Entrepreneurship and Innovation Toolkit

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Introduction

The business world is often equated to an ecosystem: the environment is comprised of interacting organizations and individuals much like the biological ecosystem (Moore, 1993). Entrepreneurship is no different, as it can be thought of as its own ecosystem, with new ventures being created, maturing, needing to adapt, or becoming extinct. Much like the biological ecosystem, in the entrepreneurial ecosystem, change occurs and gives rise to opportunity or presents challenges. It is important to consider the various levels of the ecosystem when evaluating the entrepreneurial environment. For example, the ecosystems can be analyzed at a macro level such as the terrestrial ecosystem in biology or the national economy in entrepreneurship. Additionally, ecosystems can be analyzed at more micro levels like the rain forest ecosystem in biology or the firm level in entrepreneurship.

Chapter 1 – Introduction to Entrepreneurship

> *Whilst there is no universally accepted definition of entrepreneurship, it is fair to say that it is multi-dimensional. It involves analyzing people and their actions together with the ways in which they interact with their environments, be these social, economic, or political, and the institutional, policy, and legal frameworks that help define and legitimize human activities. – Blackburn (2011, p. xiii)*
>
> *Entrepreneurship involves such a range of activities and levels of analysis that no single definition is definitive. – Lichtenstein (2011, p. 472)*
>
> *It is complex, chaotic, and lacks any notion of linearity. As educators, we have the responsibility to develop our students' discovery, reasoning, and implementation skills so they may excel in highly uncertain environments. – Neck and Greene (2011, p. 55)*

Learning Objectives

After completing this chapter you will be able to

- Examine the challenges associated with defining the concepts of *entrepreneur* and *entrepreneurship*
- Discuss how the evolution of entrepreneurship thought has influenced how we view the concept of entrepreneurship today
- Discuss how the list of basic questions in entrepreneurship research can be expanded to include research inquiries that are important in today's world
- Discuss how the concepts of entrepreneurial uniqueness, entrepreneurial personality traits, and entrepreneurial cognitions can help society improve its support for entrepreneurship
- Apply the general venturing script to the study of entrepreneurship

Overview

This chapter provides you with an overview of entrepreneurship and of the language of entrepreneurship. The challenges associated with defining *entrepreneur* and *entrepreneurship* are explored, as is an overview of how entrepreneurship can be studied.

The objective is to enable you to apply current concepts in entrepreneurship to the evaluation of entrepreneurs, their ventures, and the venturing environment. You will develop skills, including the capability to add value in the new venture sector of the economy. You will acquire and practice evaluation skills useful in consulting, advising, and making new venture decisions.

Entrepreneurs and Entrepreneurship

Considerations Influencing Definitions of Entrepreneur and Entrepreneurship

It is necessary to be able to determine exactly who *entrepreneurs* are before we can, among other things, study them, count them, provide special loans for them, and calculate how and how much they contribute to our economy.

- Does someone need to start a business from scratch to be called an entrepreneur?
- Can we call someone an entrepreneur if they bought an ongoing business from someone else or took over the operations of a family business from their parents?
- If someone starts a small business and never needs to hire employees, can they be called an entrepreneur?
- If someone buys a business but hires professional managers to run it so they don't have to be involved in the operations, are they an entrepreneur?
- Is someone an entrepreneur if they buy into a franchise so they can follow a well-established formula for running the operation?
- Is someone an entrepreneur because of what they do or because of how they think?
- Can someone be an entrepreneur without owning their own business?
- Can a person be an entrepreneur because of the nature of the work that they do within a large corporation?

It is also necessary to fully understand what we mean by *entrepreneurship* before we can study the concept.

Gartner (1990) identified 90 attributes that showed up in definitions of entrepreneurs and entrepreneurship provided by entrepreneurs and other experts in the field. The following are a few of these attributes:

- Innovation – Does a person need to be innovative to be considered an entrepreneur? Can an activity be considered to be entrepreneurial if it is not innovative?

- Activities – What activities does a person need to do to be considered an entrepreneur?
- Creation of a new business – Does someone need to start a new business to be considered to be an entrepreneur, or can someone who buys a business, buys into a franchise, or takes over an existing family business be considered an entrepreneur?
- Starts an innovative venture within an established organization – Can someone who works within an existing organization that they don't own be considered an entrepreneur if they start an innovative venture for their organization?
- Creation of a not-for-profit business – Can a venture be considered to be entrepreneurial if it is a not-for-profit, or should only for-profit businesses be considered entrepreneurial?

After identifying the 90 attributes, Gartner (1990) went back to the entrepreneurs and other experts for help in clustering the attributes into themes that would help summarize what people concerned with entrepreneurship thought about the concept. He ended up with the following eight entrepreneurship themes:

1. The Entrepreneur – The entrepreneur theme is the idea that entrepreneurship involves individuals with unique personality characteristics and abilities (e.g., risk-taking, locus of control, autonomy, perseverance, commitment, vision, creativity). Almost 50% of the respondents rated these characteristics as not important to a definition of entrepreneurship (Gartner, 1990, p. 21, 24).

    - "The question that needs to be addressed is: Does entrepreneurship involve entrepreneurs (individuals with unique characteristics)?" (Gartner, 1990, p. 25).

2. Innovation – The innovation theme is characterized as doing something new as an idea, product, service, market, or technology in a new or established organization. The innovation theme suggests that innovation is not limited to new ventures, but recognized as something which older and/or larger organizations may undertake as well (Gartner, 1990, p. 25). Some of the experts Gartner questioned believed that it was important to include innovation in definitions of entrepreneurship and others did not think it was as important.

    - "Does entrepreneurship involve innovation?" (Gartner, 1990, p. 25).

3. Organization Creation – The organization creation theme describes the behaviors involved in creating organizations. This theme described acquiring and integrating resource attributes (e.g., Brings resources to bear, integrates opportunities with resources, mobilizes resources, gathers resources) and attributes that described creating organizations (new venture development and the creation of a business that adds value). (Gartner, 1990, p. 25)

    - "Does entrepreneurship involve resource acquisition and integration (new venture creation activities)?" (Gartner, 1990, p. 25)

4. Creating Value – This theme articulated the idea that entrepreneurship creates value. The attributes in this factor indicated that value creation might be represented by transforming a business, creating a new business growing a business, creating wealth, or destroying the status quo.

- "Does entrepreneurship involve creating value?" (Gartner, 1990, p. 25).

5. Profit or Nonprofit

- "Does entrepreneurship involve profit-making organizations only" (Gartner, 1990, p. 25)?

6. Growth

- Should a focus on growth be a characteristic of entrepreneurship?

7. Uniqueness – This theme suggested that entrepreneurship must involve uniqueness. Uniqueness was characterized by attributes such as a special way of thinking, a vision of accomplishment, ability to see situations in terms of unmet needs, and creates a unique combination.

- "Does entrepreneurship involve uniqueness?" (Gartner, 1990, p. 26).

8. The Owner-Manager – Some of the respondents questioned by Gartner (1990) did not believe that small mom-and-pop types of businesses should be considered to be entrepreneurial. Some respondents felt that an important element of a definition of entrepreneurship was that a venture be owner-managed.

- To be entrepreneurial, does a venture need to be owner-managed?

Examples of Definitions of Entrepreneur

An entrepreneur can be described as "one who creates a new business in the face of risk and uncertainty for the purpose of achieving profit and growth by identifying significant opportunities and assembling the necessary resources to capitalize on them" (Zimmerer & Scarborough, 2008, p. 5).

An entrepreneur is "one who organizes, manages, and assumes the risks of a business or enterprise" (Entrepreneur, n.d.).

Examples of Definitions of Entrepreneurship

Entrepreneurship can be defined as a field of business that

> seeks to understand how opportunities to create something new (e.g., new products or services, new markets, new production processes or raw materials, new ways of organizing existing technologies) arise and are discovered or created by specific persons, who then use various means to exploit or develop them, thus producing a wide range of effects (Baron, Shane, & Reuber, 2008, p. 4)

A concise definition of entrepreneurship “is that it is the process of pursuing opportunities without limitation by resources currently in hand” (Brooks, 2009, p. 3) and “the process of doing something new and something different for the purpose of creating wealth for the individual and adding value to society” (Kao, 1993, p. 70)

The Evolution of Entrepreneurship Thought

This section includes an overview of how entrepreneurship has evolved to the present day.

The following timeline shows some of the most influential entrepreneurship scholars and the *schools of thought* (French, English, American, German, and Austrian) their perspectives helped influence and from which their ideas evolved. Schools of thought are essentially groups of people who might or might not have personally known each other, but who shared common beliefs or philosophies.

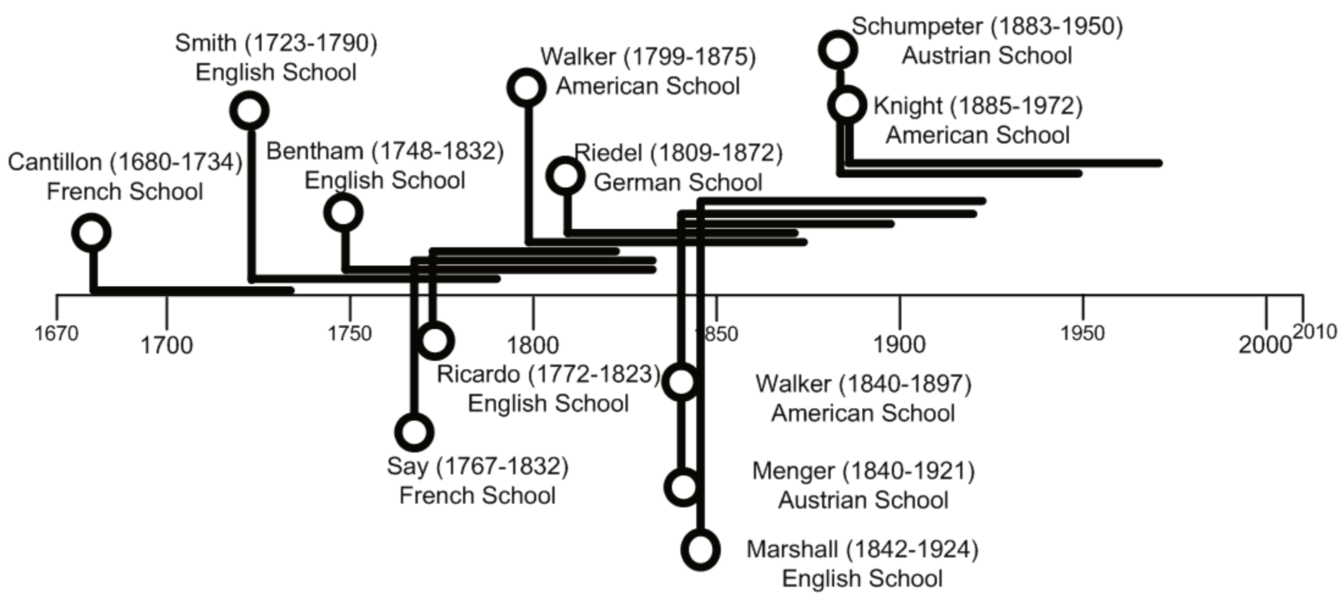


Figure 1 – Historical and Evolutionary Entrepreneurship Thought (Illustration by Lee A. Swanson)

The Earliest Entrepreneurship

The function, if not the name, of the entrepreneur is probably as old as the institutions of barter and exchange. But only after economic markets became an intrusive element of society did the concept take on pivotal importance. Many economists have recognized the pivotal role of the entrepreneur in a market economy. Yet despite his central importance in economic activity, the entrepreneur has been a shadowy and elusive figure in the history of economic theory (Hebert & Link, 2009, p. 1).

Historically those who acted similarly to the ways we associate with modern day entrepreneurs – namely those who strategically assume risks to seek economic (or other) gains – were military leaders, royalty, or merchants. Military leaders planned their campaigns and battles while assuming significant risks, but by doing so they also stood to gain economic benefits if their strategies were successful. Merchants, like Marco Polo who sailed out of

Venice in the late 1200s to search for a trade route to the Orient, also assumed substantial risks in the hope of becoming wealthy (Hebert & Link, 2009).

The entrepreneur, who was also called *adventurer*, *projector*, and *undertaker* during the eighteenth century, was not always viewed in a positive light (Hebert & Link, 2009).

Development of Entrepreneurship as a Concept

Risk and Uncertainty

Richard Cantillon (1680-1734) was born in France and belonged to the French School of thought although he was an Irish economist. He appears to be the person who introduced the term *entrepreneur* to the world. “According to Cantillon, the entrepreneur is a specialist in taking on risk, ‘insuring’ workers by buying their output for resale before consumers have indicated how much they are willing to pay for it” (Casson & Godley, 2005p. 26). The workers’ incomes are mostly stable, but the entrepreneur risks a loss if market prices fluctuate.

Cantillon distinguished entrepreneurs from two other classes of economic agents; landowners, who were financially independent, and hirelings (employees) who did not partake in the decision-making in exchange for relatively stable incomes through employment contracts. He was the first writer to provide a relatively refined meaning for the term *entrepreneurship*. Cantillon described entrepreneurs as individuals who generated profits through exchanges. In the face of uncertainty, particularly over future prices, they exercise business judgment. They purchase resources at one price and sell their product at a price that is uncertain, with the difference representing their profit (Chell, 2008; Hebert & Link, 2009).

Farmers were the most prominent entrepreneurs during Cantillon’s lifetime, and they interacted with “arbitrageurs” – or middlemen between farmers and the end consumers – who also faced uncertain incomes, and who were also, therefore, entrepreneurs. These intermediaries facilitated the movement of products from the farms to the cities where more than half of the farm output was consumed. Cantillon observed that consumers were willing to pay a higher price per unit to be able to purchase products in the smaller quantities they wanted, which created the opportunities for the intermediaries to make profits. Profits were the rewards for assuming the risks arising from uncertain conditions. The markets in which profits were earned were characterized by incomplete information (Chell, 2008; Hebert & Link, 2009).

Adolph Reidel (1809-1872), form the German School of thought, picked up on Cantillon’s notion of uncertainty and extended it to theorize that entrepreneurs take on uncertainty so others, namely income earners, do not have to be subject to the same uncertainty. Entrepreneurs provide a service to risk-averse income earners by assuming risk on their behalf. In exchange, entrepreneurs are rewarded when they can foresee the impacts of the uncertainty and sell their products at a price that exceeds their input costs (including the fixed costs of the wages they commit to paying) (Hebert & Link, 2009).

Frank Knight (1885-1972) founded the Chicago School of Economics and belonged to the American School of thought. He refined Cantillon’s perspective on entrepreneurs and risk by distinguishing insurable risk as something that is separate from uncertainty, which is not insurable. Some risks can be insurable because they have occurred enough times in the past that the expected loss from such risks can be calculated. Uncertainty, on the other hand, is not subject to probability calculations. According to Knight, entrepreneurs can't share the risk of loss by insuring themselves against uncertain events, so they bear these kinds of risks themselves, and *profit* is the reward that entrepreneurs get from assuming uninsurable risks (Casson & Godley, 2005).

