek to purchase a business venture rather than start up an enterprise. This can be a successful method of getting into business, but numerous factors need to be analysed. Purchasing a business venture is a complex transaction and the advice of professionals should always be sought. However, a few basic steps that can be easily understood are presented here, including the entrepreneur's personal preferences, examination of opportunities, evaluation of the selected venture and key questions to ask.

Personal preferences

Entrepreneurs need to recognise certain personal factors and to limit their choices of ventures accordingly. An entrepreneur's background, skills, interests and experience are all important factors in selecting the type of business to buy. In addition, personal preferences for location and size of a business should guide the selection process. If an entrepreneur always has desired to own a business in the south or west, then that is exactly where the search should begin.

Examination of opportunities

Entrepreneurs in search of a possible venture to buy need to examine the available opportunities through various sources:

- **Business brokers:** Professionals specialising in business opportunities often can provide leads and assistance in finding a venture for sale. However, the buyer should evaluate the broker's reputation, services and contacts. The entrepreneur also should remember that the broker usually represents – and gets a commission on the sale from – the seller.
- **Newspaper ads:** 'Business opportunity' classified ads are another source. Because an advertisement often will appear in one paper and not another, it may be necessary to check the classified sections of all the papers in the area.
- **Trade sources:** Suppliers, distributors, manufacturers, trade publications, trade associations and trade schools may have information about businesses for sale.
- **Professional sources:** Professionals such as management consultants, solicitors and accountants often know of businesses available for purchase.

- **Business broker:** Business brokers are like real estate brokers. They represent the seller, but the good ones have fantastic networks and can dig out opportunities that you may not find on your own. The problem is that good business brokers are inundated with customers. Most 'buyers' waste the broker's time. Some brokers are independent, others have multiple listings. Some regions have a business broker association.

Evaluation of the selected venture

After the entrepreneur considers personal preferences and examines information sources, the next step is to evaluate specific factors of the venture being offered for sale:

- the **business environment** – the local environment for business should be analysed to establish the potential of the venture in its present location
- **profits, sales and operating ratios** – the business's profit potential is a key factor in evaluating the venture's attractiveness and in later determining a reasonable price for it; to estimate the potential earning power of the business, the buyer should review past profits, sales and operating ratios and project sales and profits for the next one to two years (valuation will be discussed further, later in the chapter)
- the **business assets** – the tangible (physical) and intangible (for example, reputation) assets of the business need to be assessed, including examining:
    - inventory (age, quality, saleability, condition)
    - furniture, equipment, fixtures (value, condition, leased or owned)
    - accounts receivable (age of outstanding debts, past collection periods, credit standing of customers)
    - trademarks, patents, copyrights, business name (value, role in the business's success, degree of competitive edge)
    - goodwill (reputation, established clientele, trusted name).

Due diligence

Ronald Reagan once said, about Gorbachev's weapons proposals: 'Trust, but verify'. It's worth remembering! It is all a bit emotional selling the business that you have nurtured from birth or buying someone else's 'baby'. But the entrepreneur needs to look under the covers to see the intimate details. It's a bit like a pre-nuptial agreement.

Due diligence should not be viewed as a cost but as an investment in reducing the probability of failure of an acquisition and merger and a way to enhance the value of the combined entity.[2] Here are the ten questions that highlight critical areas that need to be addressed.[3]

- **Question 1: Why is this business being sold?** It is important to establish the owner's motivation for selling. Although the reason may be very good, such as retirement or ill health, an entrepreneur needs to investigate and verify it. If at any time the owner's reason for selling does not appear to be the prime motivation, then further research must be done on that particular business.
- **Question 2: What is the physical condition of the business?** The overall condition of the facilities needs to be carefully assessed in order to avoid major expenses after the purchase. Sometimes owners sell a business simply to avoid re-modelling the entire location.
- **Question 3: How many key personnel will remain?** In order to conduct a smooth transition, a purchasing entrepreneur needs to be sure which personnel will remain after the sale. Certain key personnel may be extremely valuable to the continuity of the venture.
- **Question 4: What is the degree of competition?** The answer to this question must cover two distinct parts – the *quantity* and the *quality* of competitors. In other words, how many competitors are there and how strong are they?

- **Question 5: What are the conditions of the lease?** When the business is being sold but not the building or property, it is vital to know all of the conditions of the present lease. In addition, the landlord's future plans should be established as far as future lease provisions are concerned.
- **Question 6: Do any liens against the business exist?** This refers to the position of creditors and the liabilities of the business. Entrepreneurs should check for any delinquent payments or outstanding debts of any kind by the business.
- **Question 7: Will the owner sign a covenant not to compete?** Legal restraint of trade is the actual purpose here, since a purchaser does not want the seller reopening a firm in direct competition. Thus, the law allows a reasonable covenant to cover the time and distance within which the seller agrees not to compete.
- **Question 8: Are any special licences required?** The buyer needs to verify the federal, state, or local requirements, if any, that pertain to the type of business being purchased.
- **Question 9: What are the future trends of the business?** This is an overall look at the particular industry trends and how this business will fit into them. In addition, the financial health of the business needs to be projected.
- **Question 10: How much capital is needed to buy?** The final purchase price is not the only factor to consider. Repairs, new inventory, opening expenses and working capital are just a few of the additional costs that should be considered.

Due diligence is a form of research to make certain what is delivered is exactly what is agreed upon. It is good business practice to verify the facts in every way. Due diligence emphasises understanding and quantifying the risk of the proposed deal, rather than the upside. Due diligence means a rigorous investigation and evaluation of an investment opportunity before committing funds. This process includes a review of its management team, business conditions, projections, philosophy and investment terms and conditions.

Absolutely vital to making a sound purchase, due diligence gives the peace of mind that any business opportunities that survive the initial screening stage are worthwhile. Verification consists of

PUSHING THE LIMITS OF DUE DILIGENCE

ENTREPRENEURIAL EDGE

As a journalist, James Mulvaney investigated Irish terrorists, mobsters, O.J. Simpson and Ferdinand Marcos. He headed the team that won the 1996 Pulitzer Prize for uncovering fraudulent practices at a fertility clinic and writing stories that led to federal indictments and the largest malpractice settlement in California history.

Now, as head of KPMG's investigative due-diligence practice, he digs up dirt on companies that are about to be acquired. For $4000 to $10 000, Mulvaney and team will pull documents from courthouses, sift through databases and check out every item on a resumé. Pay up to $50 000 and they'll track down former spouses and colleagues and interview the competition. Nowadays, when the most important acquired asset may be talent, you can't stop the snooping with a target's financials.

While most investigations end happily, a few turn up deal-killing information. In a recent case a computer company hired Mulvaney to look into the backgrounds of directors at an acquisition candidate. One board member, he discovered, was going through an acrimonious divorce – a fact the director had never mentioned. Why such a big deal? The wife stood a good chance of collecting a lot of his stock and of using those shares to insist on a board seat. The client didn't want to get embroiled in that struggle and walked away from the deal.

Another time, the KPMG private eyes looked into a targeted company that appeared clean until they checked the criminal courts and learned that half its board members were involved with organized crime. A third takeover candidate seemed okay until a media search revealed that the company had been banned from doing business in Florida, a key territory for the buyer.

Perhaps the most established M&A snoop is Strang Hayes Consulting in New York. It draws its staff from the alumni

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of the CIA, Secret Service, FBI and the Drug Enforcement Administration. Since its inception in 1989 it has conducted more than 3000 due-diligence investigations. In the past three to four years, more than half of that business has come from companies making merger-related transactions. For $10 000 Strang Hayes will do a complete background check – short of surveillance work – in less than two weeks. The same service involving cross-border executives costs $15 000 and takes up to three weeks.

'There are so many ugly stories', says President Robert Strang. One chief executive had hidden five sexual harassment lawsuits filed against him. Another executive failed to mention that he held a significant amount of stock in a competitor – which led the potential buyer to assume that the guy might not have his own company's best interests in mind. Another time the investigators discovered that roughly half the top executives of a company were unindicted co-conspirators in a fraudulent deal. From what they could tell, the company had changed its name in order to conceal that fact.

All this work is legal, mind you, but it is usually done on the sly, often without the knowledge of the targeted company. Investigators work quietly so as not to scare off the intended merger partner, disrupt the negotiations or risk being sued for libel. In fact, potential acquirers often have their lawyers hire investigators to ensure that all information is protected under attorney–client privilege. When dirt is unearthed, the potential buyer usually backs off without explaining. Let some other hapless buyer – perhaps a competitor – unearth the bad news the hard way.

Source: Luisa Kroll, 'Gotcha: Pushing the limits of due diligence', *Forbes* (30 October 2000): 184.

checking the accuracy of business plans, audited accounts and management accounts; getting replies to warranty and other standard questionnaires; patent searches; and technical studies. Unpublished accounting information and subjective information are equally important; these data are collected by calling customers, suppliers, lawyers and bankers and by checking trade journals.

TABLE 18.1: **DUE DILIGENCE STUDY AREAS**

Management	Chief executive officer Number two and three in management Management as a team Organisational structure and decision making Management characteristics Corporate ownership Documentation Management reports Strengths and weaknesses
Personnel	Corporate organisation Employee compensation Profit-sharing plan Bonus plan Payroll records Training program Attitude and morale Record maintenance Reports Motivation Hiring procedure Consultants Ratio analysis

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Contracts	In the ordinary course of business – customer contracts; supplier contracts; agency/distribution agreements, etc. Not in the ordinary course of business – partnership agreements; joint venture agreements; confidentiality/trade secret agreements, etc.
Proprietary rights	Intellectual property rights (IPR) Intellectual property agreements Pending or threatened claims for infringement or other violations Suspected or alleged infringement by third parties Arrangements for the disclosure of confidential information Agreements with employees and consultants Arrangements relating to proprietary rights of employees
Marketing	Marketing people Products Customer description Customer service Competitive analysis Industry analysis Marketing strategy Product distribution
Production	Production management Personnel and organisation Production process Purchasing, suppliers, shipping and receiving Efficiency analysis Research and development
Financial area	Management, personnel and organisation Cash and investment management Documentation Analysis of financial operations Financial statement analysis Other assets and liabilities Taxes Analysis of projections
Reference area	General information about the company Reference list: bank, other institutional lenders Accounting firm Law firm Suppliers Customers Competitors Agents, consultants, stakeholders, trade associations, brokers

Source: Ten3 East-West, 'Due diligence study areas' [it4b.icsti.su/1000ventures_e/venture_financing/due_diligence.html].

Figure 18.1 is a sample due diligence checklist that you use when you have narrowed down the potential list of acquisitions to the final three.

UNDERLYING ISSUES Buyers and sellers usually do not share the same perspective. Each has a distinct rationale and that rationale may be based on emotion. The business may or may not sell for the **fair market value**, defined as the price at which an asset would pass from a willing seller

FIGURE 18.1 **DUE DILIGENCE CHECKLIST**

Rate each of the following using a scale of 1–10 (1 = lowest; 10 = highest)

MANAGEMENT TEAM		RATING
1	Previous experience (include bios)	
2	Management team strengths	
3	Functional areas of strength and weakness (marketing, development, finance, sales, etc.)	
4	Identified key functional areas that require immediate additions/changes	
	Overall rating:	
TARGETED INDUSTRY SEGMENT		RATING
1	Addressable market size	
2	Current competition and respective positioning	
3	Possible new entrants to the market	
4	Significant competitive advantage and/or differentiation	
5	Market and adoption related risks	
	Overall rating:	
TECHNOLOGY AND PRODUCTS		RATING
1	Patents pending	
2	Architecture	
3	Standards supported	
4	Performance/scalability metrics	
5	Current adoption level of technology	
6	Review of development methodology and selected tools	
7	12 month product strategy, feature prioritisation and roadmap	
8	Technology risks (techniques/processes, tools, hiring/people etc.)	
	Overall rating:	
MARKETING PLAN		RATING
1	Addressable market size	
2	Percentage of market capture	
	Overall rating:	
FINANCIALS		RATING
1	Income statement (for three years)	
2	Sources and use document	
3	Industry comparables	
4	Valuation	
5	Capitalisation table	
6	Exit strategy	
	Overall rating:	

Source: Ten3 East-West, 'Due diligence worksheet: Evaluating a start-up company for venture investing' [www.1000ventures.com/venture_financing/due_diligence_worksheet_byindiaco.html] to a willing buyer, assuming that both are acting rationally and without compulsion and when both have reasonable knowledge of the relevant facts. Six factors determine the fair market value:

- recent profit history
- general condition of the company (such as condition of facilities, completeness and accuracy of books and records, morale and so on)
- market demand for the particular type of business
- economic conditions (especially cost and availability of capital and any economic factors that directly affect the business)
- ability to transfer goodwill or other intangible values to a new owner
- future profit potential.

However, businesses rarely change hands at fair market value. The reason is that three other factors often come into play in arriving at an agreed upon price:

- special circumstances of the particular buyer and seller
- trade-off between cash and terms
- relative tax consequences for the buyer and seller, which depend on how the transaction is structured.

The definition of fair market value is the price at which property would change hands between a willing buyer and a willing seller, both being adequately informed of all material facts and neither being compelled to buy or to sell. In the marketplace, buyer and seller are nearly always acting under different levels of compulsion. Let's look at this more deeply.

Goals of the buyer and seller

It is important to remember one's reasons for valuing an enterprise. Both major parties to the transaction, buyer and seller, will assign different values to the enterprise because of their basic objectives. The seller will attempt to establish the highest possible value for the business and will not heed the realistic considerations of the market, the environment, or the economy. To the seller the enterprise may represent a lifetime investment – or, at the very least, one that took a lot of effort. The buyer, on the other hand, will try to determine the lowest possible price to be paid. The enterprise is regarded as an investment for the buyer and they must assess the profit potential. As a result, a pessimistic view often is taken. An understanding of both positions in the valuation process is important.

Emotional bias

The second issue in valuing a business is the **emotional bias** of the seller. Whenever someone starts a venture, nurtures it through early growth and makes it a profitable business, the person tends to believe the enterprise is worth a great deal more than outsiders believe it is worth. Entrepreneurs therefore must try to be as objective as possible in determining a fair value for the enterprise (realising this fair amount will be negotiable).

Reasons for the acquisition

The third issue in valuing a business is the reasons an entrepreneur's business is being acquired. The following are some of the most common reasons for acquisition:

- developing more growth-phase products by acquiring a firm that has developed new products in the company's industry
- increasing the number of customers by acquiring a firm whose current customers will broaden substantially the company's customer base

- increasing market share by acquiring a firm in the company's industry
- improving or changing distribution channels by acquiring a firm with recognised superiority in the company's current distribution channel
- expanding the product line by acquiring a firm whose products complement and complete the company's product line
- developing or improving customer service operations by acquiring a firm with an established service operation, as well as a customer service network that includes the company's products
- reducing operating leverage and increasing absorption of fixed costs by acquiring a firm that has a lower degree of operating leverage and can absorb the company's fixed costs
- using idle or excess plant capacity by acquiring a firm that can operate in the company's current plant facilities
- integrating vertically, either backward or forward, by acquiring a firm that is a supplier or distributor
- reducing inventory levels by acquiring a firm that is a customer (but not an end user) and adjusting the company's inventory levels to match the acquired firm's orders
- reducing indirect operating costs by acquiring a firm that will allow elimination of duplicate operating costs (for example, warehousing, distribution)
- reducing fixed costs by acquiring a firm that will permit elimination of duplicate fixed costs (for example, corporate and staff functional groups).[4]

In summary, it is important that the entrepreneur and all other parties involved objectively view the firm's operations and potential. An evaluation of the following points can assist in this process:

- a firm's potential to pay for itself during a reasonable period of time
- the difficulties the new owners face during the transition period
- the amount of security or risk involved in the transaction; changes in interest rates
- the effect on the company's value if a turnaround is required
- the number of potential buyers
- current managers' intentions to remain with the firm
- the taxes associated with the purchase or sale of an enterprise.[5]

ANALYSING THE BUSINESS

In analysing small, closely held businesses, entrepreneurs should not make comparisons with larger corporations. Many factors distinguish these types of corporations and valuation factors that have no effect on large firms may be significantly important to smaller enterprises. For example, many closely held ventures have the following shortcomings:

- lack of management depth – the degrees of skills, versatility and competence are limited
- undercapitalisation – the amount of equity investment is usually low (often indicating a high level of debt)
- insufficient controls – because of the lack of available management and extra capital, measures in place for monitoring and controlling operations are usually limited
- divergent goals – the entrepreneur often has a vision for the venture that differs from the investors' goals or stockholders' desires, thus causing internal conflicts in the firm.

These weaknesses indicate the need for careful analysis of the small business.

The checklist in figure 18.2, which is patterned after the information required for an effective business plan (see chapter 10), provides a concise method for examining the various factors that differentiate one firm from another.

FIGURE 18.2 CHECKLIST FOR ANALYSING A BUSINESS

History of the business	
The original name of business and any subsequent name changes	
Date company was founded	
Names of all subsidiaries and divisions – when they were formed and their function	
States where company is incorporated	
States where company is licensed to do business as a foreign corporation	
Review of corporate charter, bylaws and minutes	
Company's original line of business and any subsequent changes	
Market and competition	
Company's major business and market	
Description of major projects	
Sales literature on products	
Growth potential of major markets in which company operates	
Name, size and market position of principal competitors	
How does company's product differ from that of the competition?	
Company's market niche	
Information on brand, trade, product names	
Sales pattern of product lines – that is, are sales seasonal or cyclical?	
Review of any statistical information available on the market – for example, trade associations, government reports, stockmarket reports	
Comparative product pricing	
Gross profit margin on each product line (analyse sales growth and profit changes for three years)	
Concentration of government business	
Research and development expenditures – historical and projected	
Sales and distribution	
How does the company sell – own sales force or through manufacturer representatives?	
Compensation of sales force	
Details on advertising methods and expenditures	
Details on branch sales offices, if any	
Details on standard sales terms, discounts offered, return and allowance policies	
Are any sales made on consignment?	
Does the company warehouse its inventory?	
If the company uses distributors, how are they paid and what are their responsibilities? (For example, do they provide warranty services?)	
Are the company's products distributed nationwide or in a certain geographic area?	
Names and addresses of the company's principal customers	
Sales volume of principal customers by product line for last few years	
How long have customers been buying from the company?	
Credit rating of principal customers	
Historical bad-debt experience of the company	

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Details on private-label business, if any	
Do sales terms involve any maintenance agreements?	
Do sales terms offer any express or implied warranties?	
Has the company experienced any product liability problems?	
Does the company lease, as well as sell, any of its own products?	
What is the percentage of foreign business? How is this business sold, financed and delivered?	
Have any new products come on the market that would make the company's products obsolete or less competitive?	
Have any big customers been lost? If so, why?	
Size and nature of market – fragmented or controlled by large companies?	
Manufacturing	
Full list of all manufacturing facilities	
Are facilities owned or leased?	
Does the company manufacture from basic raw materials, or is it an assembly-type operation?	
Types and availability of materials required to manufacture the product	
Time length of production cycle	
Does the company make a standard shelf-type product, manufacture to specification, or both?	
How is quality control handled in the factory?	
What is accounting system for work in process?	
Are any licences needed to manufacture products?	
What is the present sales capacity based on current manufacturing equipment?	
Does the company have a proprietary manufacturing process?	
What is the company's safety record in its factory operations?	
Do any problems with federal or state environmental regulations exist?	
What is stability of the company's supplier relationships?	
Employees	
Total number of employees by function	
Does a union exist? If not, what is the probability of unionisation? If a union exists, what have been its historical relations with the company?	
Any strikes or work stoppages?	
Details on local labour market	
Details on the company's wage and personnel policies	
Is employee level fixed, or can workforce be varied easily in terms of business volume?	
What is the company's historical labour turnover, especially in key management?	
Analysis of working conditions	
Analysis of general employee morale	
Has the company ever been cited for a governmental violation – for example, Occupational Health and Safety, Fair Labour Practices, etc.	
What are fringe benefits, holiday time, sick leave and so on?	
Physical facilities	
List of all company used facilities, giving location, square footage and cost	
Which facilities are owned? Which leased?	
What is present condition of all facilities, including machinery and equipment?	
If any facilities are leased, details of expiration term, cost, renewal options and so forth	

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Are current facilities adequate for current and projected needs?	
Will any major problems occur if expansion is needed?	
Is adequate insurance maintained?	
Are facilities adequately protected against casualty loss, such as fire damage, through sprinkler systems, burglar alarms, or other measures?	
Are facilities modern and functional for work process and employees?	
Are facilities air conditioned and do they have adequate electric, heat, gas, water and sanitary service?	
Are facilities easily accessible to required transportation?	
What are the cost, net book value and replacement value for company-owned buildings and equipment?	
Ownership	
List of all current owners of the company's common and preferred stock, by class if applicable	
List of all individuals and the number of their shares exercisable under stock option and warrant agreements with prices and expiration dates	
Breakdown of ownership by shares and percentage – actual and pro forma (assuming warrants and stock options exercised)	
Does common stock have pre-emptive rights on liquidation or dividend preference?	
Do the shares carry an investment letter?	
Do restrictions on the transferability of the shares or on their use as collateral exist?	
Do any buy/sell agreements exist?	
Does an employee stock ownership plan or stock bonus plan exist?	
Are the shares fully paid for?	
Are any shareholders' agreements outstanding?	
Has any stock been sold below par or stated value?	
Does cumulative voting exist?	
With respect to the principal owner's stock, have any shares been gifted or placed in a trust?	
How many shares does the principal stockholder own directly and beneficially (including family)?	
If all stock options and warrants are exercised, will the principal stockholder still control 51 per cent of the company?	
If a business is being bought or sold, what percentage of the total outstanding shares is needed for approval?	
Financial	
Three years of financial statements	
Current ratio and net quick ratio	
Net working capital and net quick assets	
Total debt as a percentage of stockholder's equity	
Source and application of funds schedules	
Analysis of the company's basic liquidity and turnover ratios	
Cash as a percentage of current liabilities	
Accounts receivable and inventory turnovers	
Age of accounts payable	
Sales to net working capital	
If the company has subsidiaries (or divisions), consolidating statements of profit and loss	

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Verification of the cash balance and maximum and minimum cash balances needed throughout year	
If the company owns marketable securities, what is their degree of liquidity (saleability) and current market values?	
Age of all accounts and notes receivable, any customer concentration and the adequacy of bad debt reserve	
Cost basis for recording inventories and any inventory reserves; age of inventory and relation to cost of sales (turnover)	
Details on all fixed assets, including date of purchase, original cost, accumulated depreciation and replacement value	
Current market appraisals on all fixed assets, real estate and machinery and equipment	
Analysis of any prepaid expenses or deferred charges; comparison of true value to book value; financial statements	
Personal financial statements of principal stockholders	
If the company carries any goodwill or intangible items, such as patents or trademarks, what is their true value (to what extent possible)? Does the company have any intangible assets of value not carried on books (such as mailing lists in a publishing operation)?	
Analysis of all current liabilities, including age of accounts payable and details of all bank debt and lines of credit, including interest rate, terms and collateral; loan agreements	
Details on all long-term debt by creditor, including loan agreement covenants that may affect future operations	
Do any contingent liabilities or other outstanding commitments, such as long-term supplier agreements exist?	
Details on franchise, lease and royalty agreements	
Income statement accounts for at least three years and analysis of any significant percentage variances, that is, cost of sales as percentage of sales	
Company's tax returns – do they differ from its financial statements? Which years still may be open for audit?	
Three-year projection of income and cash flow for reasonableness of future sales and profits and to establish financing needs	
Pension, profit-sharing, stock bonus plans for contractual commitments and unfunded past-service liability costs	
Management	
Details on all officers and directors – length of service, age, business background, compensation and fringe benefits	
Ownership positions – number of shares, stock options and warrants	
Similar details on other non-officer/non-director key management	
Organisational chart	
What compensation-type fringe benefits are offered to key management: bonuses, retirement-plan stock bonuses, company-paid insurance and deferred compensation?	
What is management's reputation in its industry?	
Does management have any personal interests in any other businesses? Does it have any other conflicts of interest?	
Does key management devote 100 per cent of its time to the business?	
Any employment contracts – amount of salary, length of time, other terms	
Has key management agreed to a non-compete clause and agreed not to divulge privileged information obtained while employed with the company?	

ENTREPRENEURIAL EDGE

DUE DILIGENCE

Hendrix F. C. Niemann was 37 years old, well educated, experienced in business and out of work. He decided to use his severance pay and his savings to purchase a business of his own. For months Niemann analysed numerous prospective businesses that were for sale: a hospital transcription service, a sandwich producer for vending machines, a sailboat dealership and a food distribution company. None of these businesses seemed to be the opportunity Niemann wanted. He was married with three children and this business opportunity had to be right.

Finally, he found an appropriate opportunity. Automatic Door Specialists, a manufacturer of security systems, had sales of $2 million, fairly good cash flow, a purchase price just above book value and a 65-year-old owner ready to retire. After going through 17 business brokers, dozens of business ads and four months of unemployment, Niemann believed this was it. He signed a letter of agreement contingent on a due-diligence process he would accomplish. (Due diligence is close examination of a firm's financial records, legal liabilities and business questions.)