Distinction Between Entrepreneur and Manager

Jean-Baptiste Say (1767-1832), also from the French School, advanced Cantillon's work, but added that entrepreneurship was essentially a form of management. Say "put the entrepreneur at the core of the entire process of production and distribution" (Hebert & Link, 2009, p. 17). Say's work resulted in something similar to a general theory of entrepreneurship with three distinct functions; "scientific knowledge of the product; entrepreneurial industry – the application of knowledge to useful purpose; and productive industry – the manufacture of the item by manual labour" (Chell, 2008, p. 20).

Frank Knight made several contributions to entrepreneurship theory, but another of note is how he distinguished an entrepreneur from a manager. He suggested that a manager crosses the line to become an entrepreneur "when the exercise of his/her judgment is liable to error and s/he assumes the responsibility for its correctness" (Chell, 2008, p. 33). Knight said that entrepreneurs calculate the risks associated with uncertain business situations and make informed judgments and decisions with the expectation that – if they assessed the situation and made the correct decisions – they would be rewarded by earning a profit. Those who elect to avoid taking these risks choose the relative security of being employees (Chell, 2008).

Alfred Marshall (1842-1924), from the English School of thought, was one of the founders of neoclassical economics. His research involved distinguishing between the terms capitalist, entrepreneur, and manager. Marshall saw capitalists as individuals who "committed themselves to the capacity and honesty of others, when he by himself had incurred the risks for having contributed with the capital" (Zaratiegui & Rabade, 2005, p. 775). An entrepreneur took control of money provided by capitalists in an effort to leverage it to create more money; but would lose less if something went wrong then would the capitalists. An entrepreneur, however, risked his own reputation and the other gains he could have made by pursuing a different opportunity.

> Let us suppose that two men are carrying on smaller businesses, the one working with his own, the other chiefly with borrowed capital. There is one set of risks which is common to both; which may be described as the trade risks of the particular business … But there is another set of risks, the burden of which has to be borne by the man working with borrowed capital, and not by the other; and we may call them personal risks (Marshall, 1961, p. 590; Zaratiegui & Rabade, 2005, p. 776).

Marshall recognized that the reward capitalists received for contributing capital was interest income and the reward entrepreneurs earned was profits. Managers received a salary and, according to Marshall, fulfilled a different function than either capitalists or entrepreneurs – although in some cases, particularly in smaller firms, one person might be both an entrepreneur and a manager. Managers "were more inclined to avoid challenges, innovations and what Schumpeter called the 'perennial torment of creative destruction' in favour of a more tranquil life" (Zaratiegui & Rabade, 2005, p. 781). The main risks they faced from firm failure were to their reputations or to their employment status. Managers had little incentive to strive to maximize profits (Zaratiegui & Rabade, 2005).

Amasa Walker (1799-1875) and his son Francis Walker (1840-1897) were from the American School of thought, and they helped shape an American perspective of entrepreneurship following the Civil War of 1861-1865. These scholars claimed that entrepreneurs created wealth, and thus played a different role than capitalists. They believed that entrepreneurs had the power of foresight and leadership qualities that enabled them to organize resources and inject energy into activities that create wealth (Chell, 2008).

Entrepreneurship versus Entrepreneur

Adam Smith (1723-1790), from the English School of thought, published *An Inquiry into the Nature and Causes of the Wealth of Nations* in 1776. In a departure from the previous thought into entrepreneurship and economics, Smith did not dwell on a particular class of individual. He was concerned with studying how all people fit into the economic system. Smith contended that the economy was driven by self-interest in the marketplace (Chell, 2008).

Also from the English School, David Ricardo (1772-1823) was influenced by Smith, Say, and others. His work focused on how the capitalist system worked. He explained how manufacturers must invest their capital in response to the demand for the products they produce. If demand decreases, manufacturers should borrow less and reduce their workforces. When demand is high, they should do the reverse (Chell, 2008).

Carl Menger (1840-1921), from the Austrian School of thought, ranked goods according to their causal connections to human satisfaction. *Lower order* goods include items like bread that directly satisfy a human want or need like hunger. *Higher order* goods are those more removed from satisfying a human need. A second order good is the flour that was used to make the bread. The grain used to make the flour is an even higher order good. Entrepreneurs coordinate these factors of production to turn higher order goods into lower order goods that more directly satisfy human wants and needs (Hebert & Link, 2009).

> Menger (1950 [1871], p. 160) established that entrepreneurial activity includes: (a) obtaining information about the economic situation, (b) economic calculation – all the various computations that must be made if a production process is to be efficient, (c) the act of will by which goods of higher order are assigned to a particular production process, and (d) supervising the execution of the production plan so that it may be carried through as economically as possible (Hebert & Link, 2009, p. 43).

Entrepreneurship and Innovation

Jeremy Bentham (1748-1832), from the English School of thought, considered entrepreneurs to be innovators. They “depart from routine, discover new markets, find new sources of supply, improve existing products and lower the costs of production” (Chell, 2008).

Joseph Schumpeter’s (1883-1950) parents were Austrian, he studied at the University of Vienna, conducted research at the University of Graz, served as Austria’s Minister of Finance, and was the president of a bank in the country. Because of the rise of Hitler in Europe, he went to the United States and conducted research at Harvard until he retired in 1949. Because of this, he is sometimes associated with the American School of thought on entrepreneurship (Chell, 2008).

Whereas Menger saw entrepreneurship as occurring because of economic progress, Schumpeter took the opposite stance. Schumpeter saw economic activity as leading to economic development (Hebert & Link, 2009). Entrepreneurs play a central role in Schumpeter's theory of economic development, and economic development can occur when the factors of production are assembled in *new combinations*.

Schumpeter (1934) viewed innovation as arising from new combinations of materials and forces. He provided the following five cases of new combinations.

1. The introduction of a new good – that is one with which consumers are not yet familiar – or of a new quality of good.
2. The introduction of a new method of production, that is one not yet tested by experience in the branch of manufacture concerned, 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 (Schumpeter, 1934, p. 66).

Another concept popularized by Schumpeter – in addition to the notion of new combinations – was *creative destruction*. This was meant to indicate that the existing ways of doing things need to be dismantled – to be destroyed – to enable a transformation through innovation to a new way of doing things. Entrepreneurs use innovation to disrupt how things are done and to establish a better way of doing those things.

Basic Questions in Entrepreneurship Research

According to Baron (2004a), there are three basic questions of interest in the field of entrepreneurship:

1. Why do some persons but not others choose to become entrepreneurs?
2. Why do some persons but not others recognize opportunities for new products or services that can be profitably exploited?
3. Why are some entrepreneurs so much more successful than others (Baron, 2004a, p. 221)?

To understand where these foundational research questions came from and what their relevance is today, it is useful to study what entrepreneurship research has uncovered so far.

Entrepreneurial Uniqueness

Efforts to teach entrepreneurship have included descriptions of entrepreneurial uniqueness based on personality, behavioural, and cognitive traits (Chell, 2008; Duening, 2010).

- Personality characteristics
    - Three personality characteristics of entrepreneurs that are often cited are:
        - Need for achievement
        - Internal locus of control (a belief by an individual that they are in control of their own destiny)
        - Risk-taking propensity
- Behavioural traits
- Cognitive skills of successful entrepreneurs

Past studies of personality characteristics and behavioural traits have not been overly successful at identifying entrepreneurial uniqueness.

> As it turned out, years of painstaking research along this line has not borne significant fruit. It appears that there are simply not any personality characteristics that are either essential to, or defining of, entrepreneurs that differ systematically from non-entrepreneurs…. Again, investigators proposed a number of behavioural candidates as emblematic of entrepreneurs. Unfortunately, this line of research also resulted in a series of dead ends as examples of successful entrepreneurial behaviours had equal counterparts among samples of non-entrepreneurs. As with the personality characteristic school of thought before it, the behavioural trait school of thought became increasingly difficult to support (Duening, 2010, p. 4-5).

This shed doubt on the value of trying to change personality characteristics or implant new entrepreneurial behaviours through educational programs in an effort to promote entrepreneurship.

New research, however, has resurrected the idea that there might be some value in revisiting personality traits as a topic of study. Additionally, Duening (2010) and has suggested that an important approach to teaching and learning about entrepreneurship is to focus on the “cognitive skills that successful entrepreneurs seem uniquely to possess and deploy” (p. 2). In the next sections we consider the new research on entrepreneurial personality traits and on entrepreneurial cognitions.

Entrepreneurial Personality Traits

While acknowledging that research had yet to validate the value of considering personality and behaviour traits as ways to distinguish entrepreneurs from non-entrepreneurs or unsuccessful ones, Chell (2008) suggested that researchers turn their attention to new sets of traits including: “the proactive personality, entrepreneurial self-efficacy, perseverance and intuitive decision-making style. Other traits that require further work include social competence and the need for independence" (p. 140).

In more recent years scholars have considered how the Big Five personality traits – extraversion, agreeableness, conscientiousness, neuroticism (sometimes presented as *emotional stability*), and openness to experience (sometimes referred to as intellect) – might be used to better understand entrepreneurs. It appears that the Big Five traits might be of some use in predicting entrepreneurial success. Research is ongoing in this area, but in one example, Caliendo, Fossen, and Kritikos (2014) studied whether personality constructs might "influence entrepreneurial decisions at different points in time" (p. 807), and found that "high values in three factors of the Big Five approach—openness to experience, extraversion, and emotional stability (the latter only when we do not control for further personality characteristics)—increase the probability of entry into self-employment" (p. 807). They also found "that some specific personality characteristics, namely risk tolerance, locus of control, and trust, have strong partial effects on the entry decision" (p. 807). They also found that people who scored higher on agreeableness were more likely to exit their businesses, possibly meaning that people with lower agreeableness scores might prevail longer as entrepreneurs. When it came to specific personality traits, their conclusions indicated that those with an external locus of control were more likely to stop being self-employed after they had run their businesses for a while. There are several implications for research like this, including the potential to better understand why some entrepreneurs behave as they do based upon their personality types and the chance to improve entrepreneurship education and support services.

Entrepreneurial Cognitions

It is only fairly recently that entrepreneurship scholars have focused on cognitive skills as a primary factor that differentiates successful entrepreneurs from non-entrepreneurs and less successful entrepreneurs. This approach deals with how entrepreneurs think differently than non-entrepreneurs (Duening, 2010; Mitchell et al., 2007).

> Entrepreneurial cognitions are the knowledge structures that people use to make assessments, judgments or decisions involving opportunity evaluation and venture creation and growth. In other words, research in entrepreneurial cognition is about understanding how entrepreneurs use simplifying mental models to piece together previously unconnected information that helps them to identify and invent new products or services, and to assemble the necessary resources to start and grow businesses (Mitchell, Busenitz, et al., 2002, p. 97).

Mitchell, Smith, et al. (2002) provided the example of how the decision to create a new venture (dependent variable) was influenced by three sets of cognitions (independent variables). They described these cognitions as follows:

> Arrangements cognitions are the mental maps about the contacts, relationships, resources, and assets necessary to engage in entrepreneurial activity; willingness cognitions are the mental maps that support commitment to venturing and receptivity to the idea of starting a venture; ability cognitions consist of the knowledge structures or scripts (Glaser, 1984) that individuals have to support the capabilities, skills, norms, and attitudes required to create a venture (Mitchell et al.,

> 2000). These variables draw on the idea that cognitions are structured in the minds of individuals (Read, 1987), and that these knowledge structures act as “scripts” that are the antecedents of decision making (Leddo & Abelson, 1986, p. 121; Mitchell, Smith, et al., 2002, p. 10)

Cognitive Perspective to Understanding Entrepreneurship

According to Baron (2004a), by taking a cognitive perspective, we might better understand entrepreneurs and the role they play in the entrepreneurial process.

> The cognitive perspective emphasizes the fact that everything we think, say, or do is influenced by mental processes—the cognitive mechanisms through which we acquire store, transform, and use information. It is suggested here that this perspective can be highly useful to the field of entrepreneurship. Specifically, it can assist the field in answering three basic questions it has long addressed: (1) Why do some persons but not others choose to become entrepreneurs? (2) Why do some persons but not others recognize opportunities for new products or services that can be profitably exploited? And (3) Why are some entrepreneurs so much more successful than others (Baron, 2004a, p. 221-222)?

Baron (2004a), illustrated how cognitive differences between people might explain why some people end up pursuing entrepreneurial pursuits and others do not. For example, *prospect theory* (Kahneman & Tversky, 1977) and other decision-making or behavioural theories might be useful in this regard. Research into cognitive biases might also help explain why some people become entrepreneurs.

Baron (2004a) also revealed ways in which cognitive concepts like signal detection theory, regulation theory, and entrepreneurial might help explain why some people are better at entrepreneurial opportunity recognition. He also illustrated how some cognitive models and theories – like risk perception, counterfactual thinking, processing style, and susceptibility to cognitive errors – might help explain why some entrepreneurs are more successful than others.

Cognitive Perspective and the Three Questions

- Why do some and not others choose to become entrepreneurs?
  - Prospect Theory
  - Cognitive Biases
- Why are some people better at recognizing entrepreneurial opportunities?
  - Signal Detection Theory
  - Regulation Theory
  - Entrepreneurial Alertness
- Why are some people more successful at entrepreneurship than others?
  - Risk Perception

    - Counterfactual Thinking
    - Processing Style
    - Susceptibility to Cognitive Errors

Entrepreneurial Scripts

- Why do some people, or groups of people, achieve high performance economic results while others do not? Is there a relationship between the attainment of high performance economic results and transaction cognitions (a type of economic thought pattern)?
    - "Cognition has emerged as an important theoretical perspective for understanding and explaining human behavior and action" (Dutta & Thornhill, 2008, p. 309).
    - Cognitions are all processes by which sensory input is transformed, reduced, elaborated, stored, recovered, and used (Neisser, 1976).
    - Cognitions lead to the acquisition of knowledge, and involve human information processing.
- Knowledge structure/script:
    - Is a mental model, or information processing short-cut that can give information form and meaning, and enable subsequent interpretation and action.
    - The subsequent interpretation and actions can result in expert performance … they can also result in thinking errors.
- Entrepreneurial scripting exercises are critical to giving learners an explicit understanding of:
    - the processes that transfer expertise, and
    - the actual expertise itself.
- The structure of scripts (based upon Mitchell (2000)
    - Scripts are generally framed as a linear sequence of steps, usually with feedback loops, that can explain how to achieve a particular task – perhaps like developing a business plan.
    - Sometimes scripts can be embedded within other scripts. For example, within a general venturing script that outlines the sequences of activities that can lead to a successful business launch, there will probably be sub-scripts describing how entrepreneurs can search for ideas, screen those ideas until one is selected, plan how to launch a sustainable business based upon that idea and including securing the needed financial resources, setting up the business, starting it, effectively managing its ongoing operations, and managing the venture such that that entrepreneur can extract the value that they desire from the enterprise at the times and in the ways they want it.
    - The most effective scripts include an indication of the norms that outline performance standards and indicate how to determine when any step in the sequence has been properly

completed.