And what did the due-diligence inspection produce? A $36 000 loss occurred in the first half of the fiscal year. Half of the accounts receivable were more than 90 days old and the majority dated back over a year. An overstated inventory caused a true loss year to date closer to $80 000. Sales were down 50 per cent. Half of the net worth of the company was gone and once the debt from the acquisition was added to the books, no money would be left for Niemann to draw a salary! It got worse as Niemann met with the key employees to find out the 'inside' story of Automatic Door Specialists. Key people had left the company to work for competitors, parts and tools were in short supply, promises had been made to customers and then forgotten and the building was a firetrap with no hot water.

All of this bad news provided Niemann with enough facts to demand a 50 per cent reduction in the purchase price or to call the deal off. The seller accepted the new purchase price and Automatic Door Specialists had a new owner. The due-diligence process paid off for Hendrix Niemann.

Source: Hendrix F. C. Niemann, 'Buying a business', *Inc.* (February 1990): 28–38.

ESTABLISHING A FIRM'S VALUE

After using the checklist in figure 18.2, the entrepreneur can begin to examine the various methods used to value a business. It should be noted that the establishment of an actual value is more of an art than a science. Estimations, assumptions and projections are all part of the process. The quantified figures are calculated based, in part, on such hidden values and costs as goodwill, personal expenses, family members on the payroll, planned losses and the like.[6]

Several traditional valuation methods are presented here, each using a particular approach that covers these hidden values and costs. Employing these methods will provide the entrepreneur with a general understanding of how the financial analysis of a firm works. Remember, also, that many of these methods are used concurrently and that the final value determination will be the actual price agreed on by the buyer and seller.

Valuation methods

Table 18.2 lists the various methods that may be used for business valuation. Each method listed is described and key points about them are presented. The three methods that are considered the principal measures used in current business valuations are:

- adjusted tangible assets (balance sheet values)
- price/earnings (multiple earnings value)
- discounted future earnings.

Here we describe all the most popular approaches.[7]

TABLE 18.2: METHODS FOR VENTURE VALUATION

METHOD	DESCRIPTION/EXPLANATION	NOTES/KEY POINTS
Fixed price	Two or more owners set initial value Based on what owners 'think' business is worth Uses figures from any one or combination of methods Common for buy/sell agreements	Inaccuracies exist due to personal estimates Should allow periodic update
Book value (known as balance sheet method) 1 Tangible 2 Adjusted tangible	1 Tangible book value: Set by the business's balance sheet Reflects net worth of the firm Total assets less total liabilities (adjusted for intangible assets) 2 Adjusted tangible book value: Uses book value approach Reflects fair market value for certain assets Upward/downward adjustments in plant and equipment, inventory and bad debt reserves	Some assets also appreciate or depreciate substantially; thus, not an accurate valuation Adjustments in assets eliminate some of the inaccuracies and reflect a fair market value of each asset
Multiple of earnings	Net income capitalised using a price/earnings (P/E) ratio (net income multiplied by P/E number) 15% capitalisation rate often used (equivalent to a P/E multiple of 6.7, which is 1 divided by 0.15) High-growth businesses use lower capitalisation rate (e.g. 5%, which is a multiple of 20) Stable businesses use higher capitalisation rate (e.g. 10%, which is a multiple of 10) Derived value divided by number of outstanding shares to obtain per-share value	Capitalisation rates vary as to firm's growth; thus, estimates or P/E used must be taken from similar publicly traded corporation
Price/earnings ratio	Similar to a return-on-investment approach Determined by price of common stock divided by after-tax earnings Closely held firms must multiply net income by an appropriate multiple, usually derived from similar publicly traded corporations Sensitive to market conditions (prices of stocks)	More common with public corporations Market conditions (stock prices) affect this ratio
Discounted future earnings (discounted cash flow)	Attempts to establish future earning power in current dollars Projects future earnings (5 years), calculates present value using a then discounted rate Based on projected 'timing' of future income	Based on premise that cash flow is most important factor Effective method if: • business being valued needs to generate a return greater than investment • only cash receipts can provide the money for reinvesting in growth
Return on investment (ROI)	Net profit divided by investment Provides an earnings ratio Need to calculate probabilities of future earnings Combination of return ratio, present value tables and weighted probabilities	Will not establish a value for the business Does not provide projected earnings

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Replacement value	Based on value of each asset if it had to be replaced at current cost Firm's worth calculated as if building from 'scratch' Inflation and annual depreciation of assets are considered in raising the value above reported book value Does not reflect earning power or intangible assets	Useful for selling a company that's seeking to break into a new line of business Fails to consider earnings potential Does not include intangible assets (goodwill, patents and so on)
Liquidation value	Assumes business ceases operation Sells assets and pays off liabilities Net amount after payment of all liabilities is distributed to shareholders Reflects 'bottom value' of a firm Indicates amount of money that could be borrowed on a secured basis Tends to favour seller since all assets are valued as if converted to cash	Assumes each division of assets sold separately at auction Effective in giving absolute bottom value below which a firm should liquidate rather than sell
Excess earnings	Developed by the US Treasury to determine a firm's intangible assets (for income tax purposes) Intent is for use only when no better method available Internal Revenue Service refers to this method as a last resort Method does not include intangibles with estimated useful lives (i.e. patents, copyrights)	Method of last resort (if no other method available) Very seldom used
Market value	Needs a 'known' price paid for a similar business Difficult to find recent comparisons Methods of sale may differ – instalment versus cash Should be used only as a reference point	Valuable only as a reference point Difficult to find recent, similar firms that have been sold

Adjusted tangible book value

A common method of valuing a business is to compute its net worth as the difference between total assets and total liabilities. However, it is important to adjust for certain assets in order to assess true economic worth, since inflation and depreciation affect the value of some assets.

In the computation of the **adjusted tangible book value**, one adds or deducts goodwill, intellectual property and patents, deferred financing costs, assets or liabilities from net worth. (Goodwill is the value of a business entity not directly attributable to its tangible assets and liabilities. It can be the firm's name, customer loyalty, employee morale and other factors that translate into higher earning power.) This upward or downward adjustment reflects the excess of the fair market value of each asset above or below the value reported on the balance sheet. Here is an example:

	BOOK VALUE	FAIR MARKET VALUE
Inventory	$100 000	$125 000
Plant and equipment	400 000	600 000
Other intangibles		(50 000)
	$500 000	$ 675 000

Excess = $175 000

Remember that in industry comparisons of adjusted values, only assets used in the actual operation of the business are included.

Other significant balance sheet and income statement adjustments include:

- bad debt reserves
- low-interest, long-term debt securities
- investments in affiliates
- loans and advances to officers, employees, or other companies.

Additionally, earnings should be adjusted. Only true earnings derived from the operations of the business should be considered. One-time items (from the sale of a company division or asset, for example) should be excluded. Also, if the company has been using a net operational loss carried forward, in which case its pre-tax income has not been fully taxed, this also should be considered.

Upward (or downward) income and balance sheet adjustments should be made for any unusually large bad-debt or inventory write-off and for certain accounting practices, such as accelerated versus straight-line depreciation.

Liquidation value

If you need the cash, how much could be made by selling the company off in pieces? Receivables might fetch 80 cents on the dollar. Short-term inventory might be worth 60 per cent of its retail value. Another way is to ask what would it cost to replace these assets? But liquidation value, like book value, suffers from an outdated concept that a business is only as good as its hard assets.

Excess earning approach

Starting with either the book value or the liquidation value, this approach then asks what would be a standard return on equity. Anything earned above this amount would be considered excess

ENTREPRENEURSHIP IN PRACTICE

BUYING A BUSINESS: DOING IT RIGHT

One reason entrepreneurs need to know how to value a business is that they may want to buy one some day. When this is the case, they should keep in mind a number of factors. Here are five of the most important:

- Get a lawyer involved from the beginning. The purchase of assets often involves tax questions, unknown risks and, in some cases, the assumption of liabilities. A lawyer can help the entrepreneur be aware of these issues before they become problems.
- Be aware of hidden risks that may not surface for 12 to 18 months. For example, a customer who was injured by a company-made product before the firm was sold may end up suing the new entrepreneur.
- Have the old owner sign a non-compete clause whereby the individual promises not to re-enter the business for a certain number of years (at least not in the local area). Be sure this clause is reasonable in terms of what is being promised; otherwise, the courts may set it aside.
- Have a certified public accountant or an outside financial expert confirm all income and expenses as well as asset accounts. In this way, the entrepreneur knows what he or she is buying.
- Before closing the deal, check out the seller. Why is the individual selling? Additionally, is the individual honest in business dealings? If not, the person may end up trying to walk away from the deal before the purchase has been finalised.

Source: 'Buying a business: What to watch out for', *Financial Enterprise* (Summer 1987): 13–14.

earnings. For example, customer loyalty clearly adds value to expected income. The major problem here is calculating the return-on-equity benchmark, but there are industry averages that can be used.

Price/earnings ratio (multiple of earnings) method

The **price/earnings (P/E) ratio** is a common method used for valuing publicly held corporations. The valuation is determined by dividing the market price of the common stock by the earnings per share. A company with 100 000 shares of common stock and a net income of $100 000 would have earnings per share of $1. If the stock price rose to $5 per share, the P/E ratio would be 5 ($5 divided by $1). Additionally, since the company has 100 000 shares of common stock, the valuation of the enterprise now would be $500 000 (100 000 shares times $5). The primary advantage of a P/E approach is its simplicity. However, this advantage applies only to publicly traded corporations.

Closely held companies do not have prices in the open market for their stock and thus must rely on the use of a multiple derived by comparing the firm to similar public corporations. This approach has four major drawbacks:

- The stock of a private company is not publicly traded. It is *illiquid*, meaning that it cannot easily be converted into cash and may actually be restricted from sale. Thus any P/E multiple usually must, by definition, be subjective and lower than the multiple commanded by comparable publicly traded stocks.
- The stated net income of a private company may not truly reflect its actual earning power. To avoid or defer paying taxes, most business owners prefer to keep pre-tax income down. In addition, the closely held business may be 'over-spending' on fringe benefits instituted primarily for the owner's benefit.
- Common stock that is bought and sold in the public market normally reflects only a small portion of the business's total ownership. The sale of a large controlling block of stock (typical of closely held businesses) demands a premium.
- It is very difficult to find a truly comparable publicly held company, even in the same industry. Growth rates, competition, dividend payments and financial profiles (liquidity and leverage) rarely will be the same.[8]

Nonetheless, when applied to a closely held firm, here is an example of how the multiple-of-earnings method could be used:

Shares of common stock = 100 000

2006 net income = $100 000

15% capitalisation rate assumed = 6.7 P/E multiple (derived by dividing 1 into 15)

Price per share = $6.70

Value of company = 100 000 × $6.70 = $670 000

Earnings multiples

This is the favourite of the lunch napkin crowd. Take your earnings (or sales) and multiply it by the P/E multiples of comparable companies. Again, finding a benchmark is sometimes difficult. Volatility is also a problem: Recent profits and sales may not reflect long-term prospects. However, if earnings and sales are stable, this is a solid technique.

Comparative value

Anyone who has sold a house knows this concept. A business broker shows what similar businesses in similar neighbourhoods have sold for recently to demonstrate market value. Of course, company transaction information is hard to gather. Still, with some perseverance that information is obtainable and if, like the multiples approach, the comparable companies are screened, this can be a solid yardstick.

Discounted earnings method

Most analysts agree that the real value of any venture is its potential earning power. The **discounted earnings method**, more than any other, determines the firm's true value. One example of a pricing formula using earning power as well as adjusted tangible book value is illustrated in table 18.3.

The idea behind discounting the firm's cash flows is that dollars earned in the future (based on projections) are worth less than dollars earned today (due to the loss of purchasing power). With this in mind, the 'timing' of projected income or cash flows is a critical factor.

The 'Experiential exercise: What is this business worth?' at the end of the chapter provides a step-by-step example of the process of discounting cash flows. Basically, the method uses a four-step process:

- Expected cash flow is estimated. For long-established firms, historical data are effective indicators, although adjustments should be made when available data indicate that future cash flows will change.
- An appropriate discount rate is determined. The buyer's viewpoint has to be considered in the calculation of this rate. The buyer and seller often disagree, since each requires a particular rate of return and will view the risks differently. Another point the seller often overlooks is that the buyer will have other investment opportunities to consider. The appropriate rate, therefore, must be weighed against these factors.
- A reasonable life expectancy of the business must be determined. All firms have a life cycle that depends on such factors as whether the business is one product/one market or multiproduct/multimarket.
- The firm's value is then determined by discounting the estimated cash flow by the appropriate discount rate over the expected life of the business.[9]

OTHER FACTORS TO CONSIDER After reviewing these valuation methods, the entrepreneur needs to remember that additional factors intervene in the valuation process and that these should be given consideration. Presented next are three factors that may influence the final valuation of the venture.

Avoiding start-up costs

Some buyers are willing to pay more for a business than the valuation methods illustrate that it is worth. This is because buyers often are trying to avoid the costs associated with start-up and are willing to pay a little more for an existing firm. The higher price they pay will still be less than actual start-up costs and also avoids the problems associated with working to establish a clientele. Thus, for some buyers a known commodity may command a higher price.

TABLE 18.3: **PRICING FORMULA USING EARNING POWER AND ADJUSTED BOOK VALUE**

STEP 1	Determine the adjusted tangible net worth of the business (the total market value of all current and long-term assets less liabilities)
STEP 2	Estimate how much the buyer could earn annually with an amount equal to the value of the tangible net worth invested elsewhere
STEP 3	Add to this a salary normal for an owner-operator of the business This combined figure provides a reasonable estimate of the income the buyer can earn elsewhere with the investment and effort involved in working in the business
STEP 4	Determine the average annual net earnings of the business (net profit before subtracting owner's salary) over the past few years This is before income taxes, to make it comparable with earnings from other sources or by individuals in different tax brackets (the tax implications of alternative investments should be carefully considered) This trend of earnings is a key factor: Have they been rising steadily, falling steadily, remaining constant, or fluctuating widely? The earnings figure should be adjusted to reflect these trends
STEP 5	Subtract the total of earning power (step 2) and reasonable salary (step 3) from this average net earnings figure (step 4) This gives the extra earning power of the business
STEP 6	Use this extra earnings figure to estimate the value of the intangibles – this is done by multiplying the extra earnings by what is termed the 'years-of-profit' figure This 'years-of-profit' multiplier pivots on these points: How unique are the intangibles offered by the firm? How long would it take to set up a similar business and bring it to this stage of development? What expenses and risks would be involved? What is the price of goodwill in similar firms? Will the seller be signing an agreement with a covenant not to compete? If the business is well established, a factor of five or more might be used, especially if the firm has a valuable name, patent, or location A multiplier of three might be reasonable for a moderately seasoned firm A younger but profitable firm might merely have a one-year profit figure.
STEP 7	Final price equals adjusted tangible net worth plus value of intangibles (extra earnings times 'years of profit')

EXAMPLE

		BUSINESS A	BUSINESS B
STEP 1	Adjusted value of tangible net worth (assets less liabilities)	\$100 000	\$100 000
STEP 2	Earning power at 10%[†] of an amount equal to the adjusted tangible net worth, if invested in a comparable risk business	10 000	10 000
STEP 3	Reasonable salary for owner-operator in the business	18 000	18 000
STEP 4	Net earnings of the business over recent years (net profit before subtracting owner's salary)	30 000	23 350
STEP 5	Extra earning power of the business (step 4 minus steps 2 and 3)	2 000	(4 650)
STEP 6	Value of intangibles – using three-year profit figure for moderately well-established firm (step 3 times step 5)	6 000	None
STEP 7	Final price (steps 1 and 6)	\$106 000	\$100 000 (or less)

In Example business A, the seller receives a value for goodwill because the business is moderately well established and earning more than the buyer could earn elsewhere with similar risks and effort.

In Example business B, the seller receives no value for goodwill because the business, even though it may have existed for a considerable time, is not earning as much as the buyer could through outside investment and effort. In fact, the buyer may feel that even an investment of \$100 000 – the current appraised value of net assets – is too much because it cannot earn sufficient return.

[†] 10% is an arbitrary figure, used for illustration. A reasonable figure depends on the stability and relative risks of the business and the investment picture generally. The rate of return should be similar to that which could be earned elsewhere with the same approximate risk.

Source: Reprinted with permission from Bank of America NT&SA, 'How to buy and sell a business or franchise', *Small Business Reporter,* 1987, 17.

Accuracy of projections

The sales and earnings of a venture are always projected on the basis of historical financial and economic data. Short histories, fluctuating markets and uncertain environments are all reasons for buyers to keep projections in perspective. It is critical they examine the trends, fluctuations, or patterns involved in projections for sales revenues (higher prices or more customers?), market potential (optimistic or realistic assumptions?) and earnings potential (accurate cost/revenue/market data?), because each area has specific factors that need to be either understood or measured for the accuracy of the projection.

Control factor

The degree of control an owner legally has over the firm can affect its valuation. If the owner's interest is 100 per cent or such that the complete operation of the firm is under their influence, then that value is equal to the enterprise's value. If the owner does not possess such control, then the value is less. For example, buying out a 49 per cent shareholder will not be effective in controlling a 51 per cent shareholder. Also, two 49 per cent shareholders are equal until a 2 per cent 'swing vote' shareholder makes a move. Obviously, minority interests also must be discounted due to lack of liquidity – a minority interest in a privately held corporation is difficult to sell. Overall, it is important to look at the control factor as another facet in the purchase of any interest in a firm.

ENTREPRENEURIAL EDGE

GETTING YOUR MONEY'S WORTH

Two years after deciding to sell their business, Doug Roberson and his partner instead merged their $18 million data communications company with an even larger one, gaining $5.7 million in stock and two five-year management contracts. A business valuation had put the overall picture in focus and allowed them to make the decision that best fit their interests. 'The valuation was worth every penny for the added insight it gave us.' Just as if they were preparing to purchase a business, Roberson and his partner knew early on that they needed to be as well prepared as possible before getting involved in something they knew nothing about.

Corporate valuation, also known as business appraisal, is often ignored when it is needed the most: applying for a loan, selling out and even entering bankruptcy, to name just a few reasons. Business owners believe no one can know their businesses like they do, so they overlook the benefits that a valuation provides. Roberson rightly avoided that 'tunnel vision'. 'What it did was allow us to prepare ourselves to respond to worries on the part of a prospective buyer. It helped us become stronger negotiators.'

Roberson paid $15 000 for the resulting 25-page report that enabled him and his partner to see the business in a different light. Even though they were involved in the everyday operations of the business, the partners had been unaware how much the business's success was contingent on key employees and major customers. Such easily lost money-makers are worrisome attributes for outside investors.

A valuation is a great business tool that comes in handy during various events. Generally, it is designed to assign a fair market value, but certain circumstances call for certain outcomes:

- For estate- and gift-tax purposes, an ideal valuation is one that's as low as possible, so as to minimise tax liabilities. Expect the appraiser to look for any documentable factor that might lower your company's value.
- For sale purposes, well-prepared sellers equip themselves with a valuation that documents the highest possible value.
- For financing purposes, bankers will look for a valuation that focuses on liquidation value rather than a company's prospects as a going concern.
- For litigation purposes, valuations are a 'dog-eat-dog' business. Set your valuation goals according to the side of the case you're on, but remember that the best investment you can make is a comprehensive, fully defensible document from the most blue-chip appraiser you can afford.

Source: Adapted from Jill Andresky Fraser, 'What's your company worth?' *Inc.* (November 1997): 111–12.

OTHER CREATIVE WAYS TO HARVEST VALUE

The dynamics of entrepreneurial value-creation, acquisition and divestment have implications for a successful exit strategy. Many entrepreneurs love to start and harvest and then start and harvest again. Some have called it the e-for-enthusiasm curve. The e-curve follows well-trod stages – start-up, expansion, maturation and exit. We have covered these stages previously but here we are interested in the **lifestyle inflection point**, a point in one's life that changes the way we think and act. Many entrepreneurs are of the serial variety and love starting businesses; they are ready to move on to a new challenge. Others reach a certain point and opt for lifestyle rather than growth.

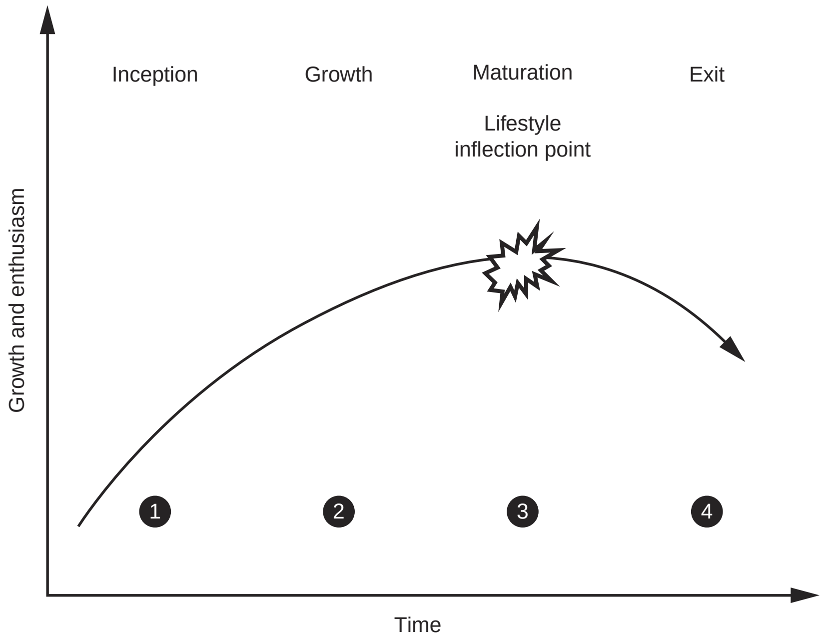
Many things can happen at this point. Some entrepreneurs turn over the business to the next generation (see chapter 20). Others look to sell it off to the highest bidder or merge with a bigger company. Still others seek to maximise and leverage their work by finding a strategic buyer and taking a **proactive exit strategy**. Finally, there is an increasingly large group of entrepreneurs who turn their attention from doing well to doing good; these are the entrepreneurial philanthropists who turn over the companies for the benefit of the common good.

More than 60 per cent of successful entrepreneurs in Australia indicated they planned to 'realise their wealth', that is, cash in, within three years. The trade sale is the most likely path to wealth realisation (42 per cent), but there are a variety of ways to achieve this goal.[10]

Trade sale

A trade sale is the sale of a business to someone within the sector. Selling to another business can be useful in eliminating competition and strengthening the trading position of both businesses.

FIGURE 18.3 E-FOR-ENTHUSIASM CURVE



Source: Adapted from 'What's your exit strategy?', *Restaurant Hospitality* 89(1) (2005): 46.

Usually this involves offering shares or assets to a single industry purchaser. Trade buyers invest for strategic as well as financial reasons. Trade sales are generally carried out on a 'caveat emptor' basis in which the seller could choose not to provide any warranties. There are three typical ways to carry out a trade sale:

- sequential negotiations with selected parties
- simultaneous negotiations with selected parties
- an open competitive tender approaching all parties considered likely to have an interest in the business.

Proactive exit

Australia's Professor Tom McKaskill believes that it is possible to achieve a premium selling price well above that suggested by the balance sheet.[11] The key is finding a strategic buyer who can actually increase the revenue to new heights. The trick is to find someone who recognises the size of the opportunity and who can then justify the size of the sale premium. McKaskill's approach starts from the presumption that conventional valuation techniques are based on an investor aiming to generate a dividend (discounted by the prevailing rate) and that this value can be assessed. This unadventurous model fails to recognise the extra benefits that could be achieved by the right buyer who leverages assets and capabilities to a higher level. How to find a strategic buyer? McKaskill lists five questions that need to be answered:

- What buyer already has a customer base that would buy my products?
- Who has a palette of products that could be sold to my customer base?
- Could my products or technology open up new markets for a buyer who has the resources for greater market development?
- Could my products be modified or extended and sold to the buyer's customer base?
- Could my business catapult the buyer into a new growth market?

Most often, the seller already knows a list of strategic buyers in the same industry or market. Of course, seller preparation is key and that means developing an 'integration-ready' plan that the buyer can readily exploit. That means investing in internal due diligence so that no underlying problems or risks can arise. For example, key employees must already have an incentive to stay. Other management need to fit into a robust succession strategy. This all takes time, about four years, according to McKaskill.

Entrepreneurial philanthropy

Entrepreneurial philanthropy is where a wealthy person transforms an existing business and personally directs a new charitable enterprise. Traditionally, entrepreneurship was only a bottom line activity. Recent research has begun to explore social entrepreneurship, that is, transforming profit-centred businesses for greater good of a community, region, nation, or the world.[12] Researchers Acs and Dana articulated the historical and uniquely American linkages in these practices.

> What differentiates American capitalism from all other forms of industrial capitalism is its historical focus on both the creation of wealth (entrepreneurship) and the distribution of wealth (philanthropy) … philanthropy provides a positive feedback mechanism for future economic growth and a cumulative causation leading to higher levels of economic development.[13]

But the practice is spreading to other countries (see Entrepreneurial edge: Entrepreneurial generosity in New Zealand, in chapter 6).

SUMMARY

Many entrepreneurs start by purchasing a venture already in existence. In this chapter, major steps were described that are critical to the purchase of any business. In addition, 10 key questions were presented and described for evaluating a particular business that has been selected for purchase.

Entrepreneurs need to understand how to value a business for either purchase or sale. Many would like to know the value of their businesses. Sometimes this is strictly for informational purposes and at other times it is for selling the operation. In either case, a number of ways of valuing an enterprise exist.

The first step is to analyse the business's overall operations, with a view to acquiring a comprehensive understanding of the firm's strong and weak points. Figure 18.1 provided a checklist for this purpose. The second step is to establish a value for the firm. Table 18.2 set forth 10 methods for the valuation of a venture. Three of the most commonly used are adjusted tangible assets; price/earnings (P/E) ratio (multiple of earnings); and discounted future earnings.

The adjusted tangible book value method computes the value of the business by revaluing the assets and then subtracting the liabilities. This is a fairly simple, straightforward process.

The P/E ratio method divides the market price of the common stock by the earnings per share and then multiplies by the number of shares issued. For example, a company with a P/E multiple of 10 and 100 000 shares of stock would be valued at $1 million.

The discounted earnings method takes the estimated cash flows for a predetermined number of years and discounts these sums back to the present using an appropriate discount rate. This is one of the most popular methods of valuing a business. Other factors to consider for valuing a business include start-up costs, accuracy of projections and the control factor.

Finally, we concluded with a discussion of the lifestyle inflection point and various strategies to harvest value from an entrepreneurial company.

KEY TERMS AND CONCEPTS

adjusted tangible book value
business assets
business environment
business valuation
discounted earnings method
emotional bias
entrepreneurial philanthropy
fair market value
lifestyle inflection point
price/earnings (P/E) ratio
proactive exit strategy
profits, sales and operating ratios

REVIEW AND DISCUSSION QUESTIONS

1. What are the basic steps to follow when buying a business?
2. Define the term due diligence. How is it applied to the acquisition of an existing venture?
3. Make a list of the study areas that one should investigate in due diligence.
4. To analyse a business, what types of questions or concerns should the entrepreneur address in the following areas – history of the business, market and competition, sales and distribution and manufacturing?
5. To analyse a business, what types of questions or concerns should the entrepreneur address in the following areas – employees, physical facilities, ownership and trade and professional checks?
6. To analyse a business, what types of questions or concerns should the entrepreneur address in the area of finance, management?
7. One of the most popular methods of business valuation is the adjusted tangible book value. Describe how this method works.
8. What does liquidation value mean?
9. Explain how the price/earnings ratio method of valuation works. Give an example.
10. What are the steps involved in using the discounted earnings method? Give an example.
11. How do the following methods of valuing a venture work – fixed price, multiple of earnings, return on investment, replacement value, liquidation value, excess earnings and market value? In each case, give an example.
12. Explain why the following are important factors to consider when valuing a business – start-up costs, accuracy of projections and degree of control.
13. What are other creative ways to harvest a firm's value?

EXPERIENTIAL EXERCISE
WHAT IS THIS BUSINESS WORTH?

A WORKED EXAMPLE

Let's look at a business you wish to acquire. You will do the following:

1 Present the net cash-flow projections for this business for five years (2007 to 2011).
2 Change the format for presenting the data (you may find it easier to use).
3 Use a present value rate of 24 per cent.

Assume you have an opportunity to buy a small division of a large company. Since you know the business intimately, you can accurately forecast the company's growth. Right now it's not profitable, but with your expertise and plans, you expect it can generate $380 000 net cash flow over five years and have a value (net worth) of $400 000 at the end of year five. (The $380 000 net cash flow is after all cash outlays.)

QUESTION

Since you want to earn a minimum annual return of 24 per cent on your investment (that is, the purchase price), how much should you pay for the division?

HERE ARE THE FACTS

Assume the acquisition will occur on 31 December 2006 and the projected annual net cash flow (the excess of all cash inflow over all cash outflow) looks like this:

	2007	2008	2009	2010	2011
Net cash flow (thousands)	$0	$40	$80	$110	$150

ANSWERS

Since you want an annual return of 24 per cent on your money, simply compute the present value of the projected net cash-flow stream. You also must compute the value of the $400 000 net worth position (projected assets less liabilities) at the end of year five.

Referring to present value tables in financial handbooks (or using a calculator), you can obtain the following data:

YEAR	PRESENT VALUE FACTOR FOR 24% RATE OF RETURN
Today	1.000
1	0.806
2	0.650
3	0.524
4	0.423
5	0.341

All that is needed now is to prepare a table showing the net cash flows for the five-year period. You then multiply the present value factor (for a 24 per cent return) by the net cash flow for each year.

YEAR	NET CASH FLOW	PRESENT VALUE FACTOR	TODAY'S VALUE
2007	$ 0	0.806	$ 0
2008	40 000	0.650	26 000
2009	80 000	0.524	41 920
2010	110 000	0.423	46 530
2011	550 000[†]	0.341	187 550[†]
Totals	$ 780 000		$ 302 000

[†] Includes $150 000 net cash flow and $400 000 net worth of division at end of fifth year

As computed, the total value of the projected net cash-flow stream is $302 000 today – and this includes the projected $400 000 net worth at the end of year five.

In other words, if the division were purchased today for its net cash-flow value of $302 000 and if the projected cash flows for the five years were generated (including the projected net worth value of $400 000), you would realise a 24 per cent annual rate of return on your $302 000 investment over the five-year period.

Source: Thomas J. Martin, *Valuation Reference Manual* (Hicksville, NY: Thomar Publications, 1987), 68. Figures updated, 2002.

EXPERIENTIAL EXERCISE

WHAT WOULD YOU RECOMMEND?

Jane Winfield would like to buy Ted Garner's company. She has conducted a detailed financial analysis of Ted's firm and has determined the following:

1. Book value of the inventory: $250 000
2. Discount rate on future earnings: 24 per cent
3. Book value of the plant and equipment: $150 000
4. Fair market value of the inventory: $400 000
5. Fair market value of other intangibles: $60 000
6. Number of shares of common stock: 100 000
7. Fair market value of the plant and equipment: $400 000
8. Price/earnings multiple: 9
9. Book market value of other intangibles: $30 000
10. Estimated earnings over the next five years:

Year 1	$200 000
Year 2	300 000
Year 3	400 000
Year 4	500 000
Year 5	600 000

Based on this information, how much should Jane value the business at, according to each of the following methods:

- a adjusted tangible assets
- b price/earnings ratio
- c discounted future earnings?

Based on your findings, recommend the valuation method she should use. Finally, given all of your calculations, estimate what the final price will be. Give reasons for this estimate. Enter your answers here.

- a Adjusted tangible assets valuation:
- b Price/earnings valuation:
- c Discounted future earnings valuation:
- d Final sales price:

CASE 18.1:

A VALUATION MATTER

Charles Jackson has always been interested in determining the value of his small business. He started the operation five years ago with $1500 of savings and since then it has grown into a firm that has 15 employees and annual sales of $1.88 million.

Charles has talked to his accountant regarding methods that can be used in valuing his business. His accountant has briefly explained two of these to Charles – adjusted tangible book value and discounted earnings. Charles has decided to use both methods in arriving at a valuation. Here is the information he has gathered to help him use both methods:

ADJUSTED ASSETS AND TOTAL LIABILITIES		ESTIMATED EARNINGS OVER NEXT 5 YEARS	
Total liabilities	$700 000	Year 1	$100 000
After re-valuation:		Year 2	125 000
Inventory	600 000	Year 3	150 000
Plant and equipment	400 000	Year 4	200 000
Other assets	100 000	Year 5	250000

Also, Charles believes that it is best to use a conservative discount rate. He has settled on 24 per cent.

QUESTION

1 Under the adjusted tangible book value method, what is Charles's business worth? Show your calculations.

2 Under the discounted earnings method, what is Charles's business worth? Show your calculations.

3 Which of the two methods is more accurate? Why?

CASE 18.2:
WHICH WILL IT BE?

Georgia Isaacson and her son Rubin have been thinking about buying a business. After talking to seven entrepreneurs, all of whom have expressed an interest in selling their operations, the Isaacsons have decided to make an offer for a retail clothing store. The store is very well located and its earnings over the past five years have been excellent. The current owner has told the Isaacsons he will sell for $500 000. The owner arrived at this value by projecting the earnings of the operation for the next seven years and then using a discount factor of 15 per cent.

The Isaacsons are not sure the retail store is worth $500 000, but they do understand the method the owner used for arriving at this figure. Georgia feels that since the owner has been in business for only seven years, it is unrealistic to discount seven years of future earnings. A five-year estimate would be more realistic, in her opinion. Rubin feels that the discount factor is too low. He believes that 20 to 22 per cent would be more realistic.

In addition to these concerns, the Isaacsons feel they would like to make an evaluation of the business using other methods. In particular, they would like to see what the value of the company would be when the adjusted tangible book value method is employed. They also would like to look at the replacement value and liquidation value methods.

'We know what the owner feels his business is worth', Georgia noted to her son. 'However, we have to decide for ourselves what we think the operation is worth. From there on we can negotiate a final price. For the moment, I think we have to look at this valuation process from a number of different angles.'

QUESTION

1 If the owner reduces the earnings estimates from seven to five years, what effect will this have on the final valuation? If the individual increases the discount factor from 15 per cent to 20 to 22 per cent, what effect will this have on the final valuation?

2 How do the replacement value and liquidation value methods work? Why would the Isaacsons want to examine these methods?

3 If the Isaacsons conclude that the business is worth $410 000, what will be the final selling price, assuming a sale is made? Defend your answer.

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Author(s): Robert E. Kennedy
Product number: 9-702-077

Reviews the issues managers face when attempting to value projects abroad. These include dealing with multiple currencies, adjusting for country and industry risk and considering expropriation and devaluation risk.

Valuation Matters

Publication date: 1 March 2002
Author(s): Alfred Rappaport, Michael J. Mauboussin
Product number: F0203D

A Note on Valuation of Venture Capital Deals

Publication date: 14 March 2001
Author(s): Thomas Hellmann
Product number: E95

Discusses some fundamental issues of valuation in venture capital deals. The topics discussed are not necessarily limited to venture capital-backed companies, but they frequently surface in entrepreneurial companies financed either by venture capitalists or other private equity investors.

The Basic Venture Capital Formula

Publication date: 13 August 2003
Revision date: 5 February 2004
Author(s): William A. Sahlman, R. Matthew Willis
Product number: 9-804-042

Briefly summarises the process that venture capitalists use to analyse high-risk, long-term investments. Contains information on methods that can be used to calculate valuation, share price, per cent ownership, implied valuation, dilution and option pools.

ENDNOTES

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ENTREPRENEURIAL FAMILIES: SUCCESSION AND CONTINUITY

19

> Contrary to popular opinion, America's family-owned and privately held corporations are not being destroyed by confiscatory taxation, ruthless competitors, unproductive labour, technological change, or insidious regulation. Family businesses fail because they allow themselves to be destroyed, slowly but surely, by the inaction of their owner/managers. The businesses fail because, more often than not, these people never make the decisions needed to ensure the vitality of their companies in an ever-changing, ever more complex world. Family business owners typically fail to recognise the needs of the future in managing their businesses.
>
> Leon A. Danco, Center for Family Business, Cleveland, Ohio

CHAPTER OBJECTIVES

1. To describe the importance of family businesses and their unique problems
2. To examine the key factors in management succession
3. To identify and describe some of the most important sources of succession
4. To relate the ways to develop a succession strategy
5. To explain the steps involved in carrying out a succession plan
6. To present a 'harvest strategy' for selling out as a final alternative

FAMILY ENTREPRENEURS IN THE ASIA–PACIFIC A large proportion of all businesses are owned and managed by families or groups of relatives. This is particularly true of new and growing businesses (see table 19.1). There is considerable variation across countries in the proportion of family firms. Reynolds et al. found that the rate of family ownership of start-up enterprises ranged from 86 per cent in Brazil to 52 per cent in Sweden. Singapore had a lower than average rate of 65 per cent.[1]

Australia and New Zealand more or less matched the rates of the United Kingdom and the United States, where about three-quarters of start-up ventures were owned primarily by families. Around 27 per cent of firms listed on the Australian Stock Exchange (ASX) are family controlled. The overall wealth of Australian family business tripled between 1996 and 2002.[2]

Because the majority of entrepreneurial firms are family-owned, their overall growth has a huge impact on national economic growth. Most of the world's best-known listed companies at some point were family-owned. Even today, some 'public' companies remain controlled, or at least influenced, by families. At Coca-Cola, the views of the Woodruff family still count. The Agnelli family still influences Fiat.

A huge number of family firms were started between 1945 and 1960. These proprietors are ageing and control is now passing to the second generation. In Australia, for example, one in five proprietors is aged 65 or more and more than one in 10 is over 70[3] and a third are over 50 years of age.[4] Strategies for succession will be required as the owners of nearly half a million Australian enterprises are over 50 years of age and their ranks are growing by 10 per cent annually.[5] Sadly, just 17 per cent of family-run operations have a documented succession plan in place.[6]

Of course, there is more to family business in our region than the **Anglo or Western model**. Here's a quick look at the variety of family businesses in our region.

- Hong Kong Chinese, Indonesian and Philippines family businesses face succession problems that are similar to other countries.[7]
- In Indonesia, for example, ethnic Chinese form only about 3 to 4 per cent of the population but control nearly three-quarters of the country's wealth.[8]
- Chinese family businesses are headquartered throughout the Asia–Pacific region, but the heart of the network is Hong Kong, Singapore, Taiwan and the China coast. Ethnic Chinese are the major source of capital in Thailand, Malaysia, Indonesia, Hong Kong, the Philippines, Vietnam and the China mainland.
- Overseas Chinese account for 80 per cent of all investment coming into China itself.[9] They share a common culture and hard work within a network of entrepreneurial relationships. Top positions are filled by family members with the head of family assuming overall command.[10]
- Chinese family businesses in Singapore are economic assets that propel the modern Singaporean economy. But their hierarchical and patriarchal nature puts them at odds with the state's Western attitudes[11] They have been transforming from **family-ruled and managed**

TABLE 19.1: FAMILY OWNERSHIP OF START-UP FIRMS

COUNTRY	START-UPS WHERE FAMILY OWNS OVER 50%
United Kingdom	77.5%
Australia	76.6%
New Zealand	74.6%
United States	74.5%
Singapore	64.7%

to **professionally managed family-ruled** models as they react to the state and face increasing competition from Western corporations.[12]

- In Thailand, family businesses have driven the industrialisation process. Before the Asian economic crisis in 1997, 220 family business groups produced two-thirds of the gross domestic product (GDP). But globalisation, social and political change and the financial crisis have seen the influence of Thailand's business families greatly reduced.[13]

CHALLENGES FACING FAMILY BUSINESSES

Most of our focus in this book has been on the individual as the unit of analysis. But if we widen our scope we see that the family is a collection of related entrepreneurial individuals. Family firms face the same economic issues as all businesses, including market and technological changes, shifting consumer tastes, ever tougher competition and political instability. But they have many aspects that are unique to them:

- they may lack the financial capability of larger, more diversified firms
- they may have less management expertise to cope with these pressures
- like all families, they have their psychological toils and tribulations.

Family businesses are by definition two overlapping systems. Families usually face inward and decision making is based more on emotions than on sound commercial judgement. On the other side, the business system requires hard analysis and results. While the family system seeks to preserve harmony and minimise change, the business system needs conflict and change if it is to survive and develop. So where the two systems overlap, personal relationship issues meet management requirements. That means special forms of conflict resolution have to be developed and adopted.

Examples of family business conflict are:

- How much should we pay family members? Families typically reward based on need. In the business world people are paid based on their market value.

SINGAPORE FAMILY BUSINESS: NO ONIONS, PLEASE

ENTREPRENEURIAL EDGE

WANGI Industrial Co. would rather be an orange than an onion. And no, the company isn't talking about getting into the food business. It's referring to its internal hierarchy.

'Communication is very important in our organisation', said vice-president of business development Chew Ker Yee. 'We would like to be an orange. We don't want to be like an onion, which has so many layers. An orange only has two layers. You peel off the skin and then you can eat it. At Wangi our hierarchy is so flat that we only have team leaders and team members.'

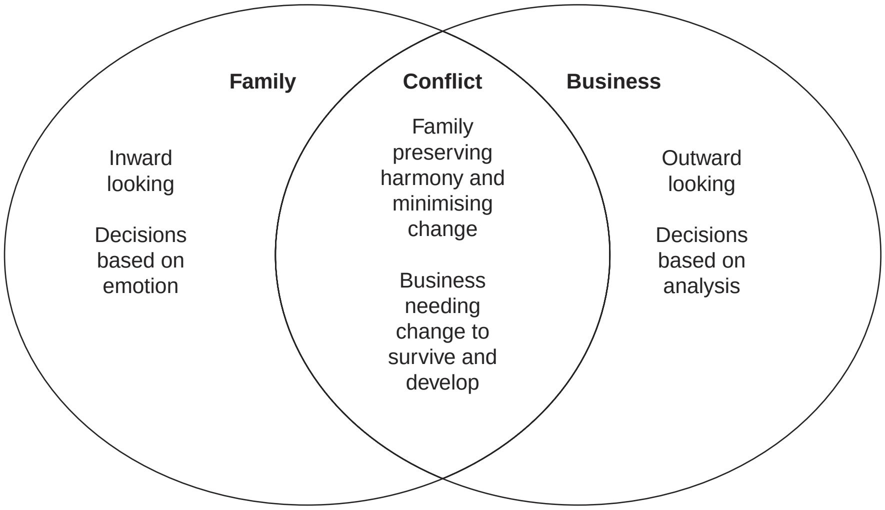
A rare management style, considering Wangi is a family business. A provider of surface finishing and optical thin-film coating solutions, Wangi was founded in 1968 by Mr Chew's father, Chew Yeow Tong. Today, the senior Mr Chew oversees as managing director, while his two sons help run the show with several teams in Singapore.

'We're trying to break away from the traditional family-style management, where the focus tends to be on loyalty and obedience', said the 30-year-old Mr Chew. 'We want to create a very performance-driven company because we need this kind of culture to be able to survive in a global environment.'

'We believe that if team Wangi wins, I personally win', said Mr Chew. 'Over there, it's very difficult to have this kind of thinking. All they want is individual gain. It's a different mindset.' Still, this won't stop the company from expanding further in China. By the end of this month it will open a new factory in Shenzhen with 50 staff initially and 200 by the first quarter of next year.

Source: 'No onions, please', *Business Times* (Singapore) (6 September 2005).

FIGURE 19.1 FAMILY – CONFLICT – BUSINESS



- How much equity ownership should family members have and should it give at all to outsiders? In the real world employers provide incentives to key employees, by offering them an equity stake in its future.

In reality, though, only one-third of family businesses globally succeed in making the leap across generations. Most are sold or wound up after the founder's death. It is said that the first generation establishes it, the second generation develops it and the third one destroys it. Some studies suggest that only 5 per cent of family firms are still creating shareholder value beyond the third generation.[14]

Family-owned companies can succeed and grow in spite of complex challenges. A variety of reasons help account for this. One is that these businesses have not been encumbered by demanding stockholders who want to dictate operating strategy. A second is that the family members are willing to sacrifice short-term profits for long-term gains. Research shows that family members are more productive than other employees.[15] A third is the companies' flexibility, a trait that has allowed family firms to respond to challenges and opportunities in an unrestricted manner. In addition, owners of family firms can convey an image of stability – that the company is in business for the long haul and will provide continuity for customers and employees alike.[16]

Family values and influences can help the operation of a business. According to researchers, three advantages may be forthcoming after start-up:

- preserving the humanity of the workplace – a family business can easily demonstrate higher levels of concern and caring for individuals than are found in the typical corporation
- focusing on the long run – a family business can take the long-run view more easily than corporate managers who are judged on year-to-year results
- emphasising quality – family businesses have long maintained a tradition of providing quality and value to the consumer.[17]

Psychologist Manfred Kets de Vries examined the advantages and disadvantages associated with family businesses.[18] Table 19.2 provides an overview of his particular items. Some of the key advantages already have been touched on (greater flexibility of action, long-term orientation,

TABLE 19.2: ADVANTAGES AND DISADVANTAGES OF FAMILY-CONTROLLED FIRMS

ADVANTAGES	DISADVANTAGES
Long-term orientation	Less access to capital markets may curtail growth
Greater independence of action	Confusing organisation
Less (or no) pressure from stock market	Messy structure
Less (or no) takeover risk	No clear division of tasks
Family culture as a source of pride	Nepotism
Stability	Tolerance of inept family members as managers
Strong identification/commitment/ motivation	Inequitable reward systems
Continuity in leadership	Greater difficulties in attracting professional management
Greater resilience in hard times	Spoiled-kid syndrome
Willing to plough back profits	Internecine strife
Less bureaucratic and impersonal	Family disputes overflow into business
Greater flexibility	Paternalistic/autocratic rule
Quicker decision making	Resistance to change
Financial benefits	Secrecy
Possibility of great success	Attraction of dependent personalities
Knowing the business	Financial strain
Early training for family members	Family members milking the business
	Disequilibrium between contribution and compensation
	Succession dramas

Source: Manfred F.R. Kets de Vries, 'The dynamics of family-controlled firms: The good news and the bad news', *Organisational Dynamics* (Winter 1993): 61.

stability, resilience and less bureaucracy). The disadvantages include family disputes, paternalistic (or maternalistic) rule, confusing organisation (no clear division of tasks), **nepotism** (promoting inept family members) and succession dramas. It is the succession challenge on which chapter 19 focuses.

THE MANAGEMENT SUCCESSION ISSUE

Research shows that many family firms go out of existence after 10 years; only three out of 10 survive into a second generation. More significant, only 16 per cent of all family enterprises make it to a third generation. One important study demonstrated these facts by examining the life expectancy of 200 successful manufacturing firms.[19] The average life expectancy for a family business is 24 years, which is also the average tenure for the founders of a business.[20]

One of the major problems most family businesses have is the lack of preparation for passing managerial control to the next generation. The cruel fact is that one generation succeeds the other with biological inevitability, yet most family businesses never formulate succession plans.

Management succession, which involves the transition of managerial decision making in a firm, is one of the greatest challenges confronting owners and entrepreneurs in family businesses.[21] At first glance, succession would not seem to be a major problem. All an owner has to do is designate which heir will inherit the operation or, better yet, train one (or more) of them to take over the business during the founder's lifetime. Unfortunately, this is easier said than done. A number of problems exist.

One of the major ones is the owner. To a large degree, the owner is the business. The individual's personality and talents make the operation what it is. If this person were to be removed from the picture, the company might be unable to continue. Additionally, this individual may not want to be removed.

TABLE 19.3: BARRIERS TO SUCCESSION PLANNING IN FAMILY FIRMS

FOUNDER/OWNER	FAMILY
Death anxiety	Death as taboo
Company as symbol	• Discussion is a hostile act
• Loss of identity	• Fear of loss/abandonment
• Concern about legacy	Fear of sibling rivalry
Dilemma of choice	Change of spouse's position
• Fiction of equality	
Generational envy	
• Loss of power	

Source: Kets de Vries, 'The dynamics of family-controlled firms', 68.

So if the owner-manager begins to have health problems or is unable to manage effectively, they may still hang on. The owner often views any family attempt to get them to step aside as greedy efforts to plunder the operation for personal gain. What's more, the owner and family members may feel anxiety over death, since raising the topic of death conjures up a negative image in everyone's mind.

Other barriers to succession include sibling rivalry, family members' fear of losing status, or a complete aversion to death for fear of loss or abandonment.[22] Table 19.3 provides a list of barriers to succession attributed to the owner and to the family.

ENTREPRENEURIAL EDGE

THE SADNESS OF RUPERT MURDOCH

As another child quits the family firm, is the Murdoch business dynasty ending? The patriarch's plan to transfer the management of News Corporation to his children is going very badly. On July 29th, 2005, Rupert Murdoch's eldest son, Lachlan, suddenly resigned from his executive roles at the company. He had personal reasons to leave: he and his wife prefer Sydney to New York and will move back. But there were troubles in the firm, too. Being deputy chief operating officer sounded important, but he was said to be frustrated that he had little say in the running of the businesses he oversaw – the group's American TV stations, its publishing business, Harper Collins and its Australian arm. He was closely involved in day-to-day operations only as publisher of the *New York Post*. Most power rested with his father and Peter Chernin, the president and chief operating officer.

Executives at News Corp also say that Lachlan was not as obsessively interested in running the businesses as his father would have liked. According to one person close to the company, some senior people complained to the boss that his son was not particularly co-operative. He did not get on well with Mr Chernin. Mr Murdoch senior is said to have made cutting remarks about Lachlan's performance in front of other executives.