General Venturing Script

Generally, entrepreneurship is considered to consist of the following elements, or subscripts (Brooks, 2009; Mitchell, 2000).

- Searching
- Idea Screening
- Planning and Financing
- Set-Up
- Start-Up
- Ongoing Operations
- Harvest

Searching (also called idea formulation or opportunity recognition)

- This script begins when a person decides they might be a potential entrepreneur (or when an existing entrepreneur decides they need more ideas in their *idea pool*).
- This script ends when there are a sufficient number of ideas in the idea pool.
- The scripting process involves a logical flow of steps (including feedback loops, actions which must occur in sequence, and actions which can be implemented at the same time as other actions) designed to:
    - *overcome mental blockages* to creativity which might hinder this person's ability to identify viable ideas;
    - *implement steps to identify* a sufficient number of ideas (most likely 5 or more) which the person is *interested in investigating* to determine whether they might be viable *given general criteria* such as this person's personal interests and capabilities;

Idea Screening (also called concept development)

- This script begins when the person with the idea pool is no longer focusing on adding new ideas to it; but is instead taking steps to choose the best idea for them *given a full range of specific criteria*.
- This script ends when one idea is chosen from among those in the idea pool.
- The scripting process involves a logical flow of steps to assess the *current situation and the trends* in the following areas. The right tools must be used for each level of analysis.
    - Do the current societal-level factors indicate that a particular idea should be considered for

implementation? Do the trends in these societal-level factors indicate that the idea will be viable and sustainable into the future?

    - Evaluate the political, economic, social, technological, environmental, and legal climates

  - Do the current industry/market-level factors indicate an idea is viable? Are the trends in these factors supportive of the idea?
    - Evaluate the degree of competitiveness in the industry, the threat of substitutes emerging, the threat of new entrants to the industry, the degree of bargaining power of buyers, and the degree of bargaining power of suppliers.
    - Do a market profile analysis to assess the attractiveness of the position within the industry that the potential venture will occupy.
  - Do the current firm-level factors support the pursuit of the idea?
    - Formulate and evaluate potential strategies to leverage organizational strengths, overcome/minimize weaknesses, take advantage of opportunities, and overcome/minimize threats;
    - Complete financial projections and analyze them to evaluate financial attractiveness;
    - Assess the founder fit with the ideas;
    - Evaluate the core competencies of the organization relative to the idea;
    - Assess advice solicited from trusted advisers

Planning and Financing (also called resource determination and acquisition)

- This script begins when the idea screening script ends and when the person begins making the plans to implement the single idea chosen from the idea pool, which is done in concert with securing financing to implement the venture idea.
- This script ends when sufficient business planning has been done and when adequate financing has been arranged.
- The scripting process involves a logical flow of steps to develop a business plan and secure adequate financing to start the business.

Set-Up (also called launch)

- This script begins when the planning and financing script ends and when the person begins implementing the plans needed to start the business.
- This script ends when the business is ready to start-up.

- The scripting process involves a logical flow of steps, including purchasing and installing equipment, securing the venture location and finishing all the needed renovations, recruiting and hiring any staff needed for start-up, and the many other steps needed to prepare for start-up.
- Start-Up (also called launch)
- This script begins when the set-up script ends and when the business opens and begins making sales.
- This script ends when the business has moved beyond the point where the entrepreneur must continually fight for the business's survival and persistence. It ends when the entrepreneur can instead shift emphasis toward business growth or maintaining the venture's stability.
- The scripting process involves a logical flow of steps needed to establish a new venture.

Ongoing Operations (also called venture growth)

- This script begins when the start-up script ends and when the business has established persistence and is implementing growth (or maintenance) strategies.
- This script ends when the entrepreneur chooses to harvest the value they generated with the venture.
- The scripting process involves a logical flow of steps needed to grow (or maintain) a venture.

Studying Entrepreneurship

The following quotations from two preeminent entrepreneurship and entrepreneurship education researchers indicate the growing interest in studies in this field.

> Entrepreneurship has emerged over the last two decades as arguably the most potent economic force the world has ever experienced. With that expansion has come a similar increase in the field of entrepreneurship education. The recent growth and development in the curricula and programs devoted to entrepreneurship and new-venture creation have been remarkable. The number of colleges and universities that offer courses related to entrepreneurship has grown from a handful in the 1970s to over 1,600 in 2005 (Kuratko, 2005, p. 577).

> Interest in entrepreneurship has heightened in recent years, especially in business schools. Much of this interest is driven by student demand for courses in entrepreneurship, either because of genuine interest in the subject, or because students see entrepreneurship education as a useful hedge given uncertain corporate careers (Venkataraman, 1997, p. 119).

Approaches to Studying Entrepreneurship

Entrepreneurship is a discipline, which means an individual can learn about it, and about how to be an effective entrepreneur. It is a myth that people are born entrepreneurs and that others cannot learn to become entrepreneurs (Drucker, 1985). Kuratko (2005) asserted that the belief previously held by some that entrepreneurship cannot be taught has been debunked, and the focus has shifted to what topics should be taught and how they should be covered.

Solomon (2007) summarized some of the research on what should be covered in entrepreneurship courses, and how it should be taught. While the initial focus was on actions like developing business plans and being exposed to real entrepreneurs, more recently this approach has been supplemented by an emphasis on technical, industry, and personal experience. “It requires critical thinking and ethical assessment and is based on the premise that successful entrepreneurial activities are a function of human, venture and environmental conditions” (p. 172). Another approach “calls for courses to be structured around a series of strategic development challenges including opportunity identification and feasibility analysis; new venture planning, financing and operating; new market development and expansion strategies; and institutionalizing innovation” (p. 172). This involves having students interact with entrepreneurs by interviewing them, having them act as mentors, and learning about their experiences and approaches through class discussions.

Sources of Information for Studying Entrepreneurship

According to Kuratko (2005), “three major sources of information supply the data related to the entrepreneurial process or perspective” (p. 579).

1. Publications (both research-based and those written for the general public)
    a. Research-based publications:
        i. Academic journals like *Entrepreneurship Theory and Practice*, *Journal of Business Venturing*, and *Journal of Small Business Management*
        ii. Proceedings of conferences like *Proceedings of the Academy of Management* and *Proceedings of the Administrative Sciences Association of Canada*
    b. Publications written for practitioners and the general public
        i. Textbooks on entrepreneurship
        ii. Books about entrepreneurship
        iii. Biographies or autobiographies of entrepreneurs
        iv. News periodicals like *Canadian Business* and *Profit*
        v. Trade periodicals like *Entrepreneur* and *Family Business*
        vi. Government publications available through sources like the *Enterprise Saskatchewan* and *Canada-Saskatchewan Business Service Centre (CSBSC)* websites and through various government resource centers
2. Direct observation and interaction with practicing entrepreneurs
    a. Data might be collected from entrepreneurs and about entrepreneurs through surveys, interviews, or other methods applied by researchers.
3. Speeches and presentations by practicing entrepreneurs

Chapter 2 – Opportunity Recognition and Design Thinking

Entrepreneurs see ways to put resources and information together in new combinations. They not only see the system as it is, but as it might be. They have a knack for looking at the usual and seeing the unusual, at the ordinary and seeing the extraordinary. Consequently, they can spot opportunities that turn the commonplace into the unique and unexpected. – Mitton (1989, p. 12)

In my opinion, all previous advances in the various lines of invention will appear totally insignificant when compared with those which the present century will witness. I almost wish that I might live my life over again to see the wonders which are at the threshold. – Charles H. Duell, Commissioner, U.S. Office of Patents, 1898-1901 (who has been incorrectly quoted as having said "Everything that can be invented has been invented")

The significant problems we face cannot be solved at the same level of thinking we were at when we created them. – Albert Einstein

I think there is a world market for maybe five computers. – Thomas Watson, Chairman of IBM, 1943

Learning Objectives

After completing this chapter you will be able to

- Discuss opportunity recognition concepts and methods as developed and/or advocated by leading thinkers like Drucker, Mitchell, Schumpeter, and Vesper
- Describe what design thinking is
- Apply design thinking to develop and assess new venture ideas

Overview

This chapter introduces a sample of perspectives and tools designed to help individuals recognize potential business opportunities. The concept of design thinking is also examined in some detail.

The objective is to help you improve your ability to apply *inspiration, ideation,* and *implementation* as part of the design thinking process.

Opportunity Recognition

The following is a discussion of entrepreneurship theorists and practitioners who have developed the concept of *opportunity recognition*. While the tools introduced in the next sections can be applied for a variety of purposes, they are particularly useful for recognizing new venture opportunities.

Baron

Opportunity recognition is

> the active, cognitive process (or processes) through which individuals conclude that they have identified the potential to create something new that has the potential to generate economic value and that is not currently being exploited or developed, and is viewed as desirable in the society in which it occurs (i.e. its development is consistent with existing legal and moral conditions). (Baron, 2004b, p. 52)

Because opportunity recognition is a cognitive process, according to Baron (2004b), people can learn to be more effective at recognizing opportunities by changing the way they think about opportunities and how to recognize them.

Drucker

Systematic innovation involves “monitoring seven sources for innovative opportunity” (Drucker, 1985, p. 35). The first four are internally focused within the business or industry, in that they may be visible to those involved in that organization or sector. The last three involve changes outside the business or industry.

- Internally Focused
    - The unexpected (unexpected success, failure, or outside events)
    - The incongruity between reality as it actually is and reality as it is assumed to be or as it ought to be
    - Innovation based on process need
    - Changes in industry structure or market structure that catch everyone unawares
- Externally Focused

    - Demographics (population changes)
    - Changes in perception, mood, and meaning
    - New knowledge, both scientific and nonscientific

Mitchell

One of the components of Mitchell's (2000) New Venture Template™ asks whether the venture being examined represents a new combination. To determine this, he suggests considering two categories of entrepreneurial discovery: *scientific discovery* and *circumstance*.

- Scientific Discovery
    - Physical/technological insight
    - New and valuable way
- Circumstantial Discovery
    - Specific knowledge of time, place, or circumstance
    - When and what you know

The second set of variables to consider are the market imperfections that can create profit opportunities: *excess demand* and *excess supply*. This gives rise to the following four types of entrepreneurial discovery.

- Invention I
    - Uses science to exploit excess demand (a market imperfection)
    - Becomes an opportunity to discover and apply the laws of nature to satisfy excess demand
    - Inventions in one industry have ripple effects in others
    - Example: invention of airplane
- Observation
    - Circumstances reveal opportunity to exploit excess demand (a market imperfection)
    - Not necessarily science-oriented
    - Example: airline industry = need for food service for passengers
- Invention II
    - Uses science to exploit excess supply (a market imperfection)
    - Example: Second most abundant element on earth after oxygen = silicon microchips
- Coordination
    - Circumstances reveals opportunity to exploit excess supply (a market imperfection)
    - Example: Producer's capacities to lower prices = Wal-Mart

Schumpeter

Schumpeter's (1934) five kinds of new combinations (see page 13) can occur within each of the four kinds of entrepreneurial discovery (Mitchell, 2000):

- New or improved good/service
  - Distinction between true advances and promotional differences
- New method of production
  - Example: assembly line method to automobile production, robotics, agricultural processing
- Opening of a new market
  - Global context: Culture, laws, local buyer preferences, business practices, customs, communication, transportation all set up new distribution channels
  - Example: Honda created a new market for smaller modestly powered motorbikes
- Conquest of a new source of supply of raw materials
  - Enhance availability of products by providing at lower cost
  - Enhance availability by making more available without compromising quality
- Reorganization of an industry

Murphy

Murphy (2011) claimed that there was a single-dimensional logic that oversimplified the approach taken to understand entrepreneurial discovery. He was bothered by the notion that entrepreneurs either deliberately searched for entrepreneurial opportunities or they serendipitously discovered them. Murphy's (2011) multidimensional model of entrepreneurial discovery suggests that opportunities may be identified (a) through a purposeful search; (b) because others provide the opportunity to the entrepreneur; (c) through prior knowledge, entrepreneurial alertness, and means other than a purposeful search; and, (d) through a combination of lucky happenstance and deliberate searching for opportunities.

Vesper

> According to experimentation research, entrepreneurial creativity is not correlated with IQ (people with high IQs can be unsuccessful in business and those with lower IQs can be successful as an entrepreneur). Research has also shown that those who practice idea generation techniques can become more creative. The best ideas sometimes come later in the idea-generation process—often in the days and weeks following the application of the idea-generating processes (Vesper, 1996).

Vesper (1996) identified several ways in which entrepreneurs found ideas:

- Prior job

- Recreation
- Chance event
- Answering discovery questions

> Although would-be entrepreneurs usually don't discover ideas by a deliberate searching strategy (except when pursuing acquisitions of ongoing firms), it is nevertheless possible to impute to their discoveries some implicit searching patterns. (Vesper, 1996, p. 60)

Vesper (1996) categorized discovery questions as follows:

- *Search questions*, which might prompt venture ideas by placing one's mind into a mode where the subconscious will work to push ideas into the conscious mind
    - What is bothering me and what might relieve that bother?
    - How could this be made or done differently that it is now?
    - What else might I like to have?
    - How can I fall the family tradition?
- *Questions based on encounters* with a potential customer request, someone else's idea, or another event
    - Can I play some role in providing this product or service to a broader market?
    - Could there be a way to do this better for the customer?
- *Questions based on evaluative reactions* to ideas
    - Could I do this job on my own instead of as an employee?
    - If people elsewhere went for this idea, might they want it here too?