Lachlan is not the only one of Mr Murdoch's children to leave in a hurry. In 2000, Elisabeth Murdoch, the second of his four adult children, suddenly quit BSkyB, a publicly-listed British satellite-television firm controlled by her father, to his surprise and dismay. Ms Murdoch was then regarded as a potential successor.

Now the only one of the children left at News Corp is James Murdoch, who recently moved from its Asian TV business to become chief executive of BSkyB. So far he is impressing investors, some of whom were sceptical at first.

The current plan is for Mr Chernin to succeed until one of the children is ready. But Mr Chernin is likely to leave the firm in the next few years. The picture is further complicated by the fact that Mr Murdoch has two young daughters from his third marriage, to Wendi Deng (another potential successor?). He reportedly wants to change the family's financial arrangements to give his youngest two children an equal share of his assets, which are held in trusts. Tension within the family is said to have been another factor in Lachlan's departure. In a further statement last weekend, Mr Murdoch said that he looks forward to the day when his son wants to return to the firm.

Source: 'The sadness of Rupert Murdoch',
Economist (6 August 2005).

The basic rule for family-owned businesses is this: The owner should develop a succession plan. Since many people want to keep the business in the family, a decision has to be made regarding an heir. This is often psychologically difficult. Choosing an heir can be like buying a cemetery plot. It is an admission of one's mortality. Owners who refuse to face the succession issue, however, place an unnecessary burden on those whom they leave behind. Family successor problems are not insurmountable. For our consideration of these problems, the best place to begin is with an identification of the key factors in succession.

KEY FACTORS IN SUCCESSION

It has been said that the concept of 'smooth succession' in a family firm is a contradiction of terms. This contradiction is because succession is a highly charged emotional issue that requires not only structural changes but cultural changes as well.[23] Family succession includes the transfer of ethics, values and traditions along with the actual business itself. The 'family business' and the 'business family' are two distinct components that must be dealt with and disentangled if progress toward succession is to be made.[24]

A number of considerations affect the succession issue.[25] One way to examine them is in terms of pressures and interests inside the firm and outside the firm. Another way is to examine **forcing events**. A third way is to examine the sources of succession.

Pressures and interests inside the firm

Two types of succession pressures originate within the family firm (see figure 19.2). One comes from the family members. The other comes from non-family employees.[26]

Family members

When members of the family are also employees, a number of succession-type problems can arise. One is that the family members may want to keep the business in existence so that they and their families will be able to manage it. Sometimes this results in the members wanting to get, or increase, control over operations. Another common development is pressure on the owner-manager to designate an heir. A third possible development is rivalry among the various branches of the family. For example, each of the owner's children may feel that the owner should put them (or one of their children) in charge of the operation. Given that only one of the family branches can win this fight, the rivalry can lead to the sale or bankruptcy of the business.[27]

Non-family employees

Non-family employees sometimes bring pressure on the owner-manager in an effort to protect their personal interests. For example, long-term employees often think the owner should give them an opportunity to buy a stake in the company, or they believe they should be given a percentage of the business in the owner's will. Such hopes and expectations are often conveyed to the owner and can result in pressure for some form of succession plan. Moreover, to the extent the non-family employees are critical to the enterprise's success, these demands cannot be ignored. The owner must reach some accommodation with these people if the business is to survive.[28]

Pressures and interests outside the firm

Outside the firm, both family members and non-family elements exert pressure on and hold interest in the firm's succession.

FIGURE 19.2 PRESSURES AND INTERESTS IN A FAMILY BUSINESS

	Inside the family	Outside the family
Inside the business	**The family managers** Hanging onto or getting hold of company control Selection of family members as managers Continuity of family investment and involvement Building a dynasty Rivalry	**The employees** Rewards for loyalty Sharing of equity, growth and success Professionalism Bridging family transitions Stake in the company
Outside the business	**The relatives** Income and inheritance Family conflicts and alliances Degree of involvement in the business	**The outsiders** Competition Market, product, supply and technology influence Tax laws Regulatory agencies

Source: Adapted and reprinted by permission of *Harvard Business Review*. An exhibit from Louise B. Barnes and Simon A. Hershon, 'Transferring power in the family business' (July/August 1976): 106. Copyright © 1976 by the President and Fellows of Harvard College; all rights reserved.

Family members

Even when family members do not play an active role in the business, they can apply pressure. Quite often these individuals are interested in ensuring that they inherit part of the operation and they will put pressure on the owner-manager toward achieving that end. In some cases they pressure in order to get involved in the business. Some family members will pressure the owner-manager to hire them. Quite often these appeals are resisted on the grounds of the firm not needing additional personnel or needing someone with specific expertise (sales ability or technical skills) and thus the owner sidesteps the request.

Non-family elements

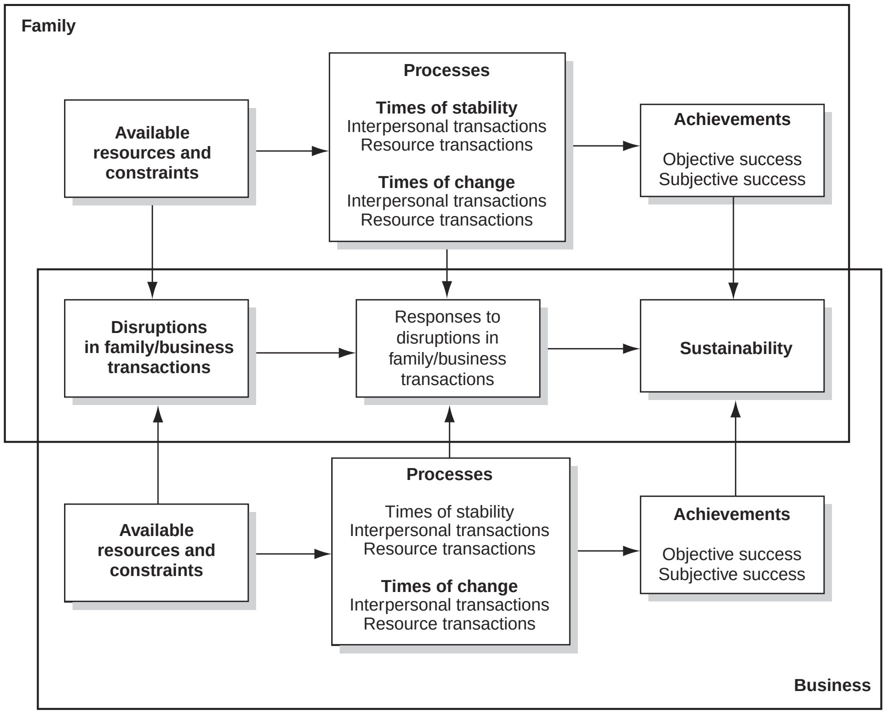
Another major source of pressure comes from external environmental factors. One of these is competitors who continually change strategy and force the owner-manager to adjust to new market considerations. Other factors include customers, technology and new-product development. These forces continually change and the entrepreneur must respond to them. Tax laws, regulatory agencies and trends in management practices constitute still other elements with which the owner-manager must contend.

Depending on the situation, any of these sources of pressure can prove troublesome.

Figure 19.3 illustrates the distinction of family and business issues in a systems model. At the interface of the family and business systems, both the family and the business respond to disruptions in their regular transaction patterns. These disruptions may come from either outside the family and business or from within them. Outside sources of disruption include public policy changes, economic upheavals and technological innovation. Inside sources of disruption include marriage, birth, death and divorce of family members. These disruptions may be either good or bad. In either case, they require a response from both the family and the business.

The extent of overlap between the family and business systems will vary from family business to family business. In family businesses where the prevailing orientation is to keep

FIGURE 19.3 SUSTAINABLE FAMILY BUSINESS MODEL



Source: Kathyrn Stafford, Karen A. Duncan, Sharon Dane and Mary Winter, 'A research model of sustainable family business', *Family Business Review* (September 1999): 197–208.

the family and the business separate, there is little overlap – diagrammatically, this case is illustrated by a small area of interface between the two systems. Conversely, in family business characterised by great overlap, the area of interface between the family and business systems is considerable.

Sustainability results from the confluence of family success, business success and appropriate responses to disruptions. In other words, sustainability requires consideration of the family as well as the business. It also requires consideration of the ability of the family and business to cooperate in responding to disruptions in a way that does not impede the success of either.[29]

Forcing events

Forcing events are those happenings that cause the replacement of the owner-manager. These events require the entrepreneur to step aside and let someone else direct the operation. The following are typical examples:

- death, resulting in the heirs immediately having to find a successor to run the operation
- illness or some other form of non-terminal physical incapacitation
- mental or psychological breakdown, resulting in the individual having to withdraw from the business
- abrupt departure, such as when an entrepreneur decides, with no advance warning, to retire immediately
- legal problems, such as incarceration for violation of the law (if this period of confinement is for more than a few weeks, succession usually becomes necessary if in name only)
- severe business decline, resulting in the owner-manager deciding to leave the helm
- financial difficulties, resulting in lenders demanding the removal of the owner-manager before lending the necessary funds to the enterprise.

These types of events are often unforeseen and the family seldom has a contingency plan for dealing with them. As a result, when they occur they often create major problems for the business.

These considerations influence the environment within which the successor will operate. Unless that individual and the environment fit well, the successor will be less than maximally effective.

Sources of succession

An **entrepreneurial successor** is someone who is high in ingenuity, creativity and drive. This person often provides the critical ideas for new-product development and future ventures. The **managerial successor** is someone who is interested in efficiency, internal control and the effective use of resources. This individual often provides the stability and day-to-day direction needed to keep the enterprise going.

When looking for an inside successor, the entrepreneur usually focuses on a son or daughter or nephew or niece with the intent of gradually giving the person operational responsibilities followed by strategic power and ownership. An important factor in the venture's success is whether the founder and the heir can get along. The entrepreneur must be able to turn from being a leader to being a coach, from being a doer to being an adviser. The heir must respect the founder's attachment to the venture and be sensitive to this person's possessive feelings. At the same time the heir must be able to use their entrepreneurial flair to initiate necessary changes.[30]

When looking ahead toward choosing a successor from inside the organisation, the founder often trains a team of executive managers consisting of both family and non-family members. This enables the individual to build an experienced management team capable of producing a successor. The founder assumes that, in time, a natural leader will emerge from the group.[31]

Two key strategies centre on the entry of the inside younger generation and when the 'power' actually changes hands. Table 19.4 illustrates the advantages and disadvantages of the **early entry strategy** versus the **delayed entry strategy**. The main question is the ability of the successor to gain credibility with the firm's employees. The actual transfer of power is a critical issue in the implementation of any succession plan.[32]

If the founder looks for a family member outside the firm, they usually prefer to have the heir first work for someone else. The hope is that the individual will make their initial mistakes early on, before assuming the family business reins.

Sometimes the founder will look for a non-family outsider to be the successor, perhaps only temporarily. The entrepreneur may not see an immediate successor inside the firm and may decide to hire a professional manager, at least on an interim basis, while waiting for an heir to mature and take over.

Another form of non-family outsider is the specialist who is experienced in getting ventures out of financial difficulty. The founder then usually gives the specialist total control and this person later hands the rejuvenated venture to another leader.

Still another non-family approach is for the founder to find a person with the right talents and to bring this individual into the venture as an assistant, with the understanding that they will eventually become president and owner of the venture. No heirs may exist, or perhaps no eligible family member is interested.

DEVELOPING A SUCCESSION STRATEGY

Developing a succession strategy involves several important steps – understanding the contextual aspects, identifying successor qualities, understanding influencing forces and carrying out the succession plan.[33]

TABLE 19.4: COMPARISON OF YOUNGER GENERATION ENTRY STRATEGIES FOR SUCCESSION IN FAMILY BUSINESS

ADVANTAGES OF EARLY ENTRY STRATEGY	DISADVANTAGES OF DELAYED ENTRY STRATEGY
Intimate familiarity with the nature of the business and employees is acquired	Conflict results when the owner has difficulty with teaching or relinquishing control to the successor
Skills specifically required by the business are developed	Normal mistakes tend to be viewed as incompetence in the successor
Exposure to others in the business facilitates acceptance and the achievement of credibility	Knowledge of the environment is limited and risks of inbreeding are incurred
Strong relationships with constituents are readily established	Specific expertise and understanding of the organisation's key success factors and culture may be lacking
The successor's skills are judged with greater objectivity	Set patterns of outside activity may conflict with those prevailing in the family firm
The development of self-confidence and growth independent of familial influence is achieved	Resentment may result when successors are advanced ahead of long-term employees
Outside success establishes credibility and serves as a basis for accepting the successor as a competent executive	
Perspective of the business environment is broadened	

Source: Jeffrey A. Barach, Joseph Ganitsky, James A. Carson and Benjamin A. Doochin, 'Entry of the next generation: Strategic challenge for family firms', *Journal of Small Business Management* (April 1988): 53.

Understanding the contextual aspects

The five key aspects that must be considered for an effective succession follow.

Time

The earlier the entrepreneur begins to plan for a successor, the better the chances of finding the right person. The biggest problem the owner faces is the prospect of events that force immediate action and result in inadequate time to find the best replacement.

Type of venture

Some entrepreneurs are easy to replace; some cannot be replaced. To a large degree, this is determined by the type of venture. An entrepreneur who is the ideas person in a high-tech operation is going to be difficult to replace. The same is true for an entrepreneur whose personal business contacts throughout the industry are the key factors for the venture's success. On the other hand, a person running an operation that requires a minimum of knowledge or expertise usually can be replaced without much trouble.

Capabilities of managers

The skills, desires and abilities of the replacement will dictate the future potential and direction of the enterprise. As the industry matures, the demands made on the entrepreneur also may change. Industries where high-tech is the name of the game often go through a change in which marketing becomes increasingly important. A technologically skilled entrepreneur with an understanding of marketing, or with the ability to develop an orientation in this direction, will be more valuable to the enterprise than will a technologically skilled entrepreneur with no marketing interest or background.

Entrepreneur's vision

Most entrepreneurs have expectations, hopes and desires for their organisation. A successor, it is hoped, will share this vision, except, of course, in cases where the entrepreneur's plans have contributed to the organisation getting into trouble and a new vision is needed. An example is Apple Computer, where one of the founders, Steven Jobs, was replaced by John Sculley because the board of directors felt that a more managerial, day-to-day entrepreneur was needed to replace the highly conceptual, analytical Jobs.

Environmental factors

Sometimes a successor is needed because the business environment changes and a parallel change is needed at the top. The Sculley/Jobs example is one case in point. Another is Edwin Land of Polaroid. Although his technological creativity had made the venture successful, Land eventually had to step aside for someone with more marketing skills. In some cases owners have had to allow financial types to assume control of the venture because internal efficiency was more critical to short-run survival than was market effectiveness.

Identifying successor qualities

Successors should possess many qualities or characteristics. Depending on the situation, some will be more important than others. In most cases, however, all will have some degree of importance.

Some of the most common of these successor qualities are: Sufficient knowledge of the business or a good position (especially marketing or finance) from which to acquire this knowledge within an acceptable time; fundamental honesty and capability; good health; energy, alertness and perception; enthusiasm about the enterprise; personality compatible with the business; high degree of perseverance; stability and maturity; reasonable amount of aggressiveness; thoroughness and a proper respect for detail; problem-solving ability; resourcefulness; ability to plan and organise; talent to develop people; personality of a starter and a finisher; and appropriate agreement with the owner's philosophy about the business.[34]

Understanding influencing forces

Locating an individual with the desired traits can be difficult. If the ideal cannot be achieved, the entrepreneur should emphasise selecting a successor with the potential to develop the attributes mentioned previously within an appropriate time frame. This choice must take into account family and business culture issues, the owner's concerns and family member concerns. The specific aspects of each of these influencing forces follow.

- **Family and business culture issues:**
    - business environment
    - stage of the firm's development
    - business's traditions and norms
    - family culture, strength and influence
    - owner's personal motivations and values.
- **Owner's concerns:**
    - relinquishing power and leadership
    - keeping the family functioning as a unit
    - defining family members' future roles in the business
    - assuring competent future leadership in the firm
    - educating family and non-family members about key roles
    - keeping non-family resources in the firm.
- **Family member concerns:**
    - gaining and losing control of family assets
    - having control over decisions made by business leadership
    - protecting interest when ownership is dispersed among family members
    - how to get money out of the business, if necessary
    - assurance that the business will continue.[35]

These forces and concerns prepare the entrepreneur for developing a management continuity strategy and policy. A written policy can be established in one of the following strategies.

- The owner controls the management continuity strategy entirely. This is very common, yet legal advice is still needed and recommended.
- The owner consults with selected family members. Here the legal adviser helps to establish a liaison between family and owner in constructing the succession mechanism.
- The owner works with professional advisers. This is an actual board of advisers from various professional disciplines and industries that works with the owner to establish the mechanism for succession (sometimes referred to as a 'quasi-board').[36]
- The owner works with family involvement. This alternative allows the core family (blood members and spouses) to actively participate in and influence the decisions regarding succession.

If the owner is still reasonably healthy and the firm is in a viable condition, the following additional actions should be considered.

- The owner formulates **buy/sell agreement**s at the very outset of the company, or soon thereafter and whenever a major change occurs. This is also the time to consider an appropriate insurance policy on key individuals that would provide the cash needed to acquire the equity of the deceased.
- The owner considers **employee stock ownership plans (ESOPs)**. If the owner has no immediate successor in mind and respects the loyalty and competence of their employees, then an appropriate ESOP might be the best solution for passing control of the enterprise. After the owner's death, the employees could decide on the management hierarchy.
- The owner sells or liquidates the business when losing enthusiasm for it but is still physically able to go on. This could provide the capital to launch another business. Whatever the owner's plans, the firm would be sold before it fails due to lack of interest.
- The owner sells or liquidates after discovering a terminal illness but still has time for the orderly transfer of management or ownership.[37]

For all of these strategies, legal advice is beneficial, but of greater benefit is having advisers (legal or otherwise) who understand the succession issues and are able to recommend a course of action.

Entrepreneurial founders of family firms often reject thoughts of succession. Yet neither ignorance nor denial will change the inevitable. It is therefore crucial for entrepreneurs to design a plan for succession very carefully. Such plans prevent today's flourishing family businesses from becoming a statistic of diminishing family dynasties.

Carrying out the succession plan

History reveals that although succession can be a problem, effective ways of dealing with it exist. The following are four important steps to remember.

Identify a successor

As difficult as it is, every owner-manager should identify a successor or at least the characteristics and experience needed of such an individual.[38] The basic question that must be answered is: Who can do the best job keeping the firm going? Survival and growth should be the primary areas of concern. The greatest hurdle is getting the key manager(s) to select someone. If it is a public firm with one person running the show, the individual may never get around to it. Privately held firms require an additional consideration. If one relative is designated as the heir apparent, how will the other relatives take it? Some founders, not wishing to hurt anyone, never make a decision. If no successor is identified, the next two steps are also ignored.

Groom an heir

In some firms the entrepreneur will pick a successor and let it be known. However, many top managers waver when it comes to actually announcing a choice. One person may appear to have the inside track, or a small number of people may exist from whom the successor will be chosen, but no one knows for sure who will get the job. In order to keep the guessing game going, the entrepreneur does not provide formal grooming. Regardless of who eventually heads the firm, precious time is lost for the person to learn the job. In small firms, the problem can be more acute. Even if the heir is designated, the founder often finds it difficult to relinquish (or at least share) the authority necessary for effective grooming. The ego factor proves to be a major stumbling block.

Agree on a plan

Effective succession requires a plan. In large enterprises this often is worked out through a series of meetings designed to ensure an orderly transfer of power and a smooth flow of operations. Smaller organisations usually need a detailed person-to-person discussion of how responsibilities will be transferred to the successor. Since large enterprises continually go through succession changes at all levels, the mechanics of power transfer need not be excessively time-consuming. The basic procedures should be fairly routine. Small owner-manager firms, however, are not so accustomed to such changes; for them a detailed plan is in order. In both cases the future direction of the firm will be a major issue.

No owner wants to step aside for a person who will change things dramatically; no entrepreneur wants to see a lifetime of effort unravelled. If the person leaving the position has any power to influence future decision making, this is the time to use it, if only by spelling out a philosophy or general course of action. Of course, if operations have not been going well, the person stepping aside will have limited influence on the successor; and if a review of operations shows that changes should be made, promises are likely to be broken (or at least modified).

Especially in small firms, attention should be given to day-to-day operations. Such consideration helps eliminate (or at least reduce) feuding. A detailed discussion of duties, obligations and operations is imperative for family businesses. At this point, it can be helpful to bring into the plan those who will be most affected by it. This participatory approach often will co-opt some critics and alleviate the fears of others. In any event, it is a useful management tactic for helping to create unity behind the new person.[39]

BUY/SELL AGREEMENTS FOR SUCCESSION

ENTREPRENEURSHIP IN PRACTICE

Many entrepreneurs owe their continued success to the combined skills of two or more owners. And when one of those owners dies, becomes disabled, or retires, it is imperative the transfer of his or her ownership interest is carried out in a way that protects the future of the business, the ownership interests of remaining shareholders and the financial security of the departing owner's family. A buy/sell agreement can provide just such protection. It ensures that interest in a closely held business is transferred in a manner advantageous to all involved parties. This type of agreement can be designed to make certain the following:

1. The remaining shareholder(s) has the first right to retain the ownership interest.
2. The departing owner (or beneficiaries) receives a fair market price for the ownership interest.
3. Lawsuits and disputes that could threaten the company's existence are avoided.
4. Funds are available to purchase the ownership interest.

Legal counsel is necessary to ensure that a buy/sell agreement addresses all of the unique circumstances of a particular company.

The two basic types of agreements are the 'cross-purchase agreement,' in which the shareholders are obligated to purchase the departing owner's stock and the 'redemption agreement,' in which the company is obligated to purchase the departing owner's stock. Each case has certain advantages, disadvantages and tax implications that need to be considered. Thus, both a lawyer and a tax accountant should be consulted.

Source: Thomas Owens, 'Buy-sell agreements', *Small Business Reports* (January 1991): 57–61.

Consider outside help

Promotion from within is a morale-building philosophy. Sometimes, however, it is a mistake. When the top person does a poor job, does promoting the next individual in line solve the problem? The latter may be the owner-manager's clone. Or consider family-owned businesses that start to outgrow the managerial ability of the top person. Does anyone in the firm really have the requisite skills for managing the operation? The questions that must be answered are: 'How can the business be effectively run?' and 'Who has the ability to do it?' Sometimes answering these questions calls for an outside person. Family businesses also face the ever-present ego factor.[40] Does the owner-manager have the wisdom to step aside and the courage to let someone else make strategic decisions? Or is the desire for control so great that the owner prefers to run the risks associated with personally managing the operation? The lesson is clear to the dispassionate observer; unfortunately, it is one many owners have had to learn the hard way.[41]

The checklist presented in figure 19.4 recaps some of the material in this chapter and sets forth important steps that should be taken to address the family succession issue.

THE HARVEST STRATEGY: SELLING OUT

After considering the various succession ideas presented in this chapter, many family-business entrepreneurs choose a **harvest strategy**, which means the venture will be sold. If this becomes the proper choice for an entrepreneur (and keep in mind it may be the best decision for an entrepreneur who has no interested family members or key

FIGURE 19.4 A CHECKLIST FOR SUCCESSION: SOME IMPORTANT STEPS

For the owners of family-run firms	
Learn to delegate authority and decentralise operations	
Develop an organisational chart	
Plan for more than one successor – increase the possibilities	
Establish a personnel development program	
Encourage the potential successor to gain experience outside of the business	
Do not neglect daughters	
Keep plans updated – continually review the progress of the business and possible successors	
Strategically plan for the future – do not always focus on putting out daily fires	
Establish family business meetings to air issues	
For the children of family-run firms	
Announce your interest in taking over the family firm	
Take responsibility for your personal development	
Get a mentor (someone 'outside' that you respect)	
Gain experience outside the family business	
Get some accountability training – hold positions that teach responsibility and offer opportunities for decision making	
Learn to blend family traditions with future business goals	
Avoid family feuds – work with the family, not against it	
Eliminate 'Dad's/Mum's ghost' – prepare a clear takeover plan that eventually phases out older family leaders and allows changes	

employees), then the owner needs to review some important considerations. The idea of 'selling out' actually should be viewed in the positive sense of 'harvesting the investment'.

Entrepreneurs consider selling their venture for numerous reasons. Based on 1000 business owners surveyed, some of the motivations are:

- boredom and burnout
- lack of operating and growth capital
- no heirs to leave the business to
- desire for liquidity
- ageing and health problems
- desire to pursue other interests.[42]

Whether due to a career shift, poor health, a desire to start another venture, or retirement, many entrepreneurs face the sell-out option during their entrepreneurial lifetime. This harvesting strategy needs to be carefully prepared in order to obtain the adequate financial rewards.[43]

Steps for selling a business

Charles O'Conor, a corporate financial consultant, recommends eight steps for the proper preparation, development and realisation of the sale.[44]

- **Step 1: Prepare a financial analysis**
  The purpose of such an analysis is to define priorities and forecast the next few years of the business. These fundamental questions must be answered:
  - What will executive and other workforce requirements be and how will we pay for them?
  - If the market potential is so limited that goals cannot be attained, should we plan an acquisition or develop new products to meet targets for sales and profits?
  - Must we raise outside capital for continued growth? How much and when?[45]
- **Step 2: Segregate assets**
  Tax accountants and lawyers may suggest the following steps to reduce taxes:
  - Place real estate in a separate corporation, owned individually or by members of the family.
  - Establish a leasing subsidiary with title to machinery and rolling stock. You can then lease this property to the operating company.
  - Give some or all of the owner's shares to heirs when values are low, but have the owner retain voting rights. Thus, when a sale is made, part or all of the proceeds can go directly to another generation without double taxation.
  - Hold management's salaries and fringe benefits at reasonable levels to maximise profits.[46]
- **Step 3: Value the business**
  The various methods used to value a venture were discussed in chapter 18. Obviously, establishing the valuation of a company constitutes a most important step in its sale.[47]
- **Step 4: Identify the appropriate timing**
  Knowing when to offer a business for sale is a critical factor. Timing can be everything. A few suggestions follow:
  - sell when business profits show a strong upward trend
  - sell when the management team is complete and experienced
  - sell when the business cycle is on the upswing, with potential buyers in the right mood and holding excess capital or credit for acquisitions.
  - sell when you are convinced that your company's future will be bright.[48]

- **Step 5: Publicise the offer to sell**
  A short prospectus on the company that provides enough information to interest potential investors should be prepared. This prospectus should be circulated through the proper professional channels – bankers, accountants, lawyers, consultants and business brokers.
- **Step 6: Finalise the prospective buyers**
  Inquiries need to be made in the trade concerning the prospective buyers. Characters and managerial reputation should be assessed in order to find the best buyer.
- **Step 7: Remain involved through the closing**
  Meeting with the final potential buyers helps to eliminate areas of misunderstanding and to negotiate the major requirements more effectively. Also, the involvement of professionals such as lawyers and accountants usually precludes any major problems arising at the closing.
- **Step 8: Communicate after the sale**
  Problems between the new owner and the remaining management team need to be resolved in order to build a solid transition. Communication between the seller and the buyer and between the buyer and the current management personnel is a key step.

In addition to these eight steps, an entrepreneur must be aware of the tax implications arising from the sale of a business. For professional advice, a tax accountant specialising in business valuations and sales should be consulted.

The eight steps outlined here, combined with the information on valuation in chapter 18, will help entrepreneurs harvest their ventures. The steps provide a clear framework within which entrepreneurs can structure a fair negotiation leading to a sale. If the purpose of a valuation is to sell the business, then the entrepreneur must plan ahead and follow through with each step.

SUMMARY

This chapter focused on family business and family management succession, which is one of the greatest challenges for entrepreneurs.

We looked at the current status of family business entrepreneurs in the Asia–Pacific region. Their range and diversity is surpassed only by their economic impact.

Family businesses face a number of unique issues, not the least of which are the psychological toils and tribulations of other families.

There is considerable potential for conflict where the family system meets the business system. The sad fact is that only one-third of family businesses make it into the second generation. But there are several factors that give strength and hope to their survival. Their disadvantages are matched by their advantages.

A number of considerations affect succession. Family and non-family members, both within and outside the firm, often bring pressure on the entrepreneur. Some want to be put in charge of the operation; others simply want a stake in the enterprise.

Two types of successors exist: An entrepreneurial successor provides innovative ideas for new-product development whereas a managerial successor provides stability for day-to-day operations. An entrepreneur may search inside or outside the family as well as inside or outside the business. The actual transfer of power is a critical issue and the timing of entry for a successor can be strategic.

Developing a succession plan involves understanding these important contextual aspects – time, type of venture, capabilities of managers, the entrepreneur's vision and environmental factors. Also, forcing events may require the implementation of a succession plan regardless of whether or not the firm is ready to implement one. This is why it is so important to identify successor qualities and carry out the succession plan.

The chapter closed with a discussion of the entrepreneur's decision to sell out. The process was viewed as a method to 'harvest' the investment and eight specific steps were presented for entrepreneurs to follow.

KEY TERMS AND CONCEPTS

Anglo or Western model
buy/sell agreement
delayed entry strategy
early entry strategy
employee stock ownership plans (ESOPs)
entrepreneurial successor
family-ruled and managed
forcing events
harvest strategy
management succession
managerial successor
nepotism
professionally managed family-ruled

REVIEW AND DISCUSSION QUESTIONS

1 Describe the size and impact of family businesses on Asia–Pacific economies.
2 What are some of the advantages and disadvantages of family firms?
3 A number of barriers to succession in family firms exist. Using table 19.2, identify some of the key barriers.
4 What pressures do entrepreneurs sometimes face from inside the family? (Use figure 19.1 in your answer.)
5 What pressures do entrepreneurs sometimes face from outside the family? (Use figure 19.1 in your answer.)
6 An entrepreneur can make a number of choices regarding a successor. Using table 19.4 as a guide, discuss each of these choices.
7 What are three of the contextual aspects that must be considered in an effective succession plan?
8 In what way can forcing events cause the replacement of an owner-manager? Cite three examples.
9 What are five qualities or characteristics successors should possess?
10 What are four steps that should be taken in carrying out a succession plan?
11 What eight steps should be followed to harvest a business? Discuss each of these steps.

EXPERIENTIAL EXERCISE

PASSING IT ON

Management succession and continuity are two of the critical concerns of most entrepreneurs. In your library, look through the past-year issues of business magazines. Focus on articles related to the management succession and continuity of specific firms. Then choose the two you find to be most interesting and informative and then for each firm answer the following questions:

1 What business is this company in?
2 What difficulties did the owner have formulating a strategy regarding their succession?
3 What was the entrepreneur's final decision on how to handle the succession?
4 What lessons can be learned from this individual's experience?

Based on what you have learned from these two cases, what recommendations would you give to an entrepreneur who is in the process of developing a succession plan? Be as helpful as possible.

CASE 19.1:

JUST AS GOOD AS EVER

When Jason Jones was found in the storage area, no one knew for sure how long he had been unconscious. Within 30 minutes he was in the emergency room of Mercy Hospital and by early evening the doctors had determined that Jason had suffered a mild heart attack.

During the first few days he was in the hospital, Jason's family was more concerned with his health than anything else. However, as it became clear Jason would be released within a week and would be allowed back at work within two weeks, family members talked about his stepping aside as president of the operation and allowing someone else to take over the reins.

Jason is president of a successful auto-parts supply house. Gross sales last year were $3.7 million. Working with him in the business are his son, daughter and two nephews. Jason started the business 22 years ago when he was 33. After working for one of the large oil firms for 10 years as a sales representative to auto-parts supply houses, Jason broke away and started his own company. At first, he hired outside help. Over the past five years, however, he has been slowly bringing his family on board. It was Jason's hope that his son would one day take over the business, but he did not see this happening for at least another 10 to 15 years.

Jason's wife, Rebecca, believes that although he should continue to work, he should begin to train his son to run the business. On the day before he left the hospital, she broached this idea with him and asked him to think about it. He replied: 'What is there to think about? I'm too young to retire and Herbert does not know the business well enough to take over. It will take at least five more years before he is ready to run the operation. Besides, all I have to do is slow down a bit. I don't have to retire. What's the hurry to run me out of the company? I'm as good as ever.'

Rebecca and Herbert believe that over the next couple of months they must continue working on Jason to slow down and to start training Herbert to take over the reins.

QUESTION

1 Why is Jason reluctant to turn over the reins to Herbert? Include a discussion of figure 19.2 in your answer.

2 Cite and discuss two reasons Jason should begin thinking about succession planning.

3 What would you recommend Rebecca and Herbert do to convince Jason they are right? Offer at least three operative recommendations.

CASE 19.2: NEEDING SOME HELP ON THIS ONE

When Jack Schultz started his company 10 years ago, he was lucky if he had two cars a day to work on. Today, Jack has 15 people working for him and he usually has a backlog of about five days' work. Some of this work is repairs caused by car accidents; a lot of it is a result of improper maintenance by the owners.

Jack is 64 years old and feels he will work for about six more years before retiring. The business is very profitable and Jack and his wife do not need to worry about retirement income. They have saved more than enough. However, Jack is concerned about what to do with the business. He has two children who work with him, Bob (31 years old) and Tim (29 years old). Jack has not asked either of them if they would want to take over the operation. He assumes they will. He also has a nephew, Richard (35 years old), working for him. All three of these relatives have been with Jack for nine years.

Jack believes that any one of the three could successfully head the venture. But he is concerned about in-fighting should he favour one over the others. On the other hand, if he turns the business over to all three of them collectively, will they be able to get along with one another? Jack has no reason to believe the three cannot work things out amicably, but he is unsure.

Jack has decided he cannot wait much longer to groom an heir. The major stumbling block is identifying who that person will be. Additionally, Jack really does not know anything about picking a successor. What characteristics should the individual possess? What types of training should the person be given? What other steps should be followed? Jack feels he needs to answer these questions as soon as possible. 'I know how to plan business operations', he told his wife last week. 'However, I don't know how to go about planning for the succession of business operations. It's a whole different idea. I need some help on this one.'

QUESTION

1 Identify and briefly describe four characteristics you would expect to find in a successful manager of this type of venture.

2 What steps does Jack need to follow to successfully identify and groom a successor? Be complete in your answer.

3 If you were going to advise Jack, what would you recommend he do first? How should he get started with his succession plan? What should he do next? Offer him some general guidance on how to handle this problem.

CASE 19.3: THE COME-BACK CORBANS

The way Corban cousins Alwyn and Brian see it, the family is back – with luck and some thoughtful succession planning, maybe for another 100 years. That is certainly the kind of long-term view they take to their enterprise, the Hawke's Bay-based wine company, Ngatarawa.

Ngatarawa is a family business story with a twist. The cousins are descendants of Assid Abraham Corban and his wife Najibie who left Lebanon in 1891, bringing 300 years of winemaking tradition and nine children with them, to establish the Corban family grape growing and winemaking enterprise that underpinned much of New Zealand's wine industry last century. After almost 70 years the Corbans were forced out of the family winemaking business. In 1975, increased competition and the need to raise more capital to grow the business in the suddenly expanding industry, left Rothmans Industries with 78 per cent of the equity in A.A. Corban and Sons. The core winemaking business passed out of family hands.

The Ngatarawa story began 23 years ago when Alwyn met Hawke's Bay pastoral farmer Garry Glazebrook and entered into a 50/50 partnership to establish a small vineyard and winery on a sliver of Glazebrook land that hosted the slowly deteriorating stables of a previously successful racing stud.

In 1988 they turned the partnership into a company with the Corban and the Glazebrook families each holding 50 per cent of the equity. The move introduced Brian Corban, a lawyer and professional director and his commercial and governance skills to the business as a founding director of the new company. A regrafted family business was starting to take root. In 1999, the Corbans bought out the Glazebrooks and the Corban family were back in the winemaking business lock, stock and wine barrels.

The transition to a family business did not, however, end the disciplined approach to governance and management introduced by Brian. A generation older than his cousin, Brian had cut his teeth on the industry as an executive in the original family business. He took over as Ngatarawa chairman and brought both industry knowledge and commercial governance skills, much to the relief of his younger and more production-focused relative. Alwyn could get on with the job of building and managing an outstanding boutique winery, leaving much of the financial planning and strategy development to his chairman cousin. The board was expanded to include Brian's wife Lindsay, a specialist in human resource management and their son Ben, a talented graphic designer with his own successful design business. Ngatarawa's new Silks label design is his creation.

'Once the company became an undiluted Corban family heritage through ownership the message became stronger because it is founded on our 300 years in the business', adds Brian Corban. 'We use the family heritage as a strong element of market differentiation supported by the wine quality and our whole marketing stance', agrees Alwyn.

The Corbans believe their whole approach to directing and managing the business has lifted several notches since they took over full control. The management and leadership style of the controlling cousins is very different. It is also manifest in what each of them identifies as the key drivers of the business. For Alwyn, the drivers are achieving critical mass, margin control in the manufacture of his wines and minimising risk through a spread of markets. Ngatarawa started exporting in 1998, mainly to the US, partly to spread risk and partly to deliver Alwyn his greater critical mass. And, as he points out, there hasn't been much growth in the New Zealand wine-drinking market over the past 10 years. For Ngatarawa to grow it must steal market share from other players.

Brian's drivers, on the other hand, are the desire to succeed financially, which means having a long term view of the business, building strong brands supported by quality and value and, thirdly, ensuring first-class marketing and distribution. 'It is brands that are critical to success in the consumer industry', he adds.

Now is a critical time for the new family business and for the wine industry, says Alwyn. 'For us it is a period for consolidating what we have, differentiating ourselves strongly and setting the base for the future.' 'Particularly in brand building and distribution', says Brian. 'If you look at the life of this winery, the first seven to 10 years was about putting a stake in the ground and pioneering virgin territory (in the Bridge Pa area of Hawke's Bay) here and succeeding in producing wines from it. The second 10 years was spent driving meaningful growth to get critical mass to ensure the viability of the business. The third 10 years will belong to brand building, marketing and getting the distribution right (domestically and internationally). The fourth 10 years will, I think, relate to increasing capital expenditure to extend the winery and build and own the portfolio of vineyards through various micro-climates in the country.'

But although they have their cautions for the future, the Corban cousins are both enthusiastic and optimistic about their new enterprise and the New Zealand wine industry. They are even talking about succession planning for the future by bringing other members of the extended Corban family on board. They are not, however, in the least interested in accepting offers from outside investors. 'We have been approached', says Brian. 'But we really are not interested.'

No question about it. 'The Corbans are back!' exclaims Brian Corban enthusiastically.

Source: Adapted from Reg Birchfield, 'The come-back Corbans – the fall and rise of New Zealand's best-known winemaking dynasty', *New Zealand Management*, November 2004, 40ff.

QUESTIONS

1. Was it a problem that the Corban and the Glazebrook families each held 50 per cent of the equity?
2. Based on this case, what is the importance of board composition for a small, growing company?
3. Why aren't the cousins accepting offers from outside investors?

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Negotiating Your Entry Into Your Family Business

Publication date: 3 October 2005
Author(s): John A. Davis
Product number: 9-806-062

Provides guidance to junior generation members of a business family concerning negotiating their entry into their family's business.

Anderson Steel Service, Inc.

Publication date: 24 July 1998
Revision date: 18 May 2005
Author(s): John Davis
Product number: 9-899-011

Explores the management of family and business issues and helps to identify a range of topics with which families in business wrestle. Describes a dilemma faced by 68-year-old Charles Anderson, the semi-retired founder of the company and the father of three sons who work with him.

The Murugappa Group: Centuries-old Business Heritage and Tradition

Publication date: 1 January 2004
Author(s): John L. Ward, Carol Adler Zsolnay
Product number: 9-KEL-121

A successful five-generation family business group in India separates its ownership role from its operational management role to meet the needs of a more global economy. This includes hiring professional non-family business unit managers as well as including non-family directors on the corporate board.

Siblings and Succession in the Family Business (HBR Case Study and Commentary)

Publication date: 1 January 1998
Author(s): Warren D. Miller, Kent Noble, Kelin Gersick, Victor Ney, Joseph A. Wolking
Product number: 98108

How do family businesses handle succession? What happens when siblings compete for the position of CEO? Can non-family board members navigate successfully through conflicts among family members? Should they even try? This fictitious case study examines a host of issues with which family businesses regularly grapple.

Selkirk Group in Asia

Publication date: 31 October 2002
Author(s): Paul W. Beamish, Lambros Karavis
Product number: 902M41

Selkirk Group is a family-owned brick manufacturer that has built an export business to Japan and other Asian markets from zero to 10 per cent of its volume in seven years. The managing director of the company raises the question of whether it is time to change its regional export strategy and organisational structure in light of the Asian economic crisis and the reasons for their competitive success in both Australia and Asia.

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20

DISADVANTAGED ENTREPRENEURS: WOMEN AND INDIGENOUS POPULATIONS

> Boys From The Bush is a social enterprise and not a social welfare approach … The critical ingredients are hard work, enterprise and money making. These young people feel proud of what they produce.
>
> Noel Pearson, Aboriginal entrepreneur[1]

CHAPTER OBJECTIVES

1

To focus on the challenges that face disadvantaged entrepreneurs and to appreciate the diversity of entrepreneurship around the world

2

To understand the particular dilemmas that face the entrepreneuse, or female entrepreneur

3

To examine the growth of women-owned businesses over the last decade

4

To discuss some of the most important factors that account for the success of women entrepreneurs

5

To explain some of the future challenges faced by women entrepreneurs

6

To highlight the cross-cultural characteristics of Indigenous entrepreneurship among the Māori of New Zealand and the Aboriginal peoples of Australia

7

To review some of the future challenges that face Indigenous entrepreneurs in the new millennium

ENTREPRENEURSHIP AND DISADVANTAGED GROUPS

What do we mean by disadvantaged entrepreneurs? There have been some interesting debates and there are a number of ways to take that word. Perhaps being disadvantaged leads one to be more entrepreneurial. For example, Scase and Goffee suggest that ‘entrepreneurs may be more likely to emerge from those groups in society which are deprived or marginal, i.e. groups which are discriminated against, persecuted, looked down upon or exceptionally exploited’.[2] Some research has even looked at entrepreneurs in the context of being ‘deviant’ or ‘marginalised’ characters. Shapero addressed the issue of the entrepreneur as being a displaced person.[3] This corresponds with what is called the **social marginality** theory put forward by Stanworth and Curran, who suggest that the perceived incongruity between an individual’s prodigious personal attributes and the position they hold in society might propel them to be entrepreneurial.[4] Hagen suggests that where the behaviour of a group is not accepted or where a group is discriminated against, then a **psychological disequilibrium** would occur.[5] This might drive a person into enterprising behaviour to compensate for this lack.

Of course, these theories do not account for all entrepreneurs, but it is an interesting hypothesis to think that disadvantaged persons would be more likely to start a new venture than other people. In this chapter we focus on entrepreneurship under conditions of **disadvantage**. In the developed world, this usually means such groups as women, youth, Indigenous people and immigrants, for example, African–Americans in New Orleans, female Indian immigrants in London, overseas Chinese living in Singapore. But it could also mean gay entrepreneurs in Sydney or San Francisco, Palestinian entrepreneurs in the Gulf, or even enterprising religious minorities such as Sikhs in Australia.

RAINBOW OF DISADVANTAGED ENTREPRENEURS

No chapter could ever effectively address all of these fascinating stories. Later in the chapter, we’ll take a deeper look at women and at Indigenous populations such as the Māori and Aboriginal Australians. But here’s a little of that rainbow of disadvantaged entrepreneurs.

- **Gay entrepreneurs in Nepal:** Lesbian entrepreneurs started a grocery in the upmarket area of Baluwatar, Nepal, to support themselves entrepreneurially and to create jobs for their community. Most of the women in the group, known as the Mitini Group, had been thrown out by their families after they disclosed their sexual preferences and refused to marry the men chosen for them. Social prejudice has led to their landlord kicking them out of their premises and to harassment by the Royal Nepalese Army.[6]
- **‘Reindeerpreneurs’ of Eastern Siberia:** Only 80 years ago, Siberian hunters and herders, known as the Kalar Evenks, lived a traditional way of life. But their sustainable, enterprising lives have constantly been disrupted. The Soviet revolution put their reindeer herding into collectives and moved the people into villages. Then came *perestroika* and the resulting socio-economic crisis of high morbidity, economic dislocation, unemployment, alcoholism and the loss of traditional cultural values. Yet over the past 20 years, the Kalar Evenks have been adapting their entrepreneurial skills to new forms of enterprise to preserve traditional values and find ways to benefit from the larger economic world. Today, Evenk entrepreneurs are finding new profitable ways to maintain their unique subsistence culture based on nomadic patterns of resource exploitation and such ‘archaic’ industries as hunting and reindeer herding.[7]
- **Tourism entrepreneurs in Kerala:** The Indian state of Kerala recognised that the lack of entrepreneurial skills among the Indigenous populations was holding back economic development. If Kerala was to conserve and sustain its natural and cultural assets, local

entrepreneurs had to ramp up their skills. The transformation of the native houseboats into a tourism product represents an illustration of Indigenous innovation and enterprise that has potential to add value to the local community and economy. Its appeal has been strengthened by relatively low barriers to entry, combined with demand for a 'new age', more socially responsible approach to holidays. Furthermore, it has revitalised traditional industries and crafts and strengthened social systems and cultural traditions.[8]

- **The Dhivehis of the Maldives:** There are no finance companies, investment banks nor trading banks in the Maldives. Nor does this country have a stock market. Yet, with little formal education, Dhivehi entrepreneurs, unskilled people using simple technology, carry out important economic functions. They do not perceive the lack of formal infrastructure or the lack of capital as a constraint. Nor are they concerned with risk. While the islands thrive on a subsistence market economy, the capital city is a town of small enterprises. Unemployment never exceeds 1 per cent and the Dhivehi people are on average the richest in the region.[9]
- **Survival rates of ethnic female entrepreneurs:** Data have shown that businesses owned by women were less likely to survive than the businesses owned by men.[10] But more sophisticated studies now show that ethnicity and gender both have an impact. Businesses in the US owned by Asian females had the highest survival rate at 52.5 per cent, followed by White females at 47.3 per cent, Hispanic females at 39.8 per cent and African–American females at 36.9 per cent.

What leads to disadvantage? Here is a list of restraints or barriers that disadvantaged people face when they consider the option of self-employment.[11]

- **Social and individual:** Lack of or inadequate food, shelter or clothing; disabilities; financial problems and related stress; difficult family environment or onerous family responsibilities; low self-esteem; literacy problems; low level of formal education and qualifications; lack of skills and qualifications needed for employment; negative experience of education; psychosocial problems; drug or alcohol abuse; disaffection for or alienation from the democratic system; disenfranchisement from democratic processes.
- **Geographic:** Rural isolation; disadvantaged urban neighbourhoods with inter-generational unemployment; lack of local access to training and education opportunities.
- **Community:** Lack of cohesive local approaches to enabling the transition to employment; lack of social capital networks with those in employment; information deficits relating to training and employment opportunities.
- **Cultural:** Language barriers experienced by immigrants and refugees; cultural differences experienced by immigrants and refugees; experience of racism on the part of ethnic minorities; experience of **discrimination** on the basis of gender, race, class, religion, age, sexual orientation, disability, family status.
- **Economic:** Few or no jobs available; lack of childcare provision to allow those with children to work; disincentives to work arising from the welfare/tax system (poverty trap).
- **Political and structural:** Lack of state provision for social services and infrastructure; government policies restricting eligibility to training programs; lack of accessible information on citizenship rights and issues; constraints on entitlement to work for asylum seekers.
- **Organisational:** Training organisations and employers using restrictive recruitment practices; training organisations having restrictive eligibility criteria, training approaches, venues and structures; training organisations lacking social supports for trainees; training programs and employers lacking engagement with the client group.

FOCUS ON THE ENTREPRENEUSE As noted in chapter 2, English actually has no genuine word for entrepreneur, so it should come as no surprise that our language also has no word for female entrepreneur. In French and increasingly in English, we use the word **entrepreneuse** to describe entrepreneurial women.

Until recently, much of what has been known about the characteristics of entrepreneurs, their motivations, backgrounds, families, occupational experience, their successes and failures, have been based on studies of male entrepreneurs. Research on the entrepreneuse is growing rapidly for two big reasons.[12] First, women approach the entrepreneurial process in a different manner from men – from making the decision to go into business in the first place, to securing finances, to dealing with suppliers. The process of involvement appears to differ significantly in comparison to the process that affects men. There is no disputing the fact that women face many of the same challenges as those faced by all start-ups, small businesses and growth-oriented businesses. The research tends to focus on the special difficulties that face women in the start-up and growth phases of their businesses. We shall return to this in a moment.

The other reason for the increasing focus on women is that they are a significant force in the entrepreneurial world. Women represent more than one-third of all people involved in entrepreneurial activity and are likely to play an even greater role when informal sectors are considered. Over the past two decades, the growth of women-owned enterprises – as measured in terms of number of businesses, revenue generation and employment – has been astounding. Countries such as Australia and New Zealand have witnessed vigour in women's entrepreneurship not seen in other countries.

Throughout the world, women make a significant contribution to the entrepreneurial advantage of nations and women-owned businesses are critical to economic prosperity. Research shows that economies with more women entrepreneurs have higher standards of living.[13] 'Empowered women, women with economic and political clout, strengthen a nation. When women win, everyone wins.'[14] Over the last two decades there has been wide recognition that women's entrepreneurship contributes substantially to growth, employment and innovation.[15]

Around the world, women's participation in entrepreneurship is only a fraction of the male rate. Table 20.1 shows the entrepreneurial 'gender gap' in the Asia–Pacific countries. Here we see the overall female and male rates as well as divided by the rates of **opportunity entrepreneurship** (exploiting a new market niche) and **necessity entrepreneurship** (being forced to start a business due to job loss or redundancy). Women are disadvantaged in every way. The world gender gap (lower right-hand cell) is only 60.5 per cent of that of men. Examine the Australia figures: Men have a much larger share of total early-stage entrepreneurial activity. The Australian **entrepreneurial gender gap** is 53.3 per cent. That means that women have only 53.3 per cent of the male entrepreneurship rate. Thailand, China and Māori in New Zealand distinguish themselves with some of the highest proportions of female entrepreneurs as a percentage of all entrepreneurs.