Vesper (1996) also highlighted several *mental blocks to departure*. He suggested that generating innovative ideas involved two tasks: to depart from what is usual or customary and to apply an effective way to direct this departure. The mental blocks in the way of departure include the following:

- Perceptual blocks
    - difficulty viewing things from different perspectives
    - seeing only what you expect to see or think what others expect you to see
- Emotional blocks
    - intolerance of ambiguity
    - preference for judging rather than seeking ideas
    - tunnel vision
    - insufficient patience

- Cultural blocks
    - a belief that reason and logic are superior to feeling, intuition, and other such approaches
    - thinking that tradition is preferable to change
    - disdain for fantasy, reflection, idea playfulness, humor
- Imagination blocks
    - fear of subconscious thinking
    - inhibition about some areas of imagination
- Environmental blocks
    - distrust of others who might be able to help
    - distractions
    - discouraging responses from other people
- Intellectual blocks
    - lack of information
    - incorrect information
    - weak technical skills in areas such as financial analysis
- Expressive blocks
    - poor writing skills
    - inability to construct prototypes

Understanding these mental blocks to departure is a first step in figuring out how to cope with them. Some tactics for departure include the following (Vesper, 1996):

- Trying different ways of looking at and thinking about venture opportunities
- Trying to continually generate ideas about opportunities and how to exploit them
- Seeking clues from business and personal contacts, trade shows, technology licensing offices, and other sources
- Not being discouraged by others' negative views because many successful innovations were first thought to be impossible to make
- Generating possible solutions to obstacles before stating negative views about them
- Using idea generating tricks like
    - Brainstorming
    - Considering multiple consequences of possible future events or changes
    - Rearranging, reversing, expanding, shrinking, combining, or altering ideas

- Developing scenarios

Design Thinking

> Design thinking is a human-centered approach to innovation that draws from the designer's toolkit to integrate the needs of people, the possibilities of technology, and the requirements for business success – Tim Brown, president and CEO (IDEO, 2015, para. 5)

The Hasso Plattner Institute of Design at Stanford University, called the d.school (http://dschool.stanford.edu/), is an acknowledged leader at promoting design thinking. You can download the *Bootcamp Bootleg* manual from the d.school website at https://dschool.stanford.edu/resources/the-bootcamp-bootleg. The following description of design thinking is from the IDEO website:

> Design thinking is a deeply human process that taps into abilities we all have but get overlooked by more conventional problem-solving practices. It relies on our ability to be intuitive, to recognize patterns, to construct ideas that are emotionally meaningful as well as functional, and to express ourselves through means beyond words or symbols. Nobody wants to run an organization on feeling, intuition, and inspiration, but an over-reliance on the rational and the analytical can be just as risky. Design thinking provides an integrated third way.
>
> The design thinking process is best thought of as a system of overlapping spaces rather than a sequence of orderly steps. There are three spaces to keep in mind: *inspiration*, *ideation*, and *implementation*. Inspiration is the problem or opportunity that motivates the search for solutions. Ideation is the process of generating, developing, and testing ideas. Implementation is the path that leads from the project stage into people's lives (IDEO, 2015, para. 7-8).

Chapter 3 – Evaluating Entrepreneurial Opportunities

> *Since idea generation and screening are relatively less costly stages in the new product development process (in terms of investment in funds, time, personnel, and escalation of commitment), it makes sense to manage the process in the most efficient and effective manner for the organization. – Rochford (1991, p. 287)*
>
> *The most serious mistakes are not being made as a result of wrong answers. The truly dangerous thing is asking the wrong question. – Peter Drucker*
>
> *I have no data yet. It is a capital mistake to theorize before one has data. Insensibly one begins to twist facts to suit theories, instead of theories to suit facts. – Arthur Conan Doyle*

Learning Objectives

After completing this chapter you will be able to

- Apply analytical skills to assess how the nature of entrepreneurial environment can influence entrepreneurial outcomes
- Apply the right tools to analyze each of the societal, industry, market, and firm levels to evaluate entrepreneurial and other business opportunities

Overview

This chapter introduces the idea that there are different types of economies while providing examples of ways to consider how economies can differ. It also introduces the distinct levels of analyses that must be considered while stressing the importance of applying the appropriate tools to conduct the analyses at each level.

Types of Economies

When studying entrepreneurship, it is important to understand the foundations upon which the area of study stands. One way to do this is to consider perspectives on different kinds of economies. In the next sections we will consider two such perspectives. The first describes the idea of the bazaar, firm, and new economies, and the second examines the idea of the sharing economy.

Bazaar, Firm, and New Economies

Entrepreneurship has existed as long as individuals have specialized in the production of a good or service to exchange with other individuals for products they needed, but did not produce themselves. Dana, Etemad, and Wright (2008) distinguished between *bazaar-type economies*, *firm-type economies*, and *the new economy*.

The Bazaar-Type Economy

> The *Bazaar-type Economy* is a social, cultural and economic system in which the physical clustering of vendors facilitates the consumer's comparative information search, by eliminating displacement time. Business is strongly affected by relationships and networks; relationships and preferential treatment are integral to business. Consumers are not treated equally. Different people pay unlike prices. The price paid and the level of service provided is a function of status and relationships. Products and services are personalised, and this leads to customer loyalty. (Dana et al., 2008, p. 110-111)

Bazaars have been around for thousands of years and, as Dana et al. (2008) note, have several distinctive features:

- It is a way of life, a cultural and social system.
- Although it is a mode for commercial activity, relationships and alliances are the focus of the activities, not the financial transactions.
- The lowest price and the best quality are less important to purchasers because they often consider the vendor as a friend they wish to help and someone who will help them in return.
- Buyers and sellers seek to maintain long-term relationships with each other; there is little or no concern with maximizing profits.
- Vendors do not consider other vendors to be rivals and there is little interest or advantage in differentiating the products offered from those sold by others.
- Prices are established through negotiation, with buyers often making the first offer of a price. Competitive tensions are between buyers and sellers rather than between sellers.
- Once relationships are established (which reduces transaction costs), both buyers and sellers tend to have high degrees of satisfaction with the transactions.

The Firm-Type Economy

> The *Firm-type Economy* is an economic institution in which location is a competitive advantage. In the shopping mall, for instance, an exclusivity clause protects the vendor, limiting competition. The consumer's comparative information search involves displacement time, and an opportunity cost is involved when seeking perfect information. Business takes place primarily within a set of impersonally defined institutions. The flow of commerce is a function of strategy based on optimisation models. The purpose of transactions is to maximise wealth efficiently, and the means to this is rational and unbiased decision-making that treats buyers as equals. The price paid and the level of service provided is established by the seller. Products and services are standardised, and this leads to efficiency that in turn allows competitive pricing. (Dana et al., 2008, p. 111)

In Canada, we are more familiar with the firm-type economy. Dana et al. (2008) highlighted the following differences between it and the bazaar.

- Firm-consumer transactions are impersonal. The focus is on the interaction between the buyer and the product rather than between the buyer and seller. Product attributes are considered to be important. Relationships between buyers and sellers are trivial and secondary as compared to the transaction itself.
- Firms engage in transactions while attempting to maximize profits through rational decision-making.
- Competition is between sellers who attempt to segment the market based on types of consumers.
- Sellers generally set prices consumers are expected to accept and pay.
- The premise is that firms treat all customers equally.

The New Economy

> The New Economy is a cultural and economic system in which the virtual clustering of vendors facilitates the consumer's comparative information search, by eliminating displacement time. The flow of commerce is strongly affected by relationships and networks; relationships and preferential treatment are integral to business. Consumers are not treated equally. Different people pay unlike prices. The price paid and the level of service provided is a function of status and relationships. Products and services are customized. (Dana et al., 2008, p. 111)

Dana et al. (2008) have observed the following norms they claim are currently in place or are developing:

- Firms no longer treat all consumers equally. Some customers receive special promotional offers, preferential treatment, and other benefits over other customers.
- Differentiation is less evident than it used to be.
- The focus has shifted (back) toward establishing relationships with consumers. Different prices are charged depending upon the nature of the relationship the firm has with the customer.
- There is now less competition than before with former rivals now cooperating through networks and

global alliances.

- The internet has become a medium through which transactions occur, reducing searching costs for consumers and, in some cases, inventory handling and production costs for firms. In some cases, consumers suggest the starting price in a negotiation process.
- In many ways, this new "reality is shared with the *Bazaar-type Economy*—a social and cultural system, a way of life and a general mode of commercial activity such that most of the flow of commerce is centred on *relationships*" (Dana et al., 2008, p. 115).

The Sharing Economy – Collaborative Consumption

One trend that has become more prominent of late, perhaps because new information technologies have enabled new developments in this area, involves individuals and businesses seeking new ways to share underutilized resources and develop new business models that focus on selling the use of something rather than selling the item itself. This arises from the desire to generate value from items that are not being used to their full potential by their owners: "Instead of buying and owning products, consumers are increasingly interested in leasing and sharing them. Companies can benefit from the trend toward 'collaborative consumption' through creative new approaches to defining and distributing their offerings" (Matzler, Veider, & Kathan, 2015).

For instance, when people have space available in their houses and wish to generate revenue from that unused or underused area, they can use Airbnb Inc. (https://www.airbnb.com/) to rent rooms. The Airbnb business model is interesting in that it facilitates the rental of spaces that it does not own. The service essentially created a new supply of accommodations for travelers in addition to the traditional hotel, motel, and bed and breakfast providers.

Uber (https://uber.com) provides people who have both a vehicle and available time with the opportunity to turn those resources into revenue by providing rides to people who need them.

Saskatoon CarShare Co-operative (http://saskatooncarshare.com/) purchases cars that its members can book online at any time. It attracts people who only need vehicles occasionally, like when they have to get groceries or run other errands:

> *It's a win for you because you save money by not having to own a car.*
>
> Being a CarShare member helps you save money. A typical car-owner spends an average of $6,400 per year. That comes out to about $533 per month or $17.64/day to maintain and operate an efficient vehicle (e.g. Honda Civic). By making simple changes to integrate walking, biking, busing and CarSharing into your traveling habits you can save some serious cash. That means you can invest your money in other things, even a down payment for a home!
>
> *It is a win for the environment, the city of Saskatoon and your community.*
>
> For every CarShare vehicle out there, another five cars are taken off the road. That means fewer vehicles need to be driven, fuelled and maintained. Besides, less vehicles on the road also means less traffic on our streets. Now there's something City Hall can get behind! (Saskatoon CarShare Co-operative, 2015)

The transaction costs—in terms of money and time—used to be very high when someone who needed something had to find a way to connect with someone else who could provide that something, and vice versa. Those transaction costs have plummeted because of the internet, and entrepreneurs are developing new methods for making unused or underused resources available to people who want them. This has formed the basis for the sharing economy.

Matzler et al. (2015) identified six ways that companies could benefit by engaging in the sharing economy:

1. Sell the use of a product rather than ownership of it.
    - For instance, Nova Rentals, tool and equipment rental company located in Mississauga, Ontario, rents tool and equipment for construction, landscaping, renovations, and contractors. Their customers range from large construction companies to small contractors, service businesses, and homeowners. (NOVA Rentals, 2015).
2. Provide customers with the opportunity to resell products they purchased.
    - Patagonia is an innovative outdoor apparel company operating under the mission to "build the best product, cause no unnecessary harm, use business to inspire and implement solutions to the environmental crisis" (Patagonia, 2015a). Although counter intuitive for many traditional business owners who strive to sell new or replacement products rather than promote less consumption, the company runs a program to "make it easy to buy, sell or trade Patagonia gear" (Patagonia, 2015b, Reuse & Recycle). They explicitly ask their customers to use the tools that Patagonia makes available to "decrease the environmental impact of their stuff over time by repairing it, finding ways to reuse it, recycling it when it's truly ready. By buying only what they need, customers can reduce their overall consumption in the long run" (Patagonia, 2015b, para. 10). In the past, Patagonia has even partnered with companies like eBay to encourage its customers to resell used Patagonia products rather than throw them out (PR Newswire, 2011).
3. By exploiting unused resources and capacities
    - Airbnb essentially takes advantage of unused space to generate revenues for homeowners. An example of exploiting unused capabilities is when homeowners who generate more energy than they need through solar, wind, and other means can sell the excess back to the electricity companies.
4. By providing repair and maintenance services.
    - Companies like Patagonia supply repair services or make it easy for customers to repair their own apparel so that fewer new products need to be produced and less is thrown away.
5. By using collaborative consumption to target new customers.

- Wolf Willow Cohousing organized in “January 2008 to explore the possibility of creating a cohousing community in Saskatoon” (Smillie, 2015, para. 1). The idea was to attract a group of like-minded older adults who would collectively develop—with the aid of project manager, architect, and construction professionals—a unique condominium housing initiative with self-contained living units and common spaces. In 2012, the 21-unit, four-level, environmentally-conscious, energy-efficient cohousing building located in a central area of Saskatoon opened with unique in-door and outdoor common areas designed specifically for the residents who were involved with designing the facility.
- The Canadian Cohousing Network (Network, 2015) provides a list of “architects, developers, facilitators, development consultants, marketers, trainers, and others” (para. 1) who can deliver services for groups wishing to develop cohousing projects.

6. By developing entirely new business models enabled by collaborative consumption
    - New business models, including those supporting the businesses and business types listed above, have emerged to take advantage of the current trend toward collaborative consumption.

Levels of Analyses

When evaluating entrepreneurial opportunities—sometimes called *idea screening*—an effective process involves assessing the various venture ideas being considered by applying different levels and types of analyses. Entrepreneurs starting ventures and running existing businesses should also regularly analyze their operating environments at the societal, industry, market, and firm-levels. The right tools, though, must be applied at each level of analysis (see Figure 5). It is critical to complete an *Essential Initial Research* at all four levels (societal, industry, market, and firm). The initial scan should be high-level, designed to assist in making key decisions (i.e. determining if there is a viable market opportunity for the venture). Secondary scans should be continuously conducted to support each part of the business plan (i.e. operations, marketing, finance). However, information should only be included if it is research-based, relevant, and value-adding. The results from such research (i.e. the Bank of Canada indicates that interest rates will be increasing in the next two years) should support business strategies within the plan (i.e. debt financing may be less favourable than equity financing). Often, obtaining support data (i.e. construction quotes) is not immediate, so plant a flag and move forward. Useful resources may include information from Statistics Canada, Bank of Canada, IBIS World Report, etc.

Societal Level

At a societal level, it is important to understand each of the political, economic, social, technological, environmental, and legal (PESTEL) factors—and, more specifically, the trends affecting those factors—that will have an impact on a venture based on a particular idea. Some venture ideas might be screened-out and others might be worth pursuing at a particular time because of the trends occurring with those PESTEL factors. Avoid the use of technical jargon that may distract readers (i.e. rivalry among firms) and use simpler language (i.e. competitive environment).

Industry Level

Apply Porter's (1985) Five Forces Model, or a similar tool designed to assess industry-level factors. This analysis will focus more specifically on the sector of the economy in which you intend to operate. Again, the right analysis tool must be used for the assessment to be effective and avoid technical jargon (i.e. threat of new entrants) and use simpler wording (i.e. difficulty of entering the market) or flip to an analysis of the threat (i.e. strategies to establish and maintain market share).

Market Level

At the market level, use a tool to generate information about the part of the industry in which your business will compete. This tool might be in the form of a set of questions designed to uncover information that you need to know to help develop plans to improve the success of your proposed venture.

Firm Level

At a firm level, both the internal organizational trends and the external market profile trends should both be analyzed. There are several tools for conducting an internal organizational analysis, and normally you should normally apply several of them.