Fortunately, some indicators also show that the 'economic gender gap' is narrowing. More and more women are taking entrepreneurship classes at university. The share of women in the labour force in the Asia–Pacific is increasing.[16] Women are starting businesses at twice the rate of men in the USA.[17] In countries such as Brazil, Ireland and Spain women are beginning new businesses at a faster rate than men and are also expanding their share of business ownership.[18] Yet there is no doubt that there is a persistent 'entrepreneurial gender gap', defined as the systematic lower rate of women's entrepreneurship.[19] There are some explanations for this.

The day-to-day experiences of women entrepreneurs differ from those of men due to the very fact that they are women. Their life experiences are different from those of men, they often lack business experience and they are socially conditioned differently from men. Women's employment choices are more sensitive to the local social environment than those of men. In fact, recent studies have shown that the choice to start a new business is more complex for women than

TABLE 20.1: ENTREPRENEURSHIP AND GENDER IN THE ASIA–PACIFIC, 2005

	TOTAL EARLY-STAGE ENTREPRENEURIAL ACTIVITY			OPPORTUNITY ENTREPRENEURSHIP			NECESSITY ENTREPRENEURSHIP			GENDER GAP: FEMALE OF ALL ENTREPRENEURS (%)
	PERCENTAGE OF ADULT POPULATION									
	OVERALL	FEMALE	MALE	OVERALL	FEMALE	MALE	OVERALL	FEMALE	MALE	
Australia	10.9	7.6	14.2	9.3	5.2	11.8	1.3	1.1	1.5	53.3
China	13.7	11.6	15.7	7.3	5.6	8.7	6.2	5.1	6.1	73.7
Japan	2.2	1.2	3.2	1.8	0.8	2.7	0.4	0.4	0.4	37.5
Māori in New Zealand	17.7	15.2	20.4	14.8	12.3	15.7	2.6	1.6	3.3	74.6
New Zealand	17.6	13.8	21.7	16.2	11.5	20.1	1.3	1.4	0.6	63.5
Singapore	7.2	5.0	9.6	6.1	4.3	7.5	1.2	0.6	1.7	52.7
Thailand	20.7	19.3	22.2	13.9	12.4	14.0	5.0	3.6	5.3	87.1
United States	12.4	9.7	15.2	10.5	8.3	12.5	1.5	0.9	1.9	63.3
Asia–Pacific	12.8	10.4	15.3	10.0	7.5	11.6	2.4	1.8	2.6	63.2
World	8.7	6.6	10.8	6.4	4.3	7.6	1.9	1.5	2.1	60.5

men and that women tend to be more sensitive than men to a variety of non-monetary incentives. For example, 'being one's own boss', a typical male driver to self-employment, has less influence on women. This is plausible because she usually has greater non-workforce commitments (such as family, the need to work from home and the consequent preclusion from hiring employees) and finds herself more often in less profitable activities.[20] For women more than for men, the choice to start a new business is often linked to necessity or to time and location flexibility; that is, to the type of independence that can accommodate family needs and child rearing. Despite all these disadvantages, just the same as men, most women are opportunity entrepreneurs, but they do have higher rates of necessity entrepreneurship.[21]

Australia

Since its election to office in 1996, the Australian government has suggested that policies designed to promote growth in the small business sector where most entrepreneurs operate should provide women with particular benefits and opportunities. The prime minister called small business 'the engine room of the Australian economy', a vital source of enterprise, innovation and jobs. He also said that increasingly small business is a source of economic opportunity for women.

Despite these exhortations, female early-stage business participation has dropped markedly in Australia from 11 per cent in 2003 to 7.6 per cent in 2005. This means that now for every 10 men participating in early-stage business activities there are a little less than five women. And the trend is shifting from the firm to home-based businesses (HBBs). More than 250 000 Australian women are now running their business from home, an increase of more than 20 per cent in the past five years. Women consider autonomy, flexible working hours and fitting into family demands as the main advantages.[22] Their contribution to the economy of home-based businesses is estimated to be worth tens of billions of dollars. The most common home businesses are day care, property and clerical services. These have downstream benefits as well. The rise of home-based businesses benefits other sectors of the market, such as stationery and office equipment suppliers.[23]

New Zealand

New Zealand women participate in most aspects of New Zealand life. Many of the top jobs within this small South Pacific nation's constitutional framework are now held by women. Women currently serve as role models in powerful positions (for example, as prime minister, chief justice, governor-general, opposition leader and speaker of the House of Representatives). Women's participation in the full-time paid workforce has increased to about half, a rise of approximately 10 per cent since 1991.[24] Over the past few decades, many women have experienced personal, professional and financial rewards from increased workforce participation helped by more flexible working arrangements, including permanent part-time work and paid maternity leave. In New Zealand the number of women employers and self-employed has doubled over the last 30 years.[25]

The trend to home-based businesses is also apparent in New Zealand. Two-thirds of New Zealand entrepreneurs are home-based, with females (47 per cent) slightly behind males at 53 per cent. For two-thirds of these women, their home-based business is their personal primary source of income and 82 per cent indicated that their level of satisfaction in performance was about what they expected or better.[26] In common with most other Western nations, women in New Zealand still earn only around three-quarters of the income of their male counterparts, thus limiting their entrepreneurial take-off abilities. Fewer women than men are self-employed. Women continue to have their unpaid work and voluntary work in the community and home undervalued. Also in common with other nations, women face difficulties accessing resources and services and experience significant risks to their independence, security, safety and health.

New Zealand women are not as well represented among the ranks of the entrepreneurs. Although they beat the world average, they have only 63.5 per cent of the male entrepreneurship rate. Nonetheless, more than other countries, New Zealand women entrepreneurs believe they have the necessary skills and motivation to start a new business and that there is general social acceptance of women starting new businesses. But they do not have the appropriate social service support when they continue to work after they start a family.[27]

SUCCESS FACTORS FOR THE ENTREPRENEUSE

It is clear that women face many obstacles and challenges – ones different from men – when it comes to choosing self-employment. Despite these disadvantages, several factors have been cited that may explain the growing successes of women as entrepreneurs. Helen Fisher, an anthropologist at Rutgers University, has found that five qualities may make women even more ready to be successful entrepreneurs.[28] These are:

- **Communication skills:** Many women tend to be better than their male counterparts at articulating their ideas and expressing themselves verbally.
- **People skills:** Many women tend to be very effective at reading emotions in the faces of others and in deciphering postures, gestures and voice inflections. As a result, they are able to interact well with others.
- **Web thinking skills:** This is the ability to gather data from the environment and construct intricate relationships between the pieces of information. Women cast the problem in a broad contextual perspective. Many men tend to compartmentalise information and use linear thinking in problem solving. Some women can view the complexity of the world around them and weigh up more of the factors that are critical to decision making. They also tend to make better use of intuition and imaginative thinking, have an ability to

employ multitask analysis, have a capability for long-term planning and possess a higher-than-average tolerance for ambiguity.[29]

- **Consensus building skills:** These are possessed by successful women business owners. Successful entrepreneurial women tend to be good negotiators. They view situations in 'win–win' terms and seek to create harmonious relationships with the parties involved.
- **Good relationship building skills:** Many successful women entrepreneurs have the ability to build and nurture good relations. Maintaining long-term client relationships in business often requires the development of friendships and the use of effective networking. Successful women entrepreneurs tend to be very good at these things.

These abilities perhaps explain why many entrepreneurial businesses in the Asia–Pacific are owned and/or managed by women (see table 20.2).

TABLE 20.2: ERNST & YOUNG'S SUCCESSFUL WOMEN ENTREPRENEURS IN THE ASIA–PACIFIC

ENTREPRENEUR/COMPANY/AWARD	ENTREPRENEURIAL ACTIVITY
Puan Hazimah binti Zainuddin, Hyrax Oil Sdn Bhd Malaysia Woman Entrepreneur of the Year 2002	Puan Hazimah binti Zainuddin started her career in an administrative role and quickly progressed into a marketing role and by the time she left employment, she held a key position in a publicly-listed company involved in the marketing of building materials. She then formed the first bumiputra company to act as an agent for a public listed company in the distribution of spare parts, lubricating oils etc. In 1991 she started Hyrax Oil Sdn Bhd focusing on design and development of top quality and high performance automotive, industrial and specialty lubricants and other petroleum derivatives.
Y. Bhg Datin Dr Liana Low, BELL Group/Syarikat Perusahaan Kelapa Sawit Sdn Bhd Malaysia Woman Entrepreneur of the Year 2004	During the recession in the late 1980s, Datin Dr Liana Low, an engineer and industrial psychologist by profession, turned around a failed palm oil mill into a profitable outfit within two years. Tenacity, innovative production techniques and seven mills forward saw the BELL Group, which she co-founded, expand into one of Malaysia's largest private owned millers. Her focus on research and development and her collaboration with world-renowned medical doctors and cosmetologists led to the diversification into the processing of oleochemical-based personal care products. A strong advocate of the green movement, she pioneered a range of the world's first totally green and natural palm-based personal care products under the brand name Liasari.
Ms Theresa Fong Nyok Yoon, Caely Holdings Bhd Malaysia Woman Entrepreneur of the Year 2003	There was little that Theresa Fong didn't do at her first place of employment – an undergarments factory. There she was involved in sewing, recruiting, training, costing and marketing. She left school in 1979 and landed her first job with a bra manufacturer that sold its products in the night market. 'I had to train the staff how to wear the bras. I had to teach them to sell the bras.' She then ventured out on her own. With savings of RM10 000 (US$1200) she bought undergarments from her previous employer and with his permission, packaged and sold them under the Caelygirl brand. By the ninth month she decided it was time to make her own undergarments. Annually, the company produces about 10.8 million pieces of inner-garments – comprising bras, briefs/panties, camisoles, boxers, baby dolls, bikinis, merry widows, nighties, girdles, bodysuits and bustiers.

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Sonia Amoroso, Cat Media Australia Young entrepreneur of the Year 2003	At 22, while still in university, Sonia Amoroso began operating a business out of a dilapidated house in Surry Hills that produced some of the most successful direct marketing campaigns in Australian history. Just a few years later she founded Cat Media. From practically zero capital, Cat Media came to be Australia's fastest growing health and beauty company, with a turnover of $32 million. Cat Media owns over 30 brand names.
Sue Ismiel, Sue Ismiel and Daughters Enterprise Pty Ltd Australia National Winner in Retail, Consumer and Industrial Products 2002	Once a medical records keeper in western Sydney, Sue Ismiel owns one of Australia's fastest growing private companies with a multimillion dollar export business. A Syrian migrant, she created her natural hair removal gel in response to her daughter's need for a product that would not irritate her sensitive skin. She spent a year perfecting her 'green goo' in her kitchen. Her creation uses lemon juice, sugar and water among other ingredients and does not need heating or chemicals to work. Friends encouraged Sue to sell her product, Nad's Natural Hair Removing Gel, commercially and it is now a household name in Australia and the United States.
Caron Taurima, Carich Computers New Zealand Entrepreneur of the Year 2003	Caron Taurima built the multimillion dollar computer training company Carich Training Centre on the back of job rejection letters. This young mother of four set up Carich as a way to help the unemployed. Within weeks of her award, Carich went into receivership, the company with a turnover of $33 million a year brought to its knees by its inability to pay its 233 staff the $430 000 it owed them, arguments with the government over funding and debts of more than $5 million.
Olivia Lum, Singapore, Hyflux Ltd Entrepreneur of the Year 2003 in Manufacturing and Industrial Products	Olivia Lum, founder of Hyflux Ltd, a Singapore-owned company specialising in membrane technology for water and fluid treatment systems, edged out her competitors to seal the title of the Manufacturing and Industrial Products Entrepreneur of the Year. Under her leadership as group CEO and president, Hyflux now commands a market capitalisation of S$450 million. The company was also named as one of the 'Forbes Global Magazine's World's 200 Best Small Companies' in 2002.
Diana Young, Mil-Com Aerospace Pte Ltd Singapore Finalist – Entrepreneur of the Year in Business Services and Technology 2002	Diana Young founded Mil-Com Aerospace Pte Ltd in 1994 offering engineering, maintenance services and technical training for the aviation industry. Since then, she has grown Mil-Com into a quality group of companies and has contributed significantly to the development of the aerospace industry. Before starting her own business, Dr Young was the Director and Group General Manager of a multinational group of 16 companies. Her portfolio of responsibilities included managing the group's two aviation companies in east and west Malaysia and the helicopter operations in the Genting Highlands. She has expanded the business internationally with offices in Malaysia, Hong Kong, China and Australia.

Source: Compiled from Ernst & Young; *Sydney Business Review*; Jean Hailes Foundation

Becoming an entrepreneuse: Differences from men

The reasons why women become entrepreneurs are quite diverse and in some respects they differ from men. Orhan and Scott identified situations that might contribute to a woman's desire to become self-employed.[30]

- **Dynastic compliance:** This is the succession dilemma caused by the accidental death of a husband. His wife accepts the job during a transition period and her decision is taken with the agreement of her grown up children.

- **No other choice:** While the male necessity entrepreneur typically starts a new venture due to job loss or redundancy, women may be forced to launch a business because they have taken some time off for their family, have followed their spouse to a different location or are trapped in low qualified, often part-time, casual positions (for example, employees in retail outlets or clerical work).
- **Entrepreneur by chance:** Sometimes there are push factors such as an accident or a financial difficulty faced by her parents. These women did not really show a genuine interest in leading the family business; they accept the role of entrepreneur rather than seeking it.
- **Natural succession:** Sometimes the business itself was created by the husband's technical expertise but his wife found it logical to assist with the start-up in a commercial and administrative position. From this platform it becomes obvious that she has the natural business talent while he remains in a technical or engineering capacity.
- **Pure entrepreneuse:** Running her own business may be a natural development of her previous experience. Here we find women with a high level of education, with degrees in law or business and diverse 'on-the-job' training. Entrepreneurship is a professional as well as a lifestyle choice.

Challenges for women entrepreneurs

In a similar way to their male counterparts, women who contemplate becoming entrepreneurs face daunting challenges, but research has shown that some of these are different from men.[31]

- **More cautious attitude toward risk:** Women generally are more risk averse than men. Women are likelier to choose a business path that has a higher expectation of success, even if the return is not as great.[32]
- **Work/home role conflict:** In addition to their careers, entrepreneurial women frequently bear the major responsibility for domestic work and, where applicable, child care. This gives rise to work/home conflict, which becomes an obstacle in managing their business. For example, Singaporean female entrepreneurs can face conflict with their spouses, with their parents and with their roles as homemakers.[33] Overall, research suggests that women business owners need to be prepared to cope with work/home role conflicts, particularly in the early years of the firm's life.
- **Burden of child care:** Working mothers often must confront a lack of adequate and affordable child care for older children.[34]
- **Discrimination in financing:** Female entrepreneurs may be as successful as men in obtaining bank credit, why do so few of them get venture capital? Thomas found women-owned business start-ups have received less than 2 per cent of available venture capital funds.[35] This is especially true in lucrative new ventures in high-tech fields.[36] Men and women also tend to differ in funds they use at start-up. While men often list investors, bank loans, or personal loans, in addition to personal funds, as sources of start-up capital women usually rely solely on personal assets, such as savings and credit cards.[37]
- **Less access to power networks:** Many women entrepreneurs – whether they manage large, small or micro businesses – don't participate in the mostly male-dominated power business circles. Women entrepreneurs tend to be isolated in marginal economic areas such as micro and informal enterprises.
- **Lack of training:** Trade organisations, chambers of commerce, export programs, associations don't reach out specifically to women, expecting women's organisations to bridge the gap. Existing assistance may not match their needs. For example, many women entrepreneurs work in the services sector, while export assistance tends to focus on trade in goods.

- **Cultural prejudice:** Cultural traditions can also hold women back from playing a more prominent role in economic life. This can take the form of informal dissuasion from working outside the home or the laws in some countries, which forbid women from inheriting property and thus preclude them from any but the smallest business activities.

MYTHS OF WOMEN'S ENTREPRENEURSHIP

Perhaps due to the lack of research studies, there are many 'myths' relating to women entrepreneurs. The Diana Project examined eight myths or stereotypes (see table 20.3) that have the potential to inhibit a woman's chance of gaining access to equity capital, thereby creating a negative context for entrepreneurial growth.[38]

The report goes on to debunk these myths and draws the conclusion that while women are contributing to new business development in every sector, their ability to acquire equity capital remains limited, in part, due to the persistence of myths.

However, a later study of Canadian entrepreneuses found that two of these myths were actually true. At least in Canada, women wishing to launch a start-up may actually not have the right educational background to start large businesses (for example, they majored less in engineering and computer science). Also, women may be starting businesses unattractive to venture capitalists. It was found that men were significantly more likely than women to be starting a venture that was high-tech.[39]

INDIGENOUS ENTREPRENEURS

The term '**Indigenous peoples**' has no universal definition. But most definitions encompass cultural groups that have a historical continuity with a region before its colonisation and who have lived largely independent or isolated from the influence of the larger nation–state. These are people who have maintained at least in part their distinct linguistic, cultural and social/organisational characteristics. Characteristics common across many Indigenous groups include reliance upon subsistence-based production and a predominantly non-urbanised society.

Indigenous societies are found in every inhabited climate zone and continent.[40] Everywhere they suffer from chronic poverty, lower education levels and poor health. The 'first wave' of direct economic assistance produced only mixed results since these programs often only tried to heal the symptoms and disregarded the cause of Indigenous social and economic dysfunction. What some now refer to as the 'second wave' of assistance is an activist process where the efforts of Indigenous people themselves are concentrated to improve their social and economic position through entrepreneurial enterprise – through creating **Indigenous entrepreneurs**.[41]

TABLE 20.3: EIGHT MYTHS ABOUT WOMEN ENTREPRENEURS

MYTH 1	Women don't want to own high growth businesses
MYTH 2	Women don't have the right educational backgrounds to build large ventures
MYTH 3	Women don't have the right types of experience to build large ventures
MYTH 4	Women aren't in the network and lack the social contacts to build a credible venture
MYTH 5	Women don't have the financial savvy or resources to start high growth businesses
MYTH 6	Women don't submit business plans to equity providers
MYTH 7	Women-owned ventures are in industries unattractive to venture capitalists
MYTH 8	Women are not a force in the venture capital industry

PROFILES OF WOMEN'S ENTREPRENEURIAL DARING-DO

CLAIR JENNIFER – WOMBAT

Clair Jennifer founded Wombat in 1988 at only 19 years of age. Says Clair, 'I knew exactly what I wanted to do, as Wombat had been a childhood dream since the age of seven. I was raised to believe that when a person left school they set their goals, then went out and achieved them. So I did'.

Absolute determination to overturn every stone, desire to learn and experience as much as possible and succeed – these seem to be Clair Jennifer's defining and driving characteristics.

Clair studied fashion at TAFE, then went on to gain as much experience as she could about all facets of the fashion retail, manufacturing and textile industries. Clair recalls, 'At the age of 17, I operated market stalls, seven days a week. Rising at 4 am, I would travel all over Sydney and outskirts in my clapped out van. For some markets, I would set up the stall in the evening, sleep under tables in near zero temperatures and then wake up and sell the next day'.

This start allowed Clair to save enough to realise her dream.

Armed with only $2000, second hand shop fittings and sheer determination, Clair opened her first store in 1988. Within a month, the clothing was selling faster than Clair could replenish supply. Within a year, Clair opened an additional 3 stores. Over a decade later, the Wombat fashion empire boasts nearly 50 stores throughout the east coast of Australia, employs over 250 staff and has an annual turnover of $36 million.

The Wombat look and feel is tangible and recognisable. It is applied across all Wombat stores and it is part of the Wombat shopping experience and part of the overall Wombat brand. Clair's IP [intellectual property] portfolio incorporates her Wombat brand, her Harry Potter label, her designs (although not officially registered with IP Australia) and her innovative business systems. 'My strategic approach to IP includes management of my design process. All of Wombat's clothing range is designed and developed in-house and the range is then contracted to various manufacturers, under tight secrecy agreements. By managing Wombat's IP in this way, Wombat maintains control over design, but [dispenses] with the expense of maintaining a manufacturing house.'

After creating the 52-store chain and a popular woman's clothing brand over 16 years, she sold the business in 2004 to Pretty Girl, a fast-growing women's retailer part-owned by the Packer family.

SONIA AMOROSO – CAT MEDIA

In the six short years since Sonia Amoroso started CAT Media with her business partner, Peter Nicholas, she has built it into a $35 million company and has ambition to make it into an internationally recognised Australian cosmetics brand – the first since the Aussie 3 Minute Miracle hair conditioner took American bathrooms by storm.

Sonia met Peter while studying communications at Sydney's University of Technology. The two of them shared an interest in marketing techniques, especially the burgeoning area of infomercials. These are the program-like advertising spots that run for a couple of minutes rather than 30 seconds, which are the mainstay of much daytime television. They also couldn't wait to go into business.

Together they began to investigate US products claiming to be anti-ageing 'cosmeceuticals'. Initially they were very sceptical about what they really had to offer. What started out as a book investigating the industry and verifying some of the formulae soon became the beginning of their own company.

In order to confirm their research, they called on family members to test the new products. 'We gave them out not really expecting them to work', Sonia remembers. But they did and what's more, the people who tested the products wanted to know where they could buy more. 'That's when we realised we were on to something', she recalls. 'In Australia, there really wasn't anything out there that could make these sorts of claims or achieve similar results.'

Sonia and Peter knew no matter how much you sold, the cost of importing the products was prohibitive and profits would reach a ceiling. What had seemed to be a great idea had stalled. Or so it seemed.

It was on a fact-finding mission to the US that the pair discovered a use for vitamin K, in particular its blood-clotting properties. They found that it helped reduce unsightly spider veins and blood capillaries on legs. Using their prior experience, they made up a formula.

'There was nothing similar out there', Sonia says. 'It was unique and the idea was in our heads constantly, but we were struggling with this imported product and were trying to weigh up what the next step should be.'

They made up their minds in August 1998. They had to act. They went for it and booked an ad for a new product, VeinAway. It simply read 'Say goodbye to ugly veins with VeinAway', but it struck a chord with the public. Overnight the phones started ringing and the product, which was sold direct, practically flew out of the warehouse.

Soon people were asking for the product in pharmacies and retailers were knocking on Sonia's door to get her product on their shelves. She had created a brand within a matter of weeks.

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Over the next two years, the profits were ploughed back into the business and new products were launched as Sonia's instincts proved right time and time again. 'I have always been the sort of person who plans for the future. I have never smoked. I rarely drink and I won't do anything that would age me prematurely. I don't want to look old', reflects Sonia.

HairNoMore became the best-selling hair-removal product for the next three years. Relaxaderm, which mimics the effects of Botox, also proved to be a hit.

But it was some canny marketing and a great name that propelled Sonia into the big league in 2000. 'We go for obvious names', she explains. 'With a limited marketing budget, we have to use whatever we can to make sure people know what the product did.'

FatBlaster became the number one weight-loss product, revitalising a moribund market. In 2002, the product won a prestigious award that beat established brands such as Panadol, Nicorette and Nurofen in terms of growth.

'The industry considered us to be a one-hit wonder. After our second product they said we were lucky', says Sonia. 'But after FatBlaster they've finally realised we're here to stay.'

LINDA JENKINSON — DISPATCH MANAGEMENT SERVICES AND LESCONCIERGES

'I love building companies. I love making a difference.' New Zealander Linda Jenkinson's goal is to build a billion dollar company. Described as formidable, fearless and lots of fun, the Kiwi girl with a 'can-do' attitude from a farm near Palmerston North has come a long way.

When Linda was 36 years old she publicly listed her own company on the New York Stock Exchange. The previous year she was made a partner of US business consultancy AT Kearney – a 220 partner practice – and resigned on the same day to lead her business … an act which coined the phrase of 'doing a Linda' among incredulous colleagues. Today, at the age of 40, she is President and CEO of LesConcierges, a company that provides a select stable of 'top end clients' with assistance-based loyalty solutions.

In between these milestones, Linda completed a Bachelor of Business Studies at Massey University and an MBA from prestigious US business school Wharton in Pennsylvania – a global credential – and worked as a business consultant for Price Waterhouse in Wellington and in New York where she advised 'some pretty big global companies' on business strategy, reorganisation, reengineering and mergers and integration. Making and taking opportunities is her operating philosophy. 'It's amazing what you get when you ask for it.'

Crossing the bridge from adviser to leading her own company brought home business realities like running a P&L, managing cash flow and a payroll. 'I've got an extensive toolkit for being a strong CEO.' On the other hand, it was immensely valuable being able to bring her professional training into the entrepreneurial arena. Her 'school of hard knocks' was Dispatch Management Services (DMS), a same day courier company she created with business partner Greg Kidd. From a two person office in San Francisco they built it into an international delivery firm with more than 6500 employees in 65 cities throughout the US, UK, Australia and New Zealand with revenue of US$240 million at its peak. DMS was listed on the NASDAQ in 1998.

'We realised New Zealand's courier dispatch management system led the world and wanted to take it global. We achieved our goal of becoming the world's largest on-demand delivery business by acquiring the number one, two and three courier players in the world's biggest on demand courier markets. We went from US$30 million revenue to $150 million in 12 months.

'I was like a CEO on steroids. I had no idea how to build a culture. It was a huge learning experience.'

While some people may see Linda's career path as a dream run … she says she's had her share of failure, which she believes is a key ingredient to achievement. 'If you're not failing enough you're not learning enough. Failure is an opportunity to change and reinvent yourself. In Silicon Valley, you're not considered to be a successful entrepreneur unless you've had three failed business ventures. Entrepreneurs thrive on the highs and lows of risk-taking – you've got to dive sometimes.'

Sources: InnovatED (Innovation in Education) funded by IP Australia, federal agency responsible for patents, trade marks and designs; Virgin Blue airlines, 'My big break', *Voyeur* (July 2004); New Zealand Trade & Enterprise, 'Giving it a go! Linda Jenkinson' [www.nzte.govt.nz/section/14165/11452.aspx].

In all nations with significant Indigenous minorities, the economic and social deprivation of Indigenous peoples has long been of deep policy concern. Colonisation and post-colonial practices deprived Indigenous people of their land, their culture and their human rights. The loss of self-determination denied Indigenous peoples the right over their own responsibility to manage their own affairs. Around the globe this has proved to have been socially and economically destructive. Stimulating a new sense of self-determination through Indigenous entrepreneurship has been a positive step for some groups, but it is not the answer for all Indigenous people.

Around the world there is a growing social awareness that policies directed to re-igniting and/or developing new Indigenous entrepreneurial activity has the potential to dramatically improve the economic and social positioning of its participants. Best-practice lessons show that the poor (both Indigenous and non-Indigenous) can achieve improved standards of living through enterprise, so much so that UN Secretary-General Kofi Annan, in a break from the United Nations' previous disregard of the private sector, initiated a Commission on the Private Sector & Development.[42] 'Entrepreneurs', he said, 'have the power to create the greatest change for their own countries.'[43] This has created more transparency and is a positive process in finding increased opportunities, enhancing economic and social improvement.

While there is substantial literature, particularly in North America, about 'minority entrepreneurship' (for example, African–Americans and Hispanics), the field of Indigenous entrepreneurship is very underdeveloped. Perhaps most researched are the Indigenous people of North America, particularly Native American Indians and Canadian Inuit, but there are many interesting studies of Indigenous entrepreneurs around the world.[44] Indigenous people around the globe are embracing entrepreneurship in the post-colonial, post-settler society. In this chapter we focus on the original inhabitants of Australia and New Zealand and look at their entrepreneurial endeavours.

Indigenous entrepreneurs in Australia

The Indigenous inhabitants of Australia consist of two distinct groups. The first comprises what is commonly referred to as the mainland Aboriginal people. The second is the Torres Strait Island people, who are from an archipelago of some 274 islands, only 17 inhabited, scattered across 48 000 square kilometres of ocean between the northern tip of Cape York Peninsula and the southern tip of Papua New Guinea, a distance of only 150 kilometres. The Torres Strait Island people have a Melanesian heritage. The 2001 Census identified only 6.4 per cent of the Australian Indigenous population as being of Torres Strait Islander origin.[45] In general, the Torres Strait Islander culture remains strong and their entrepreneurial pursuits within contemporary Australian society are worth discussing; however there has been little empirical research undertaken on Torres Strait Islander entrepreneurs, both within their homeland and/or on mainland Australia.

The second group are the mainland Aboriginal Australians, who comprise 89.4 per cent of the estimated 410 000 Indigenous population as shown in the 2001 Census. The ethnic composition of mainland Aboriginal Australians is complex; Australian Aboriginal people are not all the same. While there are similarities, there are many cultural differences which, when combined with over 400 different language groups, produces a huge diversity of cultural groups.

Archaeological evidence suggests that Aboriginal people have lived in Australia for at least 50 000 years and, prior to invasion and colonial contact, they engaged in wide-ranging trade and entrepreneurial pursuits.[46] An example is the Gunditjmara people of what is now called Lake Condah in south-western Victoria, who conducted an enterprise that involved an 8000-year-old aquaculture industry.[47] Their main product was smoked eel. This was not a subsistence or 'hunter and gatherer' existence, as the Gunditjmara lived in stone homes in permanent to semi-permanent settlements. They constructed extensive dams and water channels to enable them to manage water flows from the local river and rainfall, optimising eel and fish production in a series of man-made lakes. On harvesting, they added value to their product by smoking it, extending its durability (or shelf life), enabling the product to be traded/sold over a vast area.

Aboriginal people live in all states and mainland territories of Australia, with the highest population concentrations in the states of Queensland and New South Wales. One of the most widespread misunderstandings (fuelled by stereotyping and the tourism industry) is that they predominantly reside in the 'outback'. This is incorrect as the majority of Indigenous Australians (72.6 per cent) reside in metropolitan areas.[48] The bottom line is that Indigenous Australians are in the main an urban people who suffer high welfare-dependency, few marketable skills, less work experience and a much lower, almost non-existent, economic base.[49] In 1991, the Royal Commission into Aboriginal Deaths in Custody concluded that Aboriginal and Torres Strait Island peoples are 'the most socially, economically and culturally disadvantaged group in Australian society'.[50]

Indigenous people are caught in a spiral of discrimination that is scarcely conducive to authentic entrepreneurial activity. They experience discrimination and prejudice in the workplace. They have high levels of unemployment (between 38 and 54 per cent depending on the interpretation of government statistics).[51] They lack marketable skills and have an almost non-existent capital base. They suffer cultural deprivation and social hopelessness, fuelled by an indifferent welfare system. Building an enterprising spirit is a large ask.

There has been wide discussion but little carefully focused research on Indigenous entrepreneurship in Australia.[52] A seminal study is Foley's *Successful Indigenous Australian Entrepreneurs*. His preliminary studies provide a definition of Indigenous Australian entrepreneurs who are successful in business. It is:

> The Indigenous Australian entrepreneur alters traditional patterns of behaviour, by utilising their resources in the pursuit of self-determination and economic sustainability via their entry into self-employment, forcing social change in the pursuit of opportunity beyond the cultural norms of their initial economic resources.[53]

Foley indicates that the Indigenous Australian entrepreneur is motivated more by a need to correct negative social perceptions and racial discrimination than by a need for wealth creation. However, this work identified that the major motivator for being entrepreneurial was to provide for the entrepreneur's children and to give them a better life than that experienced by the entrepreneur. This is a justification of the pursuit towards self-determination or self-fulfilment as the interviewees in this and a subsequent work by Foley indicated.[54]

Indigenous Australians have suffered post-colonial policies of segregation, assimilation and the forced removal of children in a systematic government-controlled program to uproot the mainland Aboriginal people. The driving factor of their business activities is to ensure that their children do not suffer the same indignities to their human-rights that they experienced. These discriminatory government programs were curtailed as recently as the early to mid-1970s. The same research also indicates that the Indigenous entrepreneur may risk losing links to the Indigenous community and culture because the requirement for success in business may clash with Indigenous cultural norms and this is an area that requires further understanding.[55]

Hindle and Lansdowne distilled the collective wisdom of Indigenous Australian and American Indian entrepreneurs and entrepreneurial experts. Their definition of Indigenous entrepreneurship is: 'Indigenous entrepreneurship is the creation, management and development of new ventures by Indigenous people for the benefit of Indigenous people. The organisations thus created can pertain to either the private, public or non-profit sectors.'[56]

Both definitions add to the understanding of this growing field. The true state of Indigenous entrepreneurship in Australia however is unknown, possibly it is in decline. Based on the 1996 Population Census Data the estimated proportion of Indigenous self-employed in the labour force was 2.4 per cent. This was one-third of the non-indigenous rate of 7.3 per cent.[57] The number of Indigenous Australians actively engaged in small business indicates a declining trend since 1994.[58] The 2001 Population Census Data estimated the proportion of Indigenous self-employed in the labour force to have increased to 4.8 per cent in comparison to 2.4 per cent in 1996. The unexpected variance in these results would appear to be unnecessarily complicated census methodology by the Australian Bureau of Statistics (ABS) in 1996.[59] The important statistic to understand is that in 2001 the statistical comparison of self-employment rates between Indigenous and non-indigenous Australia decreased from 0.31 to 0.30 which supports the declining trend since 1994.[60] The sobering outcome of this literature is that 'Indigenous Australians remained three times less likely to be self-employed than other Australians'.[61]

At the 2001 Census, there were 6089 Indigenous Australians aged 15 years and over who identified as self-employed. Of these, 2058 identified as employing other people, with 1845 in urban areas.[62] The lack of descriptive data on Indigenous businesspeople is frustrating when the premier survey, the National Aboriginal and Torres Strait Islander Social Survey of 2002 (NATSISS) has no qualitative or quantitative data regarding Indigenous self-employment. This raises the important question: How is government policy informed if the basic building blocks of empirical data are not available? The problem of responsible reportage is further illustrated by the government funded *Indigenous Business Review* (IBR), the report on support for Indigenous businesses. Their findings confirmed that there is no one central agency responsible for the collection and collation of data on Indigenous economic development.[63] The resultant bureaucratic misjudgements have played a part in the failure of some Indigenous community-based businesses. This is of concern because these failures inevitably reinforce negative stereotypes of Indigenous Australian entrepreneurs – including the popular belief that Aboriginal people cannot manage their own financial affairs.

A well recorded example that highlights poor management by bureaucrats of a community-based organisation is the Warai pastoral enterprise on the Finniss River in the Northern Territory. The Warai pastoral enterprise received considerable funding from several government departments and agencies without adequate consultation and coordination between the government and community stakeholders. No research or planning was undertaken to ensure the existence of the necessary financial management tools to run a business.[64] An extensive range of infrastructure was constructed for the community venture with little being done to ensure its ongoing success through the provision of adequate financial management skills, working capital or marketing plans that set out target profit margins. This Aboriginal enterprise floundered and did not achieve its potential due to poor planning and lack of synchronisation of basic commercial business practice. The entrepreneurial capabilities of Indigenous individuals may have been evident; however it was the cooperative nature of the business structure and the inability of the government bureaucracy to interact with the participants that resulted in failure.

This brings us to another growing myth in Indigenous entrepreneurial practice. This is the espoused success stories of Aboriginal enterprise within the cooperative movement. One example used by the current government is the Cape York Partnerships (CYP), a network of interlinked locally controlled Aboriginal enterprises. The overall approach of CYP is founded on the premise that the Cape York community needs to take an entrepreneurial approach to meeting its social needs.[65] Among other activities, CYP has provided the impetus for the establishment of Indigenous Enterprise Partnerships (IEP), a non-profit organisation that channels philanthropic and corporate resources into Indigenous development.[66] As a social reform mechanism, CYP has potential, but many argue that considering the cooperative movement as an answer to economic reform is questionable, as the shortcomings of community-centred commercial and economic development have been highlighted by the IBR. Community-based businesses often lack appropriate governance mechanisms, so that cultural demands determine the use of funds rather than prudent financial management.[67]

Cultural demands within a community organisation can change the internal functioning of its business as it 'changes the incentive structure within a business and allows diffusion of responsibility over a business venture'.[68] Within a community business the lack of responsibility and direction is often at odds with the essential ingredients of any successful business, that is, profit orientation and sound commercial management skills (including asset accumulation and maintenance). When social demands override profit requirements and responsibility is not defined, business failure is inevitable as liabilities exceed assets. It is on this basis that the defunct Aboriginal and Torres Strait Islander Commercial Development Corporation (CDC) was criticised for forming partnerships with Indigenous communities rather than individuals.[69]

In 1985, the Miller Report[70] identified important deficiencies in the administration of enterprise programs, yet almost two decades later the IBR confirms that deficiencies in the management and administration of Indigenous business loan programs are still a matter of concern. The now defunct Aboriginal and Torres Strait Islander Commission's (ATSIC's) implementation of business loan programs within the framework of overall economic development for communities was not successful, resulting in ad hoc and often unsuccessful business creation.[71]

It should be remembered that ATSIC was the dominating Indigenous business financier for over a decade and that the organisation had continual difficulty in achieving its goals. In 1991 the Royal Commission into Aboriginal Deaths in Custody criticised ATSIC's stringent commercial eligibility requirements – this resulted in the establishment of the Indigenous Business Incentive Program.[72] In contrast to the Royal Commission findings, the IBR report noted unsatisfactory due diligence by ATSIC staff in the monitoring of these loans.[73]

Thus, a frustrating picture emerges regarding Indigenous economic development through entrepreneurial activity. The cooperative or community-based business has not been a success nor has it been well managed. What has worked is the creation of Indigenous Business Australia, an autonomous government body established initially as a joint venture partner in the upper end of the Indigenous entrepreneurial industry. It had a sound record of Indigenous business development. With the demise of ATSIC and changes in government policy, it has grown to enormous bureaucratic size within a short period of time, which will place strain on its ability to maintain core values and success. Where once it was a specialist and prudent investor/adviser it has now become a process centre, the one-stop-shop Indigenous business provider.

The creation of the Indigenous Stock Exchange (ISX), which is basically a trading floor where ideas meet capital, has also been an innovative step in Indigenous economic development.[74] The primary goal is to support the development of 1000 new strong and sustainable Indigenous businesses across the country by 2008. The world's first mobile trading floor, it convenes within Indigenous communities to enable entrepreneurs to put forward ideas for businesses and investment. The concept was launched by Aboriginal entrepreneur Kevin Fong and the ISX has generated more than $200 000 for Aboriginal businesses. From over 600 nominations from 80 countries, the ISX was awarded a prestigious tech award for economic development at the Silicon Valley Tech Museum.

Decades of government programs, public sector goodwill, NGO assistance coupled with the ISX has produced the critical mass necessary to start some Indigenous people in the direction of economic independence. These synergies have generated enterprises such as:

- Malabama Tours, the first indigenous owned and operated tourist enterprise to provide a link with other Indigenous tours and walks in the region from Cairns to Cooktown
- Northern Indigenous Pastoral Alliance (NIPA), which brings together Cape York and Kimberley pastoralists and is working on a franchise model to improve management practices
- Yaba Yabaju, which operates from Cooya Beach near Mossman and specialises in coastal habitat walks, interpretive talks, night spearing and fishing.

There are numerous significant commercial accomplishments that point the way to a self-sufficient future for Australia's Indigenous people as confirmed in recent qualitative case study research.[75] The future for Indigenous Australian entrepreneurial development, however, is still not certain due to the increasing poor health and education statistics, especially while:

> Indigenous Australians suffer a disproportionate burden of illness and social disadvantage compared to the general population, dying up to 20 years earlier than their non-Indigenous brothers and sisters. This is a gap which has not lessened in the last 10 years … This is worse than in Nigeria, Nepal and Bangladesh.[76]

Among Indigenous Australians there is hope as they look towards international developments in Indigenous entrepreneurship in New Zealand, Canada and some parts of the USA.

Māori entrepreneurs

By contrast, the Indigenous people of New Zealand, the Māori, have rates of entrepreneurial activity that are high in global terms. Polynesian settlers arrived in Aotearoa (in te reo (Māori language) it means 'Land of the long white cloud') about the tenth century. Aotearoa was visited briefly by the Dutch navigator Abel Tasman in 1642. However, it was not until 1769 that the British naval captain James Cook and his crew became the first Europeans to explore New Zealand's coastline thoroughly. The word Māori meant 'usual or ordinary' as opposed to the 'different' European settlers. Before the arrival of Europeans, Māori, or Indigenous Polynesian inhabitants of New Zealand, had no name for themselves as a nation, only a number of tribal names. The original meaning of Pākehā, the settlers, was a person from England. With time, Pākehā became the word to describe fair-skinned people born in New Zealand. We use the word Pākehā here in the sense of the New Zealand census as a European New Zealander.

Māori actually have a history of enterprise upon which to draw. The Māori Wars of the 1860s were fuelled not only by the settlers' hunger for land but also because Māori had become such successful entrepreneurs that they controlled a large share of the commerce throughout the country. Māori were involved with export of produce to Australia[77] and various other countries, and to some degree Māori entrepreneurial abilities were the subject of envy by Pākehā. New Zealand's most distinguished anthropologist, Sir Raymond Firth, in his early work on Māori economics, confirms that Māori had an entrepreneurial streak.

> They return cunning with respect as this may increase one's mana (spirit of respect). Māori dignify labour and reprove idleness. The deep interest taken in work, the commendation of it in proverb and in song, as well as by public opinion, the close attention paid to quality, the administration of skill, the wide fame accorded to acknowledged experts and the preservation of their names in tribal memory – all this comprises a definite social attitude in favour of industry.[78]

Māori were also fervent adopters of technology. Best known is the Māori use of the muskets to the great cost of the settler forces. Less well known is the history of Māori adaptation of European agriculture and shipping methods as well as their rapid adoption of books and use of publishing.[79] Māori are so adept at technology that their rapid uptake spawned the Māori saying 'Ka pu te ruha ka hao te rangatahi' (The old net lies in a heap while the new net goes fishing).

Why is all this important to New Zealand today? The Māori economy, though small, is 'robust and poised for continued expansion', says a recent report by the Institute of Economic Research.[80] The Māori economy is concentrated in agriculture and fishing but also in commercial and residential property investing, television, motion picture and radio services, education, health and tourism. But according to Global Entrepreneurship Monitor (GEM) research, Māori entrepreneurship has been hampered by general inadequacy, or lack, of business skills.[81]

Considerable effort has gone into studying the phenomenon of Māori entrepreneurship.[82] In 2005, Māori at 17.7 per cent of the adult population were surpassed only by Thailand and Venezuela in terms of the adult population who are early-stage entrepreneurs. Māori statistically exceed the US and UK rates and were on par with the general New Zealand population figure of 17.6 per cent. Working back from the total population of Māori, there are currently 56 000 early-stage entrepreneurs, of which 46 000 are opportunity entrepreneurs and 8000 are necessity entrepreneurs. (The rest could not be classified.)

TABLE 20.4: **MĀORI ENTREPRENEURS IN WORLD PERSPECTIVE**

	ENTREPRENEURIAL ACTIVITY			PROPORTIONS	
COUNTRY	OVERALL ENTRY-LEVEL ENTREPRENEURSHIP RATE (%)	OPPORTUNITY ENTREPRENEURSHIP RATE (%)	NECESSITY ENTREPRENEURSHIP RATE (%)	OPPORTUNITY ENTREPRENEURS AMONG ALL ENTREPRENEURS (%)	NECESSITY ENTREPRENEURS AMONG ALL ENTREPRENEURS (%)
Venezuela	25.0	15.6	9.4	62	38
Thailand	20.7	13.9	5.0	67	24
Māori	17.7	14.8	2.6	83	15
New Zealand	17.6	16.2	1.3	92	7
Jamaica	17.0	10.0	6.0	59	35
China	13.7	7.3	6.2	53	45
United States	12.4	10.4	1.5	84	12
Brazil	11.3	6.0	5.3	53	47
Chile	11.1	8.2	2.9	73	26
Australia	10.9	9.3	1.3	85	12
Singapore	7.2	6.1	1.1	84	16
Average	9.1	6.7	2.0	75.5	20.2

Māori distinguish themselves in terms of the proportion of opportunity entrepreneurs among all entrepreneurs. About 83 per cent of Māori entrepreneurs are opportunity entrepreneurs, a respectable value comparable to Australia and the United States. As expected, Māori have a higher rate of necessity entrepreneurship than the general New Zealand population. About 15 per cent of Māori entrepreneurs are necessity entrepreneurs, a rate which puts them in the same rank as such countries as Singapore and the US. It is inaccurate to say that Māori are composed largely of necessity entrepreneurs. However, Māori men have higher rates of necessity entrepreneurship than Māori women.

Overall, Māori entrepreneurs are more confident about their future business growth prospects than non-Māori entrepreneurs. The survey found that 80 per cent of Māori entrepreneurs were optimistic about business opportunities. This optimism is extraordinary when compared to the 47 per cent rate for New Zealand as a whole and the 34 per cent rate for the GEM world in 2003.

Māori are bringing together capital with human and physical resources in businesses focused on land, coastline, fisheries, tourism and mineral deposits. Also, tribal non-profit organisations that deliver social services to Māori are benefiting from the growing level of management, business and entrepreneurship expertise in Māori communities. Māori are also increasingly aware that they must move from commodity-based production to value-adding and a greater orientation towards generating profits and building business capacity.

A source of strength within Māoridom relates to Māori culture and society itself, especially its extraordinary renaissance over the last 30 years. The development of a separate Māori education system, the burgeoning interest in Māori language and culture and a revision of Māori history from a Māori perspective are the most notable examples of this resurgence in identity, pride and culture. These strengths are complemented by government policies and programs that support Māori education and development and foster alliances between Māori, government, educators and business.

In terms of wider New Zealand social and cultural norms, the manifestation of attitudes including the kiwi ingenuity, the 'number-8 wire' mentality,[83] 'giving it a go', pulling together in a crisis and acceptance of innovation, are seen as social strengths that enhance Māori entrepreneurship. The prevailing sense of pride in things Māori, the celebration of the haka – the Māori version of the national anthem – at sporting events and the growing use of Māori terms and place-names are important acknowledgements of Māori culture for Māori people. These strengths are enhanced by tribal entrepreneurial success stories such as Ngai Tahu Corporation, Kaikoura Whale Watch, Whakatu Incorporation, Mangatu Incorporation, Paraninihi Ki Waitotara Trust, Federation of Māori Authorities, Tohu Wines and Mai FM, the most popular radio station in Auckland. Other entrepreneurial successes not linked to tribal entities include (discontinued) Tamaki Tours (tourism), Wai Ata Productions (film and video production), Taylor Made (animation and graphics), Kaitaia Fire (condiments), Mana Media, the Green Juice Company (kiwi fruit products) and River Mill Bread (wheat products). Taken as a group, the initiatives are an example of the potentiality of Māori, tribal and urban, to foster entrepreneurship and develop and grow robust businesses.

In the end, Māori entrepreneurs face a number of dilemmas. Many do not speak their language (te reo Māori) well, which opens up a rift with their elders. Tribal elders may exercise power on the marae (in a traditional setting), but they generally feel powerless in today's world of technology and change. Equally, outside of traditional contexts, members of the younger generation may have little respect for their elders (kaumātua and kuia) because they perceive them to be ill-equipped to lead in the modern world. There is a tension between traditional models of leadership, in which status is derived from age and descent and the models of leadership that apply to the business world, based on the concept of merit. Young Māori resent the wasted and lost opportunities that arise from a mismatch between leadership capability and the nature of the opportunity. Māori entrepreneurs fight battles on several fronts. They have all the usual problems in getting their business off the ground. They may have to wrestle with the wider family group (hapu) to be culturally accepted. Finally, Māori entrepreneurs have a hard time being accepted as successful in the business world dominated by European New Zealanders.

SUMMARY

We began by examining the concept of 'disadvantage'. Is it possible that disadvantaged people might actually become entrepreneurs more frequently than other people? These disadvantages range from cultural and social to geographic and physical. Disadvantaged entrepreneurs come in a rainbow of ethnicities, genders and cultures.

The growth-rate of women-owned enterprises has been impressive in many countries. Women's participation in the economic arena is of great importance not only to women, but has been closely associated with higher standards of living and an increase in the overall growth rate.

Though a gender-gap exists between men and women entrepreneurs, this gap is narrowing and, in some parts of the world, women are starting new businesses at a faster rate than their male counterparts. In both New Zealand and Australia, the number of woman employers and self-employed has clearly increased.

The increasing numbers of women entrepreneurs are due to a number of factors, mainly societal and economic changes. It has been suggested that women have certain inherent qualities that make for good – and different – entrepreneurs. Other research has concluded that the driving forces behind entrepreneurs of both sexes leave them with much in common. In addition, the international community has taken a clear interest in the importance of women entrepreneurs and clear outlines to encourage further growth in women entrepreneurship have been established.

In all nations with significant Indigenous populations, slow growth of entrepreneurship and self-employment have been concerns. This can be rectified by establishing an enterprise culture that simultaneously encourages economic growth in the Indigenous communities and respects their culture and tradition.

In Australia, Aboriginal entrepreneurship may actually be declining, but numerous interesting examples exist. In contrast, the Māori population of New Zealand has excelled at establishing an entrepreneurial culture. Māori are ranked high in the world in terms of measures of early-stage entrepreneurial activity. This difference could be due partly to the entrepreneurial history of the Māori community and their belief that work is important to one's mana. Furthermore, the Māori community has historically been keen to adopt and use new technologies and methods of business. With the recent renaissance of Māori culture, a growing number of Māori have established themselves within ever-widening fields of business.