Analyzing the Trends at Each Level

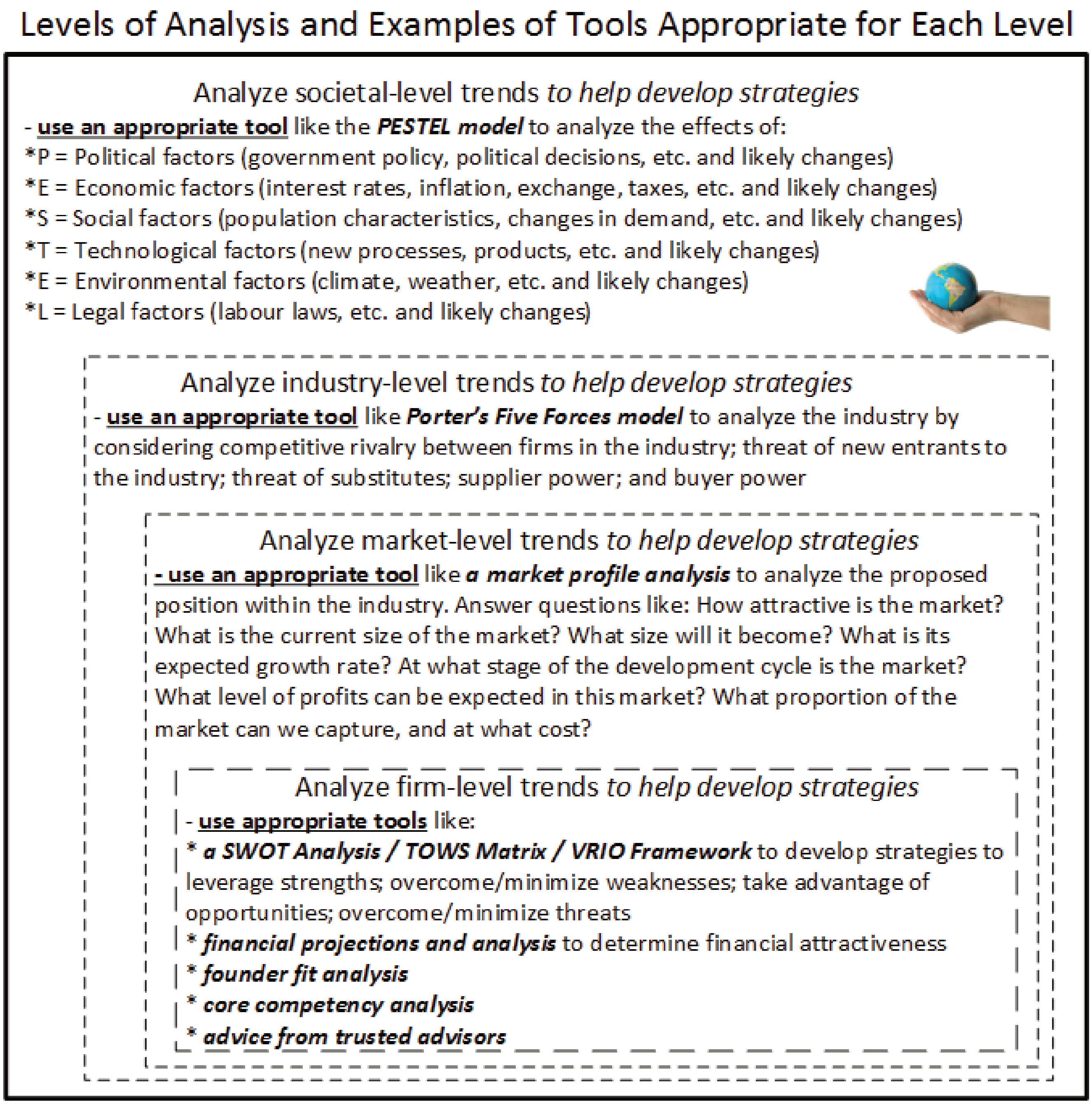


Figure 2 – Different Levels of Analysis (Illustration by Lee A. Swanson)

Analyze Societal-Level Trends

- Use an appropriate tool like the PESTEL model to assess both the current situation and the likely changes as they may affect you.
    - Political factors — federal & provincial & municipal government policy, nature of political

decisions, potential political changes, infrastructure plans, etc.

  - Economic factors — interest rates, inflation rates, exchange rates, tax rates, GDP growth, health of the economy, etc.
  - Social factors —population characteristics like age distribution and education levels, changes in demand for types of products and services, etc.
  - Technological factors — new processes, new products, infrastructure, etc.
  - Environmental factors — effects of climate/weather, water availability, smog and pollution issues, etc.
  - Legal factors — labour laws, minimum wage rates, liability issues, etc.
- Assess the impact these trends have upon the venture:
  - Do the trends uncover opportunities and threats?
  - Can opportunities be capitalized on?
  - Can problems be mitigated?
  - Can the venture be sustained?

Analyze Industry-Level Trends

- Use an appropriate tool like the Five Forces Model (Porter, 1985) to analyze the industry in which you expect to operate.
  - Horizontal relationships — threat of substitutes, rivalry among existing competitors, threat of new entrants
  - Vertical Relationships — bargaining power of buyers, bargaining power of suppliers

Analyze Market-Level Trends

- Use an appropriate method like a market profile analysis to assess the position within the industry in which you expect to operate.
  - Determine the answers to questions like the following:
    - How attractive is the market?
    - In what way are competitors expected to respond if you enter the market?
    - What is the current size of the market and how large is it expected to be?
    - What are the current and projected growth rates?
    - At what stage of the development cycle is the market?
    - What level of profits can be expected in the market?

- What proportion of the market can be captured? What will be the cost to capture this proportion and what is the cost to capture the proportion required for business sustainability?

Prior to a new business start-up, the customers that the new business wishes to attract either already purchase the product or service from a competitor to the new business—or they do not yet purchase the product or service at all. A new venture's customers, therefore, must come from one of two sources: they must a) be attracted away from existing (direct) competitors or b) be convinced to make different choices about where they spend their money so they purchase the new venture's product or service instead of spending their money in other ways (with indirect competitors). An entrepreneur must decide from which source they will attract their customers, and how they will do so. They must understand the competitive environment.

According to Porter (1996), strategy is about doing different things than competitors or doing similar things but in different ways. To develop an effective strategy, an entrepreneur must understand the competition.

To understanding the competitive environment, entrepreneurs must do the following:

- determine who their current direct and indirect competitors are and who the future competitors will be
- understand the similarities and differences in quality, price, competitive advantages, and other factors their proposed business and the existing competitors
- establish whether they can offer different products or services—or the same products or services in different ways—to attract enough customers to meet their goals
- anticipate how the competitors will react in response to the new venture's entry into the market

Analyze Firm-level Trends (organizational analysis)

There are several tools available for firm-level analysis, and usually several of them should be applied because they serve different purposes.

- Use an appropriate tool like a SWOT Analysis/TOWS Matrix to formulate and evaluate potential strategies to leverage organizational strengths, overcome/minimize weaknesses, take advantage of opportunities, and overcome/minimize threats. You will also need to do a financial analysis and take into account the founder fit and the competencies a venture should possess.
  - SWOT analysis — identify organizational strengths and weaknesses and external opportunities and threats
  - TOWS matrix — develop strategies to:
    - leverage strengths to take advantage of opportunities
    - leverage strengths to overcome threats
    - mitigate weaknesses by taking advantage of opportunities

    - mitigate weaknesses while minimizing the potential threats or the potential outcomes from threats

For analyzing a firm's strategy, apply a VRIO Framework analysis.

- While conceptualizing the resource-based view (RBV) of the firm, Barney (1997) and Barney and Hesterly (2006) identified the following four considerations regarding resources and their ability to help a firm gain a competitive advantage. Together, the following four questions make up the VRIO Framework, which can help assess a firm's capacity, determine what competencies a venture should have, and determine whether competences are valuable, rare, inimitable, and exploitable.
    - Value ─ Is a particular resource (financial, physical, technological, organizational, human, reputational, innovative) valuable to a firm because it helps it take advantage of opportunities or eliminate threats?
    - Rarity ─ Is a particular resource rare in that it is controlled by or available to relatively few others?
    - Imitability ─ Is a particular resource difficult to imitate so that those who have it can retain cost advantages over those who might try to obtain or duplicate it?
    - Organization ─ Are the resources available to a firm useful to it because it is organized and ready to exploit them?

Assess the financial attractiveness of the venture:

- Analyze similar firms in industry.
    - Comparative ratio and financial analysis (see Vesper, 1996, p. 145-148) can help determine industry norm returns, turnover ratios, working capital, operating efficiency, and other measures of firm success.
- Project market share.
    - Analyze the key industry players' relative market share, and make judgments about how the proposed venture would fare within the industry.
    - Use information from market profile analysis and key industry player analysis.
- Analyze Expected Margins.
    - Involves projecting expected margins from venture
    - Useful information might come from financial analysis, market profile analysis, and NAICS (North American Industry Classification System) codes (six digit codes used to identify an industry──first five digits are standardized in Canada, the United States, and Mexico──is gradually replacing the four digit SIC (Standard Industrial Classification) codes)
- Analyze break-even point.

    - Involves using information from margin analysis to determine break even volume and break-even sales in dollars
    - Is there sufficient volume to sustain the venture?
- Analyze Pro forma.
    - Forecasting income and assets required to generate profits
- Analyze Sensitivity.
    - What will be the likely impact if some assumed variable values change?
- Project Return on Investments (ROI).
    - Projecting the ROI from undertaking the venture
    - What is the opportunity cost of undertaking the venture?

Founder fit is an important consideration for entrepreneurs screening venture opportunities. While there are plenty of examples of entrepreneurs successfully starting all types of businesses, “technical capability can be an important if not all-important factor in pursuing ventures success” (Vesper, 1996, p. 149). Factors such as the experience, training, credentials, reputation, and social capital an entrepreneur has can play an important role in their success or failure in starting a new venture. Even when an entrepreneur can recruit expert help through business partners or employees, they may also need to possess technical skills required in that particular kind of business.

A common and useful way to help screen venture options is to seek input from experts, peers, mentors, business associates, and perhaps other stakeholders like potential customers and direct family members.

Chapter 4 – Business Models

> *A startup is a temporary organization in search of a scalable, repeatable, profitable business model. – Blank and Dorf (2012, p. xvii)*
>
> *Today countless innovative business models are emerging. Entirely new industries are forming as old ones crumble. Upstarts are challenging the old guard, some of whom are struggling feverishly to reinvent themselves.*
>
> *How do you image your organization's business model might look two, five, or ten years from now? Will you be among the dominant players? Will you face competitors brandishing formidable new business models? – Osterwalder, Pigneur, and Clark (2010, p. 4)*

Learning Objectives

After completing this chapter you will be able to

- Describe what a business model is
- Analyse existing and proposed businesses to determine what business models they are applying and what business models they plan to apply
- Develop and analyze alternative business models for new entrepreneurial ventures

Overview

In this chapter, the concept of the business model is introduced. One concept of the business model in particular, the Business Model Canvas, is explored as a way to conceptualize and categorize elements of a business model.

What are Business Models?

Magretta (2002) described business models as "stories that explain how enterprises work" (p. 87) and Osterwalder, et al. (2010) said that they describe "the rationale of how an organization creates, delivers, and captures value" (p. 14). Chatterjee (2013) said that "A business is about selling what you make for a profit. A business model is a configuration (activity systems) of what the business does (activities) and what it invests in (resources) based on the logic that drives the profits for a specific business" (p. 97).

The Business Model Canvas

The Business Model Canvas tool is based on the premise that a start-up is something quite different than an ongoing venture. A start-up should not be viewed as a smaller version of a company because starting-up a company requires very different skills than operating one does. A start-up that is still a start-up after some time—maybe after a couple of years for some kinds of start-ups—is actually a failed enterprise since it hasn't converted into an ongoing venture (Osterwalder et al., 2010).

The business model canvas is made up of nine parts that, together, end up describing the business model.

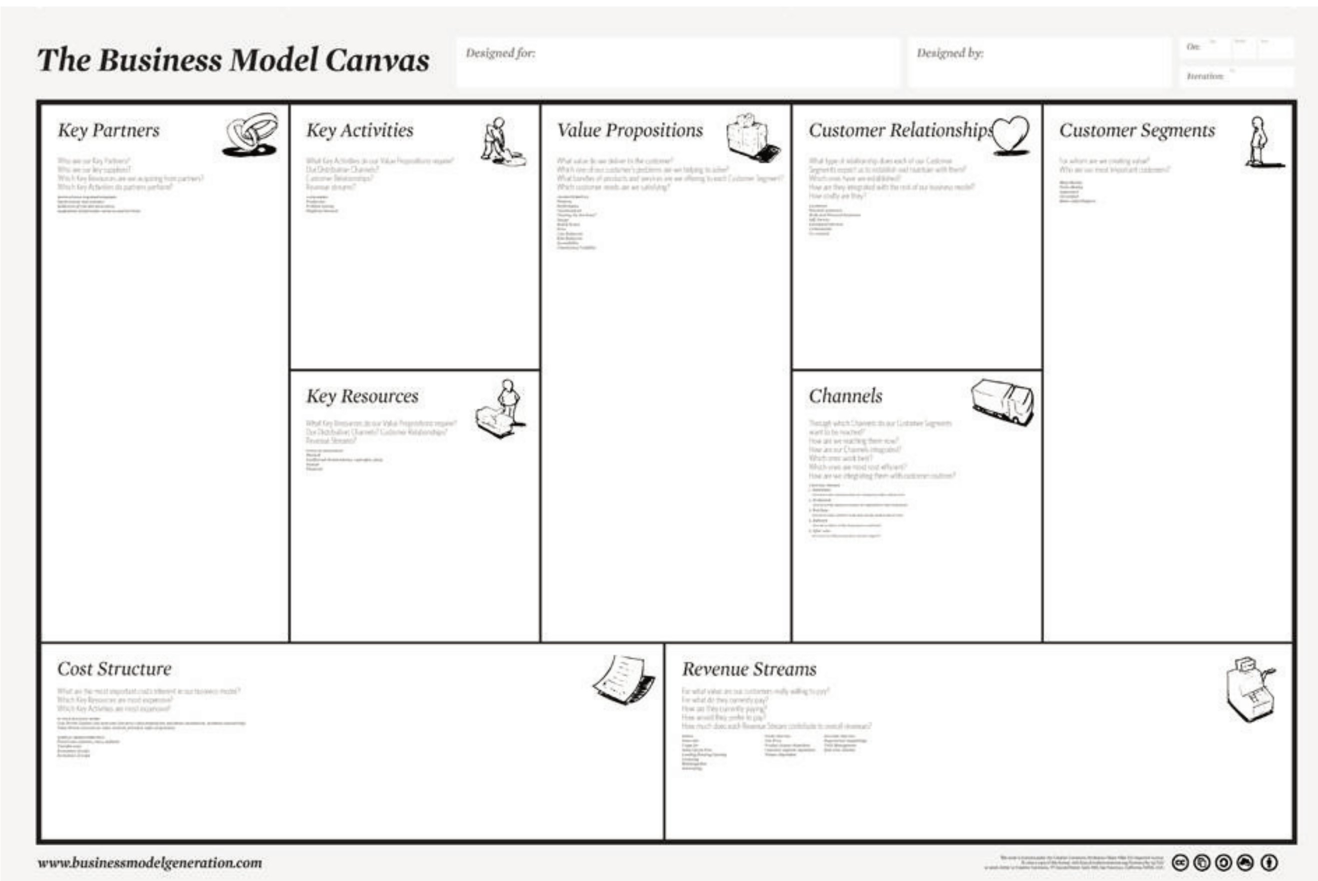


Figure 3 – Business Model Canvas from http://www.businessmodelgeneration.com (Designed by: Strategyzer AG, strategyzer.com, Creative Commons Attribution-Share Alike 3.0 Unported License)

The following elements of the Business Model Canvas were taken, with permission, from http://www.businessmodelgeneration.com.

- Key partners
    - Who are our key partners?
    - Who are our key suppliers?
    - Which key resources are we acquiring from partners?
    - Which key activities do partners perform?
    - Motivations for partnerships: optimization and economy; reduction of risk and uncertainty; acquisition of particular resources and activities
- Key activities
    - What key activities do our value propositions require?
    - Our distribution channels?
    - Customer relationships?
    - Revenue streams?
    - Categories: production; problem-solving; platform/network
- Key resources
    - What key resources do our value propositions require?
    - Our distribution channels?
    - Customer relationships?
    - Revenue streams?
    - Types of resources: physical; intellectual (brand patents, copyrights, data); human; financial
- Value propositions
    - What value do we deliver to the customer?
    - Which one of our customer's problems are we helping to solve?
    - What bundles of products and services are we offering to each customer segment?
    - Which customer needs are we satisfying?
    - Characteristics: newness; performance; customization; "getting the job done"; design; brand/status; price; cost reduction; risk reduction; accessibility; convenience/usability
- Customer relationships
    - What type of relationship does each of our customer segments expect us to establish and maintain with them?
    - Which ones have we established?
    - How are they integrated with the rest of our business model?

    - How costly are they?
    - Examples: personal assistance; dedicated personal assistance; self-service; automated services; communities; co-creation
- Customer segments
    - For whom are we creating value?
    - Who are our most important customers?
    - Mass market; niche market; segmented; diversified; multi-sided platform.
- Channels
    - Through which channels do our customer segments want to be reached?
    - How are we reaching them now?
    - How are our channels integrated?
    - Which ones work best?
    - Which ones are most cost-efficient?
    - How are we integrating them with customer routines?
    - Channel phases:
        - Awareness – How do we raise awareness about our company's products and services?
        - Evaluation – How do we help customers evaluate our organization's value proposition?
        - Purchase – How do we allow customers to purchase specific products and services?
        - Delivery – How do we deliver a value proposition to customers?
        - After sales – How do we provide post-purchase customer support?
- Revenue streams
    - For what value are our customers really willing to pay?
    - For what do they currently pay?
    - How are they currently paying?
    - How would they prefer to pay?
    - How much does each revenue stream contribute to overall revenues?
    - Types: asset sale; usage fee; subscription fees; lending/renting/leasing; licensing; brokerage fees; advertising
    - Fixed pricing: list price; product feature dependent; customer segment dependent; volume

dependent

  - Dynamic pricing: negotiation (bargaining); yield management; real-time-market

- Cost structure
  - What are the most important costs inherent in our business model?
  - Which key resources are most expensive?
  - Which key activities are most expensive?
  - Is your business more: cost driven (leanest cost structure, low price value proposition, maximum automation, extensive outsourcing); value driven (focused on value creation, premium value proposition).
  - Sample characteristics: fixed costs (salaries, rents, utilities); variable costs; economies of scale; economies of scope

The idea is to keep adding descriptions or plans to the nine components to create the initial business model and then to actually do the start-up activities and replace the initial assumptions in each of the nine parts with newer and better information or plans to let the business model evolve. This model is partly based on the idea that the owner should be the one interacting with potential customers so he or she fully understands what these potential customers want. These interactions should not only be done by hired sales people, at least until the business model has evolved into one that works, which can only happen when the venture owner is completely engaged with the potential customers and the other business operations (Osterwalder et al., 2010).

A business plan shouldn't be created until the above has been done because you need to know what your business model is before you can really create a business plan (Osterwalder et al., 2010). This seems to imply that the Business Model Canvas is best suited to technology-based and other types of companies that can be basically started and operated in some way that can later be converted into an ongoing venture. By starting operations and making adjustments as you go, you are actually doing a form of market research that can be compiled into a full business plan when one is needed.

According to Osterwalder, et al. (2010), the things we typically teach people in business school are geared to helping people survive in larger, ongoing businesses. What is taught—including organizational structures, reporting lines, managing sales teams, advertising, and similar topics—is not designed to help students understand how a start-up works and how to deal with the volatile nature of new ventures. The Business Model Canvas idea is meant to help us understand start-ups.

The Business Model Canvas tool is intended to be applied when business operations can be started on a small scale and adjustments can continually be made until the evolving business model ends up working in real life. This is in contrast to the more traditional approach of pre-planning everything and then going through the set-up and start-up processes and ending up with a business venture that opens for business one day without having proven at all that the business model it is founded upon will even work. These traditional start-ups sometimes flounder along as the owners find that their plans are not quite working out and they try to make adjustments on the fly. It can be difficult to make adjustments at this time because the processes are already set up. For example, sales teams might be in the field trying to make sales and blaming the product developers for the difficulty they are having, and the product developers might be blaming the sales teams for not being able to sell the product properly. The real issue might be that the company simply isn't meeting customers' needs and they don't have any good mechanism for detecting and understanding and fixing this problem.

Lean Start-up

Consistent with the Business Model Canvas approach, Ries (2011) advanced the idea of the lean start-up. His definition of a startup is "a human institution designed to create a new product or service under conditions of extreme uncertainty" (p. 27), and the lean start-up approach involves releasing a *minimal viable product* to customers with the expectation that this early prototype will change and evolve frequently and quickly in response to customer feedback. This is meant to be a relatively easy and inexpensive way to develop a product or service by relying on customer feedback to guide the pivots in new directions that will ultimately—and relatively quickly—lead to a product or service that will have the appeal required for business success. It is only then that the actual business can truly emerge.

Ries's (2011) five lean start-up principles start with the idea that entrepreneurs are everywhere and that anyone working in an environment where they seek to create new products or services "under conditions of extreme uncertainty" (27) can use the lean start-up approach. Second, a start-up is more than the product or service; it is an institution that must be managed in a new way that promotes growth through innovation. Third, startups are about learning "how to build a sustainable business" (p. 8-9) by validating product or service design through frequent prototyping that allows entrepreneurs to test the concepts. Forth, startups must follow this process or feedback loop: create products and services; measure how the market reacts to them; and learn from that reaction to determine whether to pivot or to persevere with an outcome the market accepts. Finally, Ries (2011) suggested that entrepreneurial outcomes and innovation initiatives need to be measured through innovative accounting.

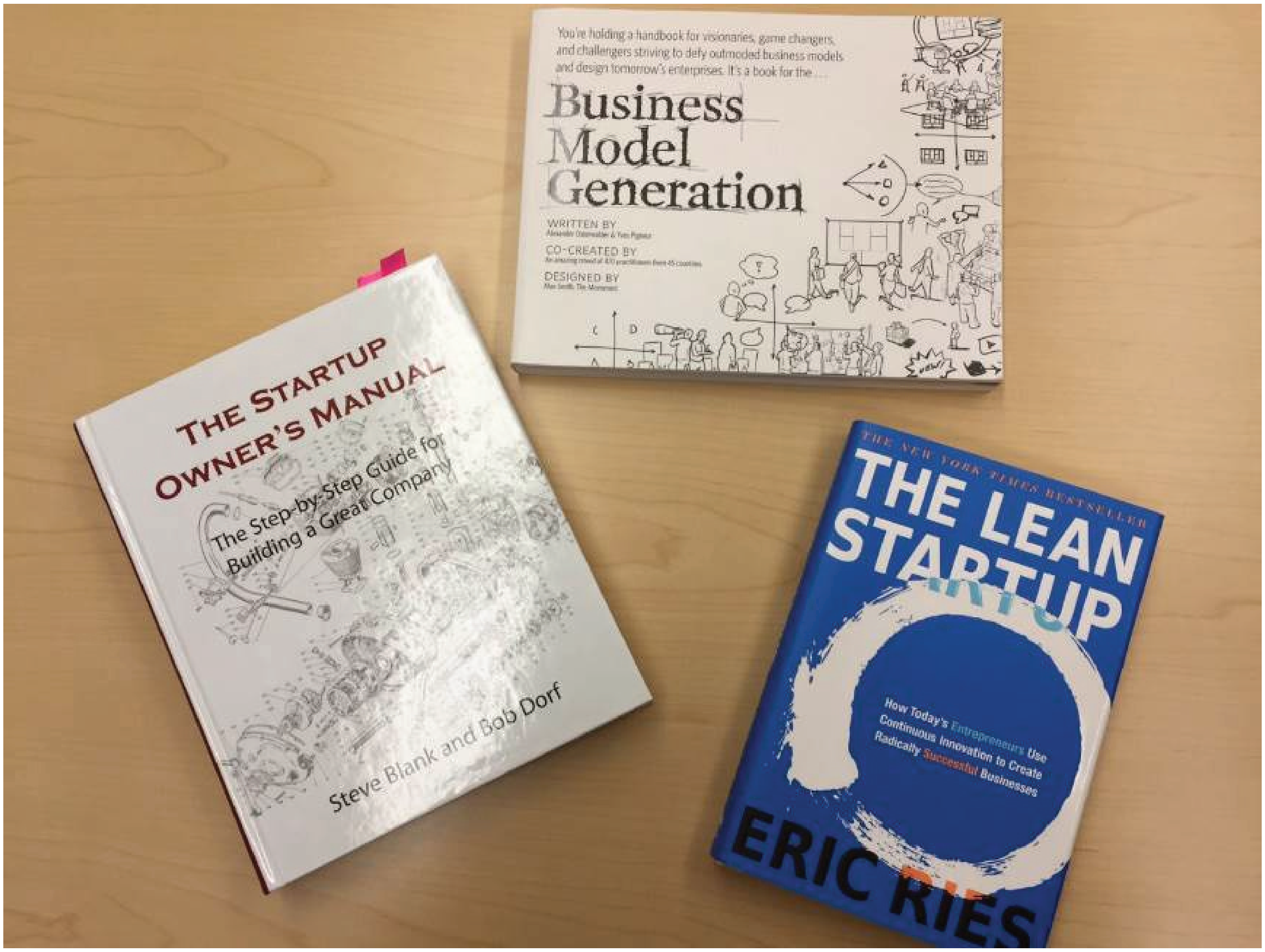


Figure 4 – Business Model and Lean Start-up Books (Photo by Lee A. Swanson)

Growth Wheel

According to its website, GrowthWheel® (http://www.growthwheel.com/) is a decision-making tool for start-up and growth companies to help business advisers and entrepreneurs focus, set agendas, make decisions, and take action (GrowthWheel, 2015). It is effectively a more complex and detailed tool than the Business Model Canvas for describing a business model. A web search will yield a variety of tools, like the Business Model Canvas and the GrowthWheel®, that can be used to describe business models.

Franchises as Business Models

Franchises are basically business models developed by others (franchisors) that have been proven to work in multiple contexts and that are sold to entrepreneurs (franchisees) who will implement the business model in contexts that the franchisor believes will result in a successful enterprise. Franchises apply various business models. Some are *turnkey franchises*, like McDonald's, where the entire business structure is set up from the design of the stores to the supply system, and the franchisor sets up virtually everything for the new franchisee.

Other franchise models, like that defining Tap ‘N’ Pay Canada (http://www.tapnpay.ca/)—a business that provides debit and credit card machines and point of sale equipment—advertise relatively low fees charged to franchisees and quick set-ups in as little as two weeks (http://www.betheboss.ca/franchises/tap-n-pay).

Chapter 5 – Business Planning

Business planning is an important precursor to action in new ventures. By helping firm founders to make decisions, to balance resource supply and demand, and to turn abstract goals into concrete operational steps, business planning reduces the likelihood of venture disbanding and accelerates product development and venture organizing activity. – Delmar and Shane (2003, p. 1165)

We always plan too much and always think too little. We resent a call to thinking and hate unfamiliar argument that does not tally with what we already believe or would like to believe. – Joseph Schumpeter

Trying to predict the future is like trying to drive down a country road at night with no lights while looking out the back window. – Peter Drucker

Learning Objectives

After completing this chapter you will be able to

- Describe the purposes of business planning
- Describe common business planning principles
- List and explain the elements of the business plan development process outlined in this book
- Explain the purposes of each of the elements of the business plan development process outlined in this book
- Explain how applying the business plan development process outlined in this book can aid in developing a business plan that will meet entrepreneurs' goals
- Describe general business planning guidelines and format

Overview

This chapter describes the purposes of business planning, the general concepts related to business planning, and guidelines and a format for a comprehensive business plan.

Business Planning Purposes

Business plans are developed for both internal and external purposes. Internally, entrepreneurs develop business plans to help put the pieces of their business together. The most common external purpose for a business plan is to raise capital.

Internal Purposes

- The business plan is the road map for the development of the business because it
    - defines the vision for the company
    - establishes the company's strategy
    - describes how the strategy will be implemented
    - provides a framework for analysis of key issues
    - provides a plan for the development of the business
    - is a measurement and control tool
    - helps the entrepreneur to be realistic and to put theories to the test

External Purposes

The business plan is often the main method of describing a company to external audiences such as potential sources for financing and key personnel being recruited. It should assist outside parties to understand the current status of the company, its opportunities, and its needs for resources such as capital and personnel. It also provides the most complete source of information for valuation of the business.