KEY TERMS AND CONCEPTS

consensus building
disadvantage
discrimination
dynastic compliance
entrepreneurial gender gap
entrepreneuse
indigenous entrepreneurs
indigenous people
natural succession
necessity entrepreneurs
opportunity entrepreneurs
psychological disequilibrium
role conflict
social marginality
web thinking

REVIEW AND DISCUSSION QUESTIONS

1 What is social marginality theory? Is it possible disadvantaged people can actually become more entrepreneurial than other people?
2 Identify the diversity of disadvantaged entrepreneurs around the world. Name some examples not mentioned in the text.
3 What are the barriers and restraints that disadvantaged entrepreneurs face?
4 Why isn't there a word for entrepreneur or entrepreneuse in English?
5 What is the entrepreneurial gender gap?
6 How do Australia and New Zealand fare in terms of women entrepreneurs?
7 What are factors that may help account for the success of women as entrepreneurs? Which one of these is the most important? Why?
8 What are some reasons why women become entrepreneurs that are different for men's motivations?
9 What are some challenges for women entrepreneurs that may be different from those faced by men?
10 Which of the myths about women entrepreneurs do you believe and why?
11 What are the elements of a definition of 'Indigenous peoples'?
12 Can entrepreneurial development solve the problems of poverty and disenfranchisement?
13 What are the main demographic and social characteristics of Indigenous Australians?
14 What does it mean that Aboriginal Australians are caught in a spiral of discrimination?
15 What do you think accounts for the differences between Māori and Aboriginal entrepreneurship rates?

CASE 20.1:

A LIVING CULTURE, TAMAKI MĀORI VILLAGE

Often the values and needs of sustainable tourism sit uncomfortably with the requirements of commercially-driven tourism enterprises. The Tamaki Māori Village in Rotorua, New Zealand, bears testament to the fact that the two can exist and succeed symbiotically.

Founded by Māori brothers, Mike and Doug Tamaki, their driving vision of helping to preserve the Māori culture and add authenticity to the tourism experience has been fulfilled, as has their ancillary aim to develop and run a successful Māori tourism business. What makes this story even more remarkable is that success has not been achieved with aid from governments or outside funding, but rather it is a product of sheer hard work and inspiration of the two brothers, plus a little help from a Harley-Davidson motorcycle.

Rotorua is the geothermal capital of Aotearoa New Zealand. While other industries such as agriculture, retail and forestry have also flourished in the area, it is tourism that remains at the centre of the region's infrastructure. One-fifth of the city's working population is employed in the tourism industry, which must carefully balance a dynamic and contemporary attitude, with a steadfast commitment to the 600-year-old cultural heritage.

Tourism in the region and throughout New Zealand, has tended to reflect the ideologies of the period. By the twentieth century Māori were being widely used as a marketing tool by Pākehā operators. Marketing and tourism products were often characterised by 'kitsch' and not altogether culturally appropriate depictions of Māori culture. The culture was 'portrayed', rather than 'experienced', with cultural groups brought to hotels in order to 'perform'. This approach saw the development and perpetuation of a 'tongue-poking, poi-twirling, skirt-swinging' cliché surrounding Māori and their culture.

It was against this background of Māori tourism stereotypes and limited Māori economic involvement in the industry that brothers Mike and Doug Tamaki developed Tamaki Tours and later the Tamaki Māori Village. The driving vision of the brothers was to provide visitors with an authentic, deeper and more spiritual experience of Māori culture and to run a successful Māori business.

It is perhaps ironic, then, that the birth of the business that was to win New Zealand's top Māori tourism award, began with the sale of an American cultural icon – a Harley-Davidson motorcycle. In the late 1980s Mike Tamaki had been driving tour buses around the region for a major tourism company. Mike's interactions with the tourists led him to believe that they wanted more than basic sightseeing; they longed for a fuller, more meaningful experience. They wanted to know 'who you were, the people, the places'. He had unwittingly discovered a huge gap in the market and an opportunity to create more personalised tours, which included elements of culture and storytelling.

Mike approached his brother Doug, who was the proud owner of a classic Harley-Davidson. It took Mike three months of sweet-talking his brother to convince him to trade his beloved motorcycle for a mini-bus. The mini-bus, a sixteen passenger affair, was hand-painted with signs, and brochures promoting the newly established 'Tamaki Tours' were printed. The Tamakis' personalised tours, laden with sights, story-telling, Māori culture and humour, began in September 1990. In their first week of business the brothers took five people on their tour; by the end of the year they had 5000 clients.

This success was a result of the Tamakis' vision, hard work and personal sacrifice. As Mike explains, although there were opportunities for them to get outside funding for the project, the fact that they built their business based on their own zeal and personal sacrifices made them all the more determined to make it succeed. 'There were possibilities for us to get government grants to kick-start an Indigenous business, but we didn't want to go down that track because we wanted to start our own business on the same level playing field as anybody else who was going to start a business. The Harley-Davidson was a sacrifice and from there on in there were many other sacrifices. We were always undercapitalised. We had dreams of getting bigger and bigger, but whenever we needed to spend money, we had no money left. So we learned to do business the real way, along the road of hard knocks.'

One of the Tamakis' tours was a three-day excursion into the Ureweras. This National Park, known for its ruggedly beautiful forest, is about as far removed from civilisation as you can get. It was this tour that 'turned us inside out', says Mike. The brothers had hired a Tuhoe (a local Māori tribe) guide. 'He was a big guy, heavily tattooed, with dreadlocks and missing teeth. He had a huge smile and he loved the land and the people on the tour. As we got to the edge of the forest he would jump out and do a karakia (prayer). We went through the Urewera Forest and he completely reinterpreted everything. He spiritualised everything – the mountains, the trees, the forest, the sky, the land – and put the tourists into the environment. Once we finished this three day tour we were on a whole different spiritual plane.'

The Urewera tours became a turning point for the company. Mike and Doug realised that they wanted an authentic, spiritualised Māori cultural experience to be the centrepiece of their business, rather than as an adjunct. The brothers took a step back and looked at the infrastructure of their company. They solicited outside help from a business manager and devised a three year development plan. They perceived that there was a market opportunity for an authentic hangi (ground-oven cooked) meal and concert in a marae (traditional meeting place) setting. The philosophy behind this specialisation was twofold. First, there was a niche in the market and the brothers had received feedback from tourists indicating that the hotel-based concerts seemed staged and plastic. Second, the brothers wanted to get local maraes working again.

Mike and Doug then sought backing from local iwi (tribe) for access to a marae for their tour. After visiting a dozen marae in the area, speaking about their vision and ensuring that marae protocol would not be compromised, one site agreed to work with the brothers. As part of their new tour, the brothers brought busloads of tourists to the marae where they were fed a traditional hangi meal, entertained with live song and dance and given hands-on, participative insight into Māori culture.

However, the marae tour soon proved too successful. Because of the ever-burgeoning numbers of visitors it quickly became too taxing on the marae. The tour was running seven days a week and it soon began to overshadow and interfere with all the other activities in which the local iwi were involved. It was obvious to the brothers they would have to develop their own site for a marae experience. By coincidence, their bus broke down one day alongside a piece of land that appeared to be a perfect spot for such a development. It was in native forest and was the site of an ancient fortified pa (Māori village). The land was owned by a Māori trust that was enthusiastic about supporting the development.

It was never smooth sailing for the brothers. They were developing a product that represented a traditional and sacred culture and this meant that they had to be commercially aggressive and culturally sensitive. There was always going to be a degree of apprehension and tension associated with the Tamakis' vision of a commercial tourism enterprise, based in large measure on concerns that the culture could end up being compromised. For many years Māori had seen their culture bastardised in order to provide a clean, neat tourism industry package. Elders did not want to see similar misrepresentations in the Tamakis' business.

There are also many important and sacred protocols associated with the marae which must be observed and respected. Therefore, a consultative process was paramount, one where iwi could express their concerns and expectations and the Tamakis' could address and reconcile these. Six months of consultation with local kaumatua (elders) took place in order to ensure that the tourism development was culturally appropriate, while still being commercially viable.

In 1994, the Tamaki Māori village began operations. By 1998, it had won both the Māori Tourism Award and New Zealand's Supreme Tourism Award. The awards bear testament to the development and popularity of a thriving Māori business. The Village has also recently developed and opened a Tribal Arts and Crafts Market Place encompassing eight shops and a café where unique Indigenous arts and crafts are manufactured. The Market Place provides local Māori artists with the opportunity to own their own small business. In addition to employing Māori and providing the opportunity for local Māori artists to own their own businesses, the Village has other far-reaching benefits for both local Māori and Māori more generally. For example, the Village actively encourages the study of Māoritanga (the Māori Culture). The Village also provides a vital opportunity for urban Māori, many of whom have been disenfranchised from their culture, to be reacquainted with its richness and warmth. By avoiding traditional stereotypes and settings, the Village authenticates Māori cultural tourism and gives it back the spirituality which is lacking when portrayed in a hotel setting. This authenticity is setting a benchmark for other tour operators, which, in turn, will break many of the Māori stereotypes that have been prevalent in the industry.

Source: Michael Hatton, 'Community-based tourism in the Asia–Pacific' [cullin.org/cbt/index.cfm?section=cover].

QUESTIONS

1. How did the Tamaki brothers use their cultural heritage in starting their business? Do you think this was to their advantage when assuring success?
2. How does a policy of enterprise culture fit in with the success of the Tamaki brothers?
3. How did the Tamaki brothers manage to combine the need to be culturally sensitive and commercially aggressive? Do you think their solution was agreeable?

CASE 20.2:

THE BODY SHOP AND INDIGENOUS ENTREPRENEURS

Community Trade is The Body Shop's targeted purchasing program of accessories and natural ingredients from disadvantaged communities around the world. In this speech to the Australian Reconciliation Commission, Body Shop Director Barrie Thomas talks about how they are helping Indigenous entrepreneurs.

Our Indigenous peoples are being called upon at an ever-increasing rate to feed the wheels of our so-called modern and progressive societies. Over the past centuries, Western economics has stripped many Indigenous people of their lands, their traditions and their culture. In effect, economics has made Indigenous people visitors to their own country …

So how are we going to use economics to change the future, what are the alternatives and how do we all participate?

For a number of years, The Body Shop [TBS] worldwide has tackled the issue of inclusion of Indigenous people in economic prosperity with a program called 'Community Trade'. This program operates on the principle that through the development of trade links we can reverse some of the damage of the past and create a future that holds some promise for our most disadvantaged. We believe that primary sourcing of product in disadvantaged communities can assist in relieving the economic hardship of those communities. Rather than create dependency on charity, we prefer to provide sustainable trade, which assists communities to support themselves.

The program aims to change the way in which we engage with Indigenous people, by realigning the power of the players so that they become equal participants in the development of business and ultimately, communities. For example, we provide market information that allows Indigenous people to participate by at least enabling them to bid for manufacturing contracts.

We also develop credit terms that balance the economic equation. By providing partial payment up front, manufacturers can start production without having to borrow from banks, which often traps them in a cycle of poverty and indebtedness. We believe that it is more than just sourcing of ingredients that can bring about a change in the current exploitative situation, however. To create a truly economically participative situation, we need to come from the same perspective, we need to see a common vision of the future. To attain this, our program operates from principles that state:

- We will respect people's rights to control their resources, land and lives.
- We will respect all environments and trade in renewable natural materials.
- We will benefit the primary producer and treat trading partners with respect and dignity.
- We will create successful and sustainable trade links and encourage small-scale community economics which can be easily duplicated.
- We will pay special attention to those minority groups, women, disadvantaged people and businesses that are marginalised by their access to global markets.

Currently, TBS is working in conjunction with the Hope Vale community in Cape York, Australia on a venture to produce tea tree oil. This oil, in the first instance, will be used by TBS in its products and ultimately will be sold in the mainstream market. The venture is not really about tea tree oil, however. It is about developing an industry that supports the community, an industry that does not exploit the environment and, most importantly, an industry that comes from Indigenous wisdom.

Setting up industries in communities is not a mystery. It is not impossible, it just takes a reframing of priorities. It is deciding who really are the stakeholders in our overall business, not just from a pure economic framework, but from a framework of our real obligation as business, our obligation to create wealth for all. It is saying that the community which buys from us is as important as the people who work for us and as the people who receive the profit from us. They are not merely markets to be sold to, nor resources to exploit or passengers on our economic ship, but people who have as great a stake in our communities as we profess to have.

For a beginning, mechanisms need to be developed that seek to ensure that Indigenous people can become full and equal partners in any business that could be created in communities. There are limited options for Indigenous people to develop basic business skills that allow them to be successful and participate in the management of their own lands and resources. This situation is exacerbated by the fact that even those business courses that are available are presented by an unfamiliar culture using a system that devalues Indigenous wisdom. This situation must change. We must create learning environments that respect traditional wisdom as well as Western knowledge, environments that encourage Indigenous entrepreneurship and action while respecting culture. The foundations of economically self-sufficient Indigenous community will be laid through education and respect, not words and rhetoric.

Further to this challenge is the challenge for governments and business to establish trading ventures with Indigenous people, businesses that are not just resource industries but businesses that offer real skills development in communities, businesses that offer a career structure for the young that will help reverse the social disintegration and urban drift in rural Australia …

Successful business development in Indigenous communities means we will need to turn our eyes from the short-term financial balance sheet and look at the social balance sheet …

By creating sustainable business with Indigenous people that respects cultures, we will create a better Australia. The destiny of Aboriginal and non-Aboriginal Australia lies together. By developing joint ventures and working together we will understand each other at a deeper level. The development of businesses in Indigenous communities can assist in changing the current paradigm. I believe that through business we can assist Indigenous Australians to come from a position of host rather than visitor, of fellow journeyman not passenger, of brother not foe.

Source: Australian Reconciliation Convention, Speech by Mr Barrie Thomas, Director, The Body Shop, [www.austlii.edu.au/au/other/IndigLRes/car/1997/3/book3/html/06shra34.htm].

QUESTIONS

1. How difficult is it to develop enterprises in isolated areas?
2. Why do we say that economic participation is the building block to equal rights?
3. When Australians say that true reconciliation cannot be achieved without a high level of economic independence, what do they mean?
4. When developing and implementing policies for economic participation and development, how is it possible to guarantee that special features of Indigenous societies and cultures are identified?
5. How can we involve Indigenous peoples in all aspects of the development and implementation of policies and programs for stimulating economic development?
6. How is it possible to identify and prepare for the social costs that affect the communities involved?

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Dawn Riley at America True (C1)

Publication date: 7 July 2000
Author(s): Linda A. Hill, Kristin C. Doughty
Product number: 9-401-011

Dawn Riley, CEO/Captain of America True, the first co-ed syndicate to race for the America's Cup, is based in Auckland, New Zealand. Riley has built a culture focused on open communication and shared decision making. But the practice of consensus-based decision making does not seem to be working for two critical issues that have recently come up – a design question about the training boat and an issue about Riley's position on the boat. Riley wonders if it is time to step in. This case describes how Riley built the syndicate, provides information on the sailing and design program and explores Riley's role as a 'producing manager'.

Extend Fertility

Publication date: 16 December 2004
Revision date: 21 July 2005
Author(s): Myra M. Hart, Sylvia Sensiper
Product number: 9-805-065

Focuses on the search for opportunity, the generation and evaluation of business concepts, creation of a business plan and the start-up process. Follows experienced entrepreneur Christy Jones as she combines her business skills and personal experience to generate new business concepts.

Oprah Winfrey

Publication date: 8 May 2003
Revision date: 1 June 2005
Author(s): Nancy F. Koehn, Erica Helms, Edrienne Brandon, Mia Mends
Product number: 9-803-190

Examines the entrepreneurial career of Oprah Winfrey, analysing her evolution from part-time radio newscaster to internationally recognised talk show host and media executive.

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part 6

ENTREPRENEURIAL CASE ANALYSIS

GAVALA ABORIGINAL ART AND CULTURAL CENTRE

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Alana and Gavin Flick are Indigenous Australian entrepreneurs who are from the Kamilaroi Nation. The Kamilaroi traditional homelands are located in northern New South Wales approximately in the area north–south between Tamworth and Goondiwindi, then west to Narrabri and Lightning Ridge, northern New South Wales. They have been in business since commencing Gavala Aboriginal Art and Cultural Centre in 1995. Gavala is Sydney's only 100 per cent owned and operated Aboriginal retail outlet for Indigenous Australian fine art, artefacts, clothing and cultural experiences. The name Gavala is made up of the first three letters of Gavin's name and likewise Alana to show their synergy and shared union in their business pursuits.

Gavala is recognised by many as Sydney's premier gallery for authentic Indigenous Australian goods. However, the journey from their initial business start up to the present has not been easy for Alana, Gavin or their family. Frustrated in their work environment in the early 1990s they realised that the education syllabus was not improving the socio-economic plight of Indigenous Australia, nor was it educating non-Indigenous people on Indigenous issues. There was far too much stereotyping and mistruths about Indigenous Australians. Spurred on by the passion to correct this social injustice they had a dream to educate non-Indigenous people with a cultural gallery.

In hindsight Alana and Gavin's greatest assets have been the support from their children, their artistic family, both 'blood' and wider related kin, and their Indigenous suppliers. Perhaps their stubbornness not to give up when things went against them was also a worthy attribute. They have demonstrated an ability to review problems, such as protracted major building renovations that diminished their floor traffic in their current address. They adopted an aggressive marketing plan by employing an Indigenous marketing manager who later became the first Indigenous Australian University lecturer in Tourism. This illustrates their willingness to invest outside of the status quo by providing training and opportunities for their Indigenous staff to improve themselves. This has a dual outcome as it is also beneficial to the business if managed correctly. Alana and Gavin also invested into technology with a simple and descriptive website that was strategically linked to other sites targeting incoming international tourists. Simply explained, based on a previous bad experience, when retail customers were distracted by the Centre Management's construction, they looked 'outside of the box' and sought other markets. They are entrepreneurial in their approach to business problems.

To provide a background to the planning that has gone into this business, when Alana and Gavin decided to commence Gavala they realised they needed start-up capital beyond their modest savings. Their experience was similar to most if not all Indigenous Australian's who consider entering small business. Banks and similar financial institutions' lending policies are less than supportive. In general, finance for small business operators in Australia is difficult to obtain; if you are Aboriginal the degree of difficulty increases dramatically. Realising this, they looked at methods to build up their financial reserves and also to create market awareness of themselves and their products. The practice that they adopted was to obtain smooth river stones which they would paint with Aboriginal motifs. Then they proudly marketed these as 'Rock Art' and sold them. This provided an invaluable experience in the harsh world of retailing for Indigenous people in a non-Indigenous dominated tourist-dependant industry. They then opened a store in the Rocks area of Sydney and later established themselves in the tourist precinct of Darling Harbour where they remain today.

In time, their product range has increased and they have tried different lines, always monitoring any new product's success. Their current range of products and services includes:

- artefact demonstrations
- Aboriginal art history lectures
- Aboriginal cultural lectures
- bush food catering
- commissioned art works (see below).
- corporate gifts (see below).

Gavala can design a unique art piece maintaining authenticity and cultural values. Each piece comes with a letter of

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authenticity and the story of the painting. Examples commissioned include: 'Children of the Sun' for President Clinton and 'Message Stick' for Prince Harry.

Gavala also caters to the corporate gift market by providing individualised gifts for clients. The corporate gift service has been operating for ten years, satisfying any needs or requirements for Aboriginal products – whether on the scale of 250 overseas clients requiring pillow gifts or more select artworks for visiting company executives. This service includes the hand painting of company details, dates and occasions to be included onto the back of certain gifts. Recent examples include: 350 pairs of music sticks for SOBO–Journalist Program for SOCOG; 150 gathering dishes for native floral presentation to athletes at the Sydney Paralympic Games; 7500 personalised boomerangs – gifts for paralympian athletes; message sticks for Bob Carr's Milan visit; official gifts for Michael Knight's and Tim Fisher's China visits; official gifts for the President of Japan by the Premier's Department; 75 pairs of handmade mulga clap sticks for Australia Day celebrations for the Premier's Department.

In addition, the retail outlet contains a broad and continuously changing inventory of art works, fabrics, clothing apparel, gift wear, Indigenous artefacts, Indigenous books, music, Indigenous musical instruments, and tourist-related lines.

The product range and services are diverse and as demand changes or opportunities are realised, Gavala will no doubt diversify into new areas. Perhaps the most outstanding aspect of the business culture that Alana and Gavin have developed and upheld is their moral and ethical dealings with Indigenous artists. Until recent times many galleries and art agents who dealt with Indigenous artists paid the artists in tobacco, alcohol and basic food stuffs or trade goods. Even now there are still stories of unscrupulous art dealers who continue this practice. Alana and Gavin have always paid their artists by cheque or cash. They pride themselves on purchasing direct from the artist or through licensed or authorised agents where royalties and commissions are paid directly to the artists. This is why, when you ask an Indigenous person where to buy Aboriginal art, inevitably you will be advised 'Gavala in Darling Harbour'. Hilary Clinton, Hugh Grant, Elizabeth Hurley, Tom Arnold, the President of Germany, the Prime Minister of Japan, and our own Cathy Freeman are included in their customer list.

Alana and Gavin have become role models and mentors for many business people (Indigenous and non-Indigenous). Their hard work, networking, cultural integrity and ethical stance have allowed them to carve out a niche in a very competitive market.

One of the misconceived criticisms of Indigenous businesses is that they automatically obtain financial support from the federal government. This is not the case and Gavala is an example of an Indigenous Australian family who have gone against the odds, invested their life savings into an enterprise and developed that dream to obtain self-determination through financial independence that few other Indigenous Australians enjoy. The 2001 Census identified only 2058 Indigenous Australians being in business that employed people and only 1845 of those were in urban areas. Alana and Gavin are two of this very small group. In addition, they have achieved business establishment without the financial support of federally funded bodies that are established to help Indigenous enterprise.

Research by the author has found that the dominating intrinsic motivator for Indigenous Australian entrepreneurs is to provide for their children in a lifestyle that they could only dream of. This involves simple things that many Australian's take for granted, such as access to education, access to medical facilities, fresh wholesome food, adequate clothing and a living standard on a par with the Australian average.

The reader may not understand the plight of the Aboriginal Australian population that relates to this incentive in business. The Australian Medical Association's Public Report Card in 2002 on Aboriginal Health advises us that Indigenous infant mortality rates are twice those of the general population. Indigenous babies are twice as likely to have low birth weights, Indigenous people die on average 25 years earlier than other Australians, respiratory deaths are four times as high and circulatory deaths almost three times as high. Indigenous mortality rates are three times that of the total population, education retention at Year 12 is 36 per cent for Indigenous people and 73 per cent for non-Indigenous. With statistics like these no wonder Alana and Gavin, together with the other 2056 Indigenous business employers, would want to create a better life for their children – to give them the same opportunities that most non-Indigenous people take for granted.

However, Alana and Gavin are also driven by another passion. The same research by the author that revealed the intrinsic motivator of providing for their children also revealed that the single dominant inhibitor to Aboriginal involvement in business enterprise and entrepreneurial activity is racism. The Australian Bureau of Statistics advises that Indigenous Australians comprise only 2.4 per cent of the overall population and are a small minority within their own country. Racism is a dominant factor of Aboriginal life, fuelled often by ignorance. Alana and Gavin, within Gavala's business philosophy, realise and acknowledge this. Their social entrepreneurship aspirations counteract negative perceptions within the wider community and for participating international visitors. Their business philosophy is:

- the maintenance of cultural integrity
- sensitivity to Aboriginal cultural issues
- authentic, entertaining and high quality presentations
- friendly and informative customer service
- royalties and commissions going directly to artists
- authenticity of Aboriginal art and artefacts

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○ the promotion of individual artists and their communities
○ the support of Indigenous business enterprise
○ showcasing authentic Aboriginal culture to the world
○ presentation of traditional and contemporary Aboriginal art
○ qualified Aboriginal teachers
○ the promotion of young Indigenous artists.

Their philosophy reinforces their ethical stance on cultural integrity in addition to ethical integrity in dealing with Indigenous artists. However, above all, it is dominated by an educational role. One of the specific aims of Gavala is to educate – this is evident in their product range and in their business philosophy.

This entrepreneurial profile illustrates two Indigenous Australian entrepreneurs who commenced business with little, creating capital followed by the re-investment of income into a nascent enterprise, developing skills in networking and market links, diversifying in product development, yet maintaining key ethical standards. In many ways they forged a new industry standard in the Indigenous art market. In addition, they have helped train and develop numerous Indigenous staff, which has led to new vocational aspirations for Indigenous youth in areas where they were among the first to enter. Gavala has created a benchmark in the Indigenous tourism product – above all, Alana and Gavin have assisted in the education of countless international tourists on Aboriginal culture and have dispelled many of the colonial myths and negative stereotypes regarding Indigenous business operators in their dealings with their domestic clientele. They have not only provided for their children, their children have also obtained a valuable experience in retail management during the long hours that they have worked with their parents in their combined search for a shared goal.