Business Planning Principles

Business Plan Communication Principles

As Hindle and Mainprize (2006) note, business plan writers must strive to communicate their expectations about the nature of an uncertain future. However, the liabilities of newness make communicating the expected future of new ventures difficult (more so than for existing businesses). They outline five communications principles:

- Expectations
    - Translation of your vision of the venture and how it will perform into a format compatible with the expectations of the readers
    - Communicate that
        - you have identified and understood the key success factors and risks
        - the projected market is large and you expect good market penetration

        - you have a strategy for commercialization, profitability, and market domination
        - you can establish and protect a proprietary and competitive position
- Milestones
    - Anchoring key events in the plan with specific financial and quantitative values
    - Communicate that
        - your major plan objectives are in the form of financial targets
        - you have addressed the dual need for planning and flexibility
        - you understand the hazards of neglecting linkages between certain events
        - you understand the importance of quantitative values (rather than just chronological dates)
- Opportunities
    - Nothing lasts forever—things can change to impact the opportunity: tastes, preferences, technological innovation, competitive landscape
    - Communicate these four aspects to distinguish the business concept, distinctive competencies, and sustainable advantages:
        - the new combination upon which venture is built
        - magnitude of the opportunity or market size
        - market growth trends
        - venture's value from the market (% of market share proposed or market share value in dollars)
- Context
    - Four key aspects describing context within which new venture is intended to function (internal and external environment)
    - Communicate
        - how the context will help or hinder the proposal
        - how the context may change & affect the business & the range of flexibility or response that is built into the venture
        - what management can or will do in the event the context turns unfavourable
        - what management can do to affect the context in a positive way
- Business Model
    - Brief and clear statement of how an idea actually becomes a business that creates value
    - Communicate

        - Who pays, how much, and how often?
        - The activities the company must perform to produce its product, deliver it to its customers and earn revenue
        - And be able to defend assertions that the venture is attractive and sustainable and has a competitive edge

Business Plan Credibility Principles

Business plan writers must strive to project credibility (Hindle & Mainprize, 2006), so there must be a match between what the entrepreneurship team (resource seekers) needs and what the investors (resource providers) expect based on their criteria. A take it or leave it approach (i.e. financial forecasts set in concrete) by the entrepreneurship team has a high likelihood of failure in terms of securing resources. Hindle and Mainprize (2006) outline five principles to help entrepreneurs project credibility:

- Team
    - Without the right team, nothing else matters.
    - Communicate
        - What do they know?
        - Who do they know?
        - How well are they known?
- Elaboration
    - Break down individual tasks into their sub-parts so each step maximizes the upside and minimizes the downside:
        - sub-strategies
        - ad-hoc programs
        - specific tactical action plans
- Scenario Integration
    - Claiming an insuperable lead or a proprietary market position is naïve.
    - Venture building is like chess:
        - Anticipate several moves in advance
        - View the future as a movie vs. snapshot
- Financial Link
    - Key assumptions related to market size, penetration rates, and timing issues of market context outlined in the business plan should link directly to the financial statements.
    - Income and cash flow statements must be preceded by operational statements setting forth

    - the primary planning assumptions about market sizes, sales, productivity, and basis for the revenue estimate.
- The Deal
    - If the main purpose is to enact a harvest, then the business plan must create a value-adding deal structure to attract investors.
    - Common things: viability, profit potential, downside risk, likely life-cycle time, potential areas for dispute or improvement

General Business Plan Guidelines

Many businesses must have a business plan to achieve their goals. The following are some basic guidelines for business plan development.

- A standard format helps the reader understand that the entrepreneur has thought everything through, and that the returns justify the risk.
- Binding the document ensures that readers can easily go through it without it falling apart.
- Be 100% certain that
    - everything is completely integrated: the written part must say exactly the same thing as the financial part
    - all financial statements are completely linked and valid (make sure all balance sheets validly balance)
    - the document is well formatted (layout makes document easy to read and comprehend—including all diagrams, charts, statements, and other additions)
    - everything is correct (there are NO spelling, grammar, sentence structure, referencing, or calculation errors)
    - the document easy to read and comprehend because it is organized well with no unnecessary repetition
        - It is usually unnecessary—and even damaging—to state the same thing more than once. To avoid unnecessarily duplicating information, you should combine sections and reduce or eliminate duplication as much as possible.
    - all the necessary information is included to enable readers to understand everything in your document
    - the terms you use in your plan are clear
        - For example, if your plan says something like “there is a shortage of 100,000 units with competitors currently producing 25,000. We can help fill this huge gap in demand with our capacity to produce 5,000 units,” a reader is left completely

confused. Does this mean there is a total shortage of 100,000 units, but competitors are filling this gap by producing 25,000 per year (in which case there will only be a shortage for four years)? Or, is there an annual shortage of 100,000 units with only 25,000 being produced each year, in which case the total shortage is very high and is growing each year? You must always provide the complete perspective by indicating the appropriate time frame, currency, size, or another measurement.

    - if you use a percentage figure, you indicate to what it refers, otherwise the figure is completely useless to a reader.
    - if your plan includes an international element, which currencies the costs, revenues, prices, or other values are quoted in
        - This can be solved by indicating up-front in the document the currency in which all values will be quoted. Another option is to indicate each time which currency is being used, and sometimes you might want to indicate the value in more than one currency. Of course, you will need to assess the exchange rate risk to which you will be exposed and describe this in your document.
- credibility is both established and maintained
    - If a statement is included that presents something as a fact when this fact is not generally known, always indicate the source. Unsupported statements damage credibility
    - Be specific. A business plan is simply not of value if it uses vague references to high demand, carefully set prices, and other weak phrasing. It must show hard numbers (properly referenced, of course), actual prices, and real data acquired through proper research. This is the only way to ensure your plan is considered credible.

Developing a *High Power Business Plan*

The business plan development process described next has been extensively tested with entrepreneurship students and has proven to provide the guidance entrepreneurs need to develop a business plan appropriate for their needs; a *high power business plan*.

The Stages of Development

There are six stages involved with developing a *high power business plan*. These stages can be compared to a process for hosting a dinner for a few friends. A host hoping to make a good impression with their anticipated guests might analyze the situation at multiple levels to collect data on new alternatives for healthy ingredients, what ingredients have the best prices and are most readily available at certain times of year, the new trends in party appetizers, what food allergies the expected guests might have, possible party themes to consider, and so on. This analysis is the *Essential Initial Research* stage.

In the *Business Model* stage, the host might construct a menu of items to include with the meal along with a list of decorations to order, music to play, and costume themes to suggest to the guests. The mix of these kinds of elements chosen by the host will play a role in the success of the party.

The *Initial Business Plan Draft* stage is where the host rolls up his or her sleeves and begins to assemble make some of the food items, put up some of the decorations, send invitations, and generally get everything started for the party.

During this stage, the host will begin to realize that some plans are not feasible and that changes are needed. The required changes might be substantial, like the need to postpone the entire party and ultimately start over in a few months, or less drastic, like the need to change the menu when an invited guest indicates that they can't eat food containing gluten. These changes are incorporated into the plan to make it realistic and feasible in the *Making the Business Plan Realistic* stage.

Making A Plan to Appeal to Stakeholders stage involves further changes to the party plan to make it more appealing to both the invited guests and to make it a fun experience for the host. For example, the host might learn that some of the single guests would like to bring dates and others might need to be able to bring their children to be able to attend. The host might be able to accommodate those desires or needs in ways that will also make the party more fun for them—maybe by accepting some guests' offers to bring food or games, or maybe even hiring a babysitter to entertain and look after the children.

The final stage—*Finishing the Business Plan*—involves the host putting all of the final touches in place for the party in preparation for the arrival of the guests.

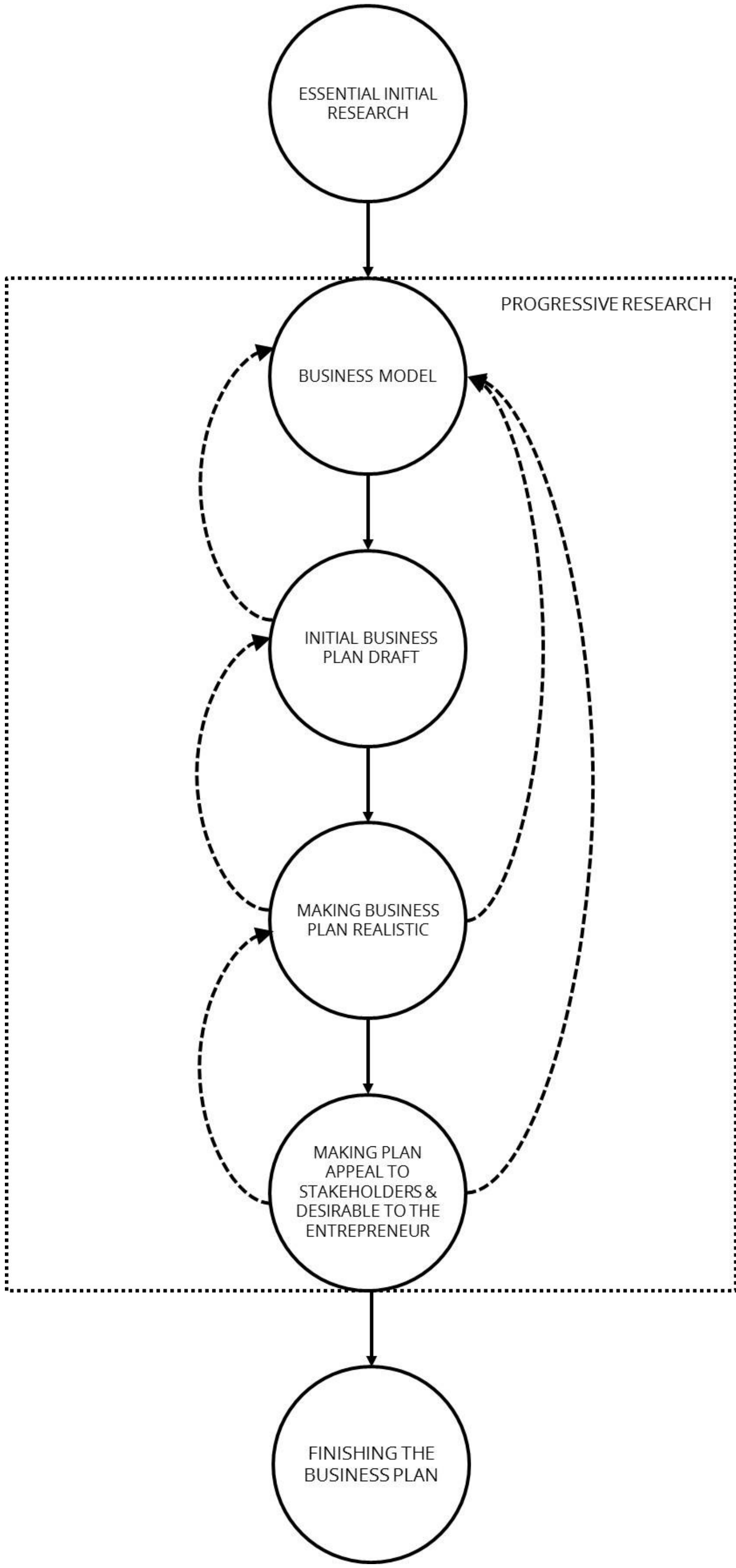


Figure 5 – Business Plan Development Process (Illustration by Lee A. Swanson)

Essential Initial Research

A business plan writer should analyze the environment in which they anticipate operating at each of the societal, industry, market, and firm levels of analysis (see pages 51–60). This stage of planning, the essential initial research, is a necessary first step to better understand the trends that will affect their business and the decisions they must make to lay the groundwork for, and to improve their potential for success.

In some cases, much of the essential initial research should be included in the developing business plan as its own separate section to help build the case for readers that there is a market need for the business being considered and that it stands a good chance of being successful.

In other cases, a business plan will be stronger when the components of the essential initial research are distributed throughout the business plan as a way to provide support for the plans and strategies outlined in the business plan. For example, the industry or market part of the essential initial research might outline the pricing strategies used by identified competitors and might be best placed in the pricing strategy part of the business plan to support the decision made to employ a particular pricing strategy.

Business Model

Inherent in any business plan is a description of the business model chosen by the entrepreneur as the one that they feel will best ensure success. Based upon their essential initial research of the setting in which they anticipate starting their business (their analysis from stage one) an entrepreneur should determine how each element of their business model—including their revenue streams, cost structure, customer segments, value propositions, key activities, key partners, and so on—might fit together to improve the potential success of their business venture (see Chapter 4 – Business Models).

For some types of ventures, at this stage an entrepreneur might launch a lean start-up (see page 68) and grow their business by continually pivoting, or constantly adjusting their business model in response to the real-time signals they get from the markets' reactions to their business operations. In many cases, however, an entrepreneur will require a business plan. In those cases, their initial business model will provide the basis for that plan.

Of course, throughout this and all of the rounds in this process, the entrepreneur should seek to continually gather information and adjust the plans in response to the new knowledge they gather. As shown in Figure 8 by its enclosure in the progressive research box, the business plan developer might need conduct further research before finishing the business model and moving on to the initial business plan draft.

Initial Business Plan Draft

The Business Plan Draft stage involves taking the knowledge and ideas developed during the first two stages and organizing them into a business plan format. An approach preferred by many is to create a full draft of the business plan with all of the sections, including the front part with the business description, vision, mission, values, value proposition statement, preliminary set of goals, and possibly even a table of contents and lists of tables and figures all set up using the software features enabling their automatic generation. Writing all of the operations, human resources, marketing, and financial plans as part of the first draft ensures that all of these parts can be appropriately and necessarily integrated. The business plan will tell the story of a planned business startup in two ways by using primarily words along with some charts and graphs in the operations, human resources, and marketing plans and in a second way through the financial plan. Both ways must tell the same story.

The feedback loop shown in Figure 8 demonstrates that the business developer may need to review the business model. Additionally, as shown by its enclosure in the progressive research box, the business plan developer might need conduct further research before finishing the Initial Business Plan Draft stage and moving on to the Making Business Plan Realisticstage.

Making Business Plan Realistic

The first draft of a business plan will almost never be realistic. As the entrepreneur writes the plan, it will necessarily change as new information is gathered. Another factor that usually renders the first draft unrealistic is the difficulty in making certain that the written part—in the front part of the plan along with the operations, human resources, and marketing plans—tells the exact same story as the financial part does. This stage of work involves making the necessary adjustments to the plan to make it as realistic as possible.

The Making Business Plan Realistic stage has two possible feedback loops. The first goes back to the Initial Business Plan Draft stage in case the initial business plan needs to be significantly changed before it is possible to adjust it so that it is realistic. The second feedback loop circles back to the Business Model stage if the business developer need to rethink the business model. As shown in Figure 8 by its enclosure in the progressive research box, the business plan developer might need conduct further research before finishing the Making Business Plan Realistic stage and moving on to the Making Plan Appeal to Stakeholders stage.

Making Plan Appeal to Stakeholders and Desirable to the Entrepreneur

A business plan can be realistic without appealing to potential investors and other external stakeholders, like employees, suppliers, and needed business partners. It might also be realistic (and possibly appealing to stakeholders) without being desirable to the entrepreneur. During this stage the entrepreneur will keep the business plan realistic as they adjust plans to appeal to potential investors and to themselves.

If, for example, investors will be required to finance the business start, some adjustments might need to be relatively extensive to appeal to potential investors' needs for an exit strategy from the business, to accommodate the rate of return they expect from their investments, and to convince them that the entrepreneur can accomplish all that is promised in the plan. In this case, and in others, the entrepreneur will also need to get what they want out of the business to make it worthwhile for them to start and run it. So, this stage of adjustments to the developing business plan might be fairly extensive, and they must be informed by a superior knowledge of what targeted investors need from a business proposal before they will invest. They also need to be informed by a clear set of goals that will make the venture worthwhile for the entrepreneur to pursue.

The caution with this stage is to balance the need to make realistic plans with the desire to meet the entrepreneur's goals while avoiding becoming discouraged enough to drop the idea of pursuing the business idea. If an entrepreneur is convinced that the proposed venture will satisfy a valid market need, there is often a way to assemble the financing required to start and operate the business while also meeting the entrepreneur's most important goals. To do so, however, might require significant changes to the business model.

One of the feedback loops shown in Figure 8 indicates that the business plan writer might need to adjust the draft business plan while ensuring that it is still realistic before it can be made appealing to the targeted stakeholders and desirable to the entrepreneur. The second feedback loop indicates that it might be necessary to go all the way back to the Business Model stage to re-establish the framework and plans needed to develop a realistic, appealing, and desirable business plan. Additionally, this stage's enclosure in the progressive research box suggests that the business plan developer might need conduct further research.

Finishing the Business Plan

The final stage involves putting all of the important finishing touches on the business plan so that it will present well to potential investors and others. This involves making sure that the math and links between the written and financial parts are accurate. It also involves ensuring that all the needed corrections are made to the spelling, grammar, and formatting. The final set of goals should be written to appeal to the target readers and to reflect what the business plan says. An executive summary should be written and included as a final step.

General Business Plan Format

Title page

Include nice, catchy, professional, appropriate graphics to make it appealing for targeted readers

Executive summary

- Can be longer than normal executive summaries, up to three pages
- Write after remainder of plan is complete
- Includes information relevant to targeted readers as this is the place where they are most likely to form their first impressions of the business idea and decide whether they wish to read the rest of the plan

Table of Contents

List of Tables

Each table, figure, and appendix included in the plan must be referenced within the text of the plan so the relevance of each of these elements is clear.

List of Figures

Introduction

- Describes the business concept
- Indicates the purpose of the plan
- Appeals to targeted readers

Business Idea

- May include description of history behind the idea and the evolution of the business concept if relevant

Vision

- Generally outlines what the owner intends for the venture to be
- Should inspire all members of the organization
- Should help stakeholders aspire to achieve greater things through the venture because of the general direction provided through the vision statement

Mission

- Should be very brief—a few sentences or a short paragraph
- Indicates what your organization does and why it exists—may describe the business strategy and philosophy

Values

- Indicates the important values that will guide everything the business will do
- Outlines the personal commitments members of the organization must make, and what they should consider to be important
- Defines how people behave and interact with each other.
- Should help the reader understand the type of culture and operating environment this business intends to develop

Major Goals

- Describes the major organizational goals
- Ensures each goal is:
    - Specific, Measurable, Action-Oriented, Realistic, and Timely [SMART]

  - Realistic, Understandable, Measurable, Believable, and Achievable [RUMBA]
- Perfectly aligns with everything in plan

Operating Environment

Trend Analysis

- Includes an analysis of how the current and expected trends in the political, economic, social, technological, environmental, and legal (PESTEL) factors will impact the development of this business
  - Consider whether this is the right place for this analysis: it may be better positioned in, for example, the Financial Plan section to provide context to the analysis of the critical success factors, or in the Marketing Plan to help the reader understand the basis for the sales projections.

Industry Analysis

- Includes an analysis of the industry in which this business will operate
- Commonly uses the Five Forces Model (Porter, 1985)
  - consider whether this is the right place for this analysis: it may be better placed in, for example, the Marketing Plan to enhance the competitor analysis, or in the Financial Plan to provide context to the industry standard ratios in the Investment Analysis section

Operations Plan

- Answers several key questions:
  - What are your facility plans?
    - Where will your facility be located?
      - expressed as a set physical location
      - expressed as a set of requirements and characteristics
    - How large will your facility be and why must it be this size?
    - How much will it cost to buy or lease your facility?
    - What utility, parking, and other costs must you pay for this facility?
    - What expansion plans must be factored into the facility requirements?
    - What transportation and storage issues must be addressed by facility decisions?
    - What zoning and other legal issues must you deal with?
    - What will be the layout for your facility and how will this best accommodate customer and employee requirements?

    - What constraints are you operating under that will restrict your capacity to produce and sell your product?
        - Given these constraints, what is your operating capacity (in terms of production, sales, etc.)?
    - What is the workflow plan for your operation?
    - What work will your company do and what work will you outsource?

Operations Timeline

- Outlines several key questions:
    - When will you make the preparations, such as registering the business name and purchasing equipment, to start the venture?
    - When will you begin operations and make your first sales?
    - When will other milestone events occur such as moving operations to a larger facility, offering a new product line, hiring new key employees, and beginning to sell products internationally?
- May include a graphical timeline showing when these milestone events have occurred and are expected to occur

Business Structure and other Set-up Elements

Somewhere in your business plan you must indicate what legal structure your venture will take. Your financial statements, risk management strategy, and other elements of your plan are affected by the type of legal structure you choose for your business:

- Sole Proprietorship
- Partnership
- Limited Partnership
- Corporation
- Cooperative

As part of your business set-up, you need to determine what kinds of control systems you should have in place, establish necessary relationships with suppliers and prior to your start-up, and generally deal with a list of issues like the following. Many of your decisions related to the following should be described somewhere in your business plan:

- Naming
- Zoning, equipment prices, suppliers, etc.

- Location
- Lease terms, leasehold improvements, signage, pay deposits, etc.
- Getting business license, permits, etc.
- Setting up banking arrangements
- Setting up legal and accounting systems (or professionals)
- Ordering equipment, locks and keys, furniture, etc.
- Recruiting employees, set up payroll system, benefit programs, etc.
- Training employees
- Testing the products/services that will be offered
- Testing the *systems* for supply, sales, delivery, and other functions
- Deciding on graphics, logos, promotional methods, etc.
- Ordering business cards, letter head, etc.
- Setting up supplier agreements
- Buying inventory, insurance, etc.
- Revising business plan
- And many more things, including, when possible, attracting purchased orders in advance of start-up through personal selling (by the owner, a paid sales force, independent representatives, or by selling through brokers wholesalers, catalog houses, retailers), a promotional campaign, or other means

Start-up

- What is required to start up your business, including the purchases and activities that must occur before you make your first sale?
- When identifying capital requirements for start-up, a distinction should be made between fixed capital requirements and working capital requirements.

Fixed Capital Requirements

- What fixed assets, including equipment and machinery, must be purchased so your venture can conduct its business?
- This section may include a start-up budget showing the machinery, equipment, furnishings, renovations, and other capital expenditures required prior to operations commencing.
- If relevant you might include information showing the financing required; fixed capital is usually financed using longer-term loans.

Working Capital Requirements

- What money is needed to operate the business (separately from the money needed to purchase fixed assets) including the money needed to purchase inventory and pay initial expenses?
- This section may include a start-up budget showing the cash required to purchase starting inventories, recruit employees, conduct market research, acquire licenses, hire lawyers, and other operating expenditures required prior to starting operations.
- If relevant you might include information showing the financing required … working capital is usually financed with operating loans, trade credit, credit card debt, or other forms of shorter-term loans.

Risk Management Strategies

- Includes descriptions of the organization's risk exposure
    - enterprise – liability exposure for things like when someone accuses your employees or products you sell of injuring them.
    - financial – securing loans when needed and otherwise having the right amount of money when you need it
    - operational – securing needed inventories, recruiting needed employees in tight labour markets, customers you counted on not purchasing product as you had anticipated, theft, arson, natural disasters like fires and floods, etc.
- Always includes descriptions of the planned strategies for managing each of the risks identified
    - avoid – choose to avoid doing something, outsource, etc.
    - reduce – through training, assuming specific operational strategies, etc.
    - transfer – insure against, outsource, etc.
    - assume – self-insure, accept, etc.

Operating Processes

- What operating processes will you apply?
- Depending upon the type of business for which you are creating your plan, you will need to describe different things:
    - Retail and wholesale operations
        - How will you ensure your cash is managed effectively?
        - How will you schedule your employees?
        - How will you manage your inventories?
        - If you will have a workforce, how will you manage them?

        - etc.
    - Service operation
        - How will you bill out your employee time?
        - How will you schedule work on your contracts?
        - etc.
    - Manufacturing operation
        - How you will manufacture your product (process flow, job shop, etc.?)
        - How will you maintain quality?
        - How will you institute and manage effective financial monitoring and control systems that provide needed information in a timely manner?
        - How will you manage expansion?
        - etc.

Facilities

- May include planned layouts for facilities

Organizational Structure

- May include information on Advisory Boards or Board of Directors from which the company will seek advice or guidance or direction
- May include an organizational chart
- Can nicely lead into the Human Resources Plan

Human Resources Plan

- Answers key questions:
    - How do you describe your desired corporate culture?
    - What are the key positions within your organization?
    - How many employees will you have?
    - What characteristics define your desired employees?
    - What is your recruitment strategy? What processes will you apply to hire the employees you require?
    - What is your leadership strategy and why have you chosen this approach?
    - What performance appraisal and employee development methods will you use?

- What is your organizational structure and why is this the best way for your company to be organized?
- How will you pay each employee (wage, salary, commission, etc.)? How much will you pay each employee?
- What are your payroll costs, including benefits?
- What work will be outsourced and what work will be completed in-house?
- Have you shown and described an organizational chart?

Recruitment and Retention Strategies

- Includes how many employees are required at what times
- Estimates time required to recruit needed employees
- Estimates all recruitment costs including
  - employment advertisements
  - contracts with employment agency or search firms
  - travel and accommodations for potential employees to come for interviews
  - travel and accommodations for interviewers
  - facility, food, lost time, and other interviewing costs
  - relocation allowances for those hired including flights, moving companies, housing allowances, spousal employment assistance, etc.
- may include a schedule showing the costs of initial recruitment that then flows into your start-up expense schedules

Leadership and Management Strategies

- What is your leadership philosophy?
- Why is it the most appropriate leadership approach for this venture?

Training

- What training is required because of existing rules and regulations?
- How will you ensure your employees are as capable as required?
- In which of the following areas will you provide training for your employees?
  - Health and safety (legislation, WHMIS, first aid, defibulators, etc.)
  - Initial workplace orientation

    - Management
    - Financial systems
    - Sales
    - Contracts
    - Product features
    - Other

Performance Appraisals

- How will you manage your performance appraisal systems?

Health and Safety

- Any legal requirements should be noted in this section (and also legal requirements for other issues that may be included in other parts of the plan)

Compensation

- Always completely justifies your planned employee compensation methods and amounts
- Always includes all components of the compensation (CPP, EI, holiday pay, etc.)
- Outlines how will you ensure both internal and external equity in your pay systems
- Describes any incentive-based pay or profit sharing systems planned
- May include a schedule here that shows the financial implications of your compensation strategy and supports the cash flow and income statements shown later

Key Personnel

- May include brief biographies of the key organizational people

Marketing Plan

- What primary and secondary research have you done?
    - You must show evidence of having done proper research, both primary and secondary. If you make a statement of fact, you must back it up with properly referenced supporting evidence. If you indicate a claim is based on your own assumptions, you must back this up with a description as to how you came to the conclusion.
- Somewhere in your plan have you done an effective analysis of the economic environment relevant to your business?

    - It is a given that you must provide some assessment of the economic situation as it relates to your business. For example, you might conclude that the current economic crisis will reduce the potential to export your product and it may make it more difficult to acquire credit with which to operate your business. Of course, conclusions such as these should be matched with your assessment as to how your business will make the necessary adjustments to ensure it will thrive despite these challenges, or how it will take advantage of any opportunities your assessment uncovers.
- Somewhere in your plan have you done an effective assessment of the industry within which your venture will operate?
    - You must provide an assessment of the industry coupled with descriptions of how your venture will prosper in those circumstances. A common approach used to assess the industry is to apply Porter's (1985) Five Forces Model.
        - If you apply the Five Forces Model, do so in the way in which it was meant to be used to avoid significantly reducing its usefulness while also harming the viability of your industry analysis. This model is meant to be used to consider the entire industry—not a subcomponent of it (and it usually cannot be used to analyze a single organization).
    - Your competitor analysis might fit within your assessment of the industry or it might be best as a section within your marketing plan. Usually a fairly detailed description of your competitors is required, including an analysis of their strengths and weaknesses. In some cases, your business may have direct and indirect competitors to consider. Be certain to maintain credibility by demonstrating that you fully understand the competitive environment.
    - Assessments of the economic conditions and the state of the industry appear incomplete without accompanying appraisals outlining the strategies the organization can/should employ to take advantage of these economic and industry situations. So, depending upon how you have organized your work, it is usually important to couple your appraisal of the economic and industry conditions with accompanying strategies for your venture. This shows the reader that you not only understand the operating environment, but that you have figured out how best to operate your business within that situation.
- Have you done an effective analysis of your venture? (See the Organizational Analysis section below.)

Market Analysis

- Usually contains customer profiles, constructed through primary and secondary research, for each market targeted
- Contains detailed information on the major product benefits you will deliver to the markets targeted
- Describes the methodology used and the relevant results from the primary market research done

- If there was little primary research completed, justifies why it is acceptable to have done little of this kind of research and/or indicate what will be done and by when
- Includes a complete description of the secondary research conducted and the conclusions reached
- Describes potential customers
    - Define your target market in terms of identifiable entities sharing common characteristics. For example, it is not meaningful to indicate you are targeting Canadian universities. It is, however, useful to define your target market as Canadian university students between the ages of 18 and 25, or as information technology managers at Canadian universities, or as student leaders at Canadian universities. Your targeted customer should generally be able to make or significantly influence the buying decision.
    - You must usually define your target market prior to describing your marketing mix, including your proposed product line. Sometimes the product descriptions in business plans seem to be at odds with the described target market characteristics. Ensure your defined target market aligns completely with your marketing mix (including product/service description, distribution channels, promotional methods, and pricing). For example, if the target market is defined as Canadian university students between the ages of 18 and 25, the product component of the marketing mix should clearly be something that appeals to this target market.
    - Carefully choose how you will target potential customers. Should you target them based on their demographic characteristics, psychographic characteristics, or geographic location?
- Identifies how your targeted customers make their buying decisions
    - You will need to access research to answer this question. Based on what you discover, you will need to figure out the optimum mix of pricing, distribution, promotions, and product decisions to best appeal to how your targeted customers make their buying decisions.

Competition

- Fully describes the nature of your competitors
    - However, this information might fit instead under the market analysis section.
- Describes all your direct competitors
- Describes all your indirect competitors
- If you can, includes a competitor positioning map to show where your product will be positioned relative to competitors’ products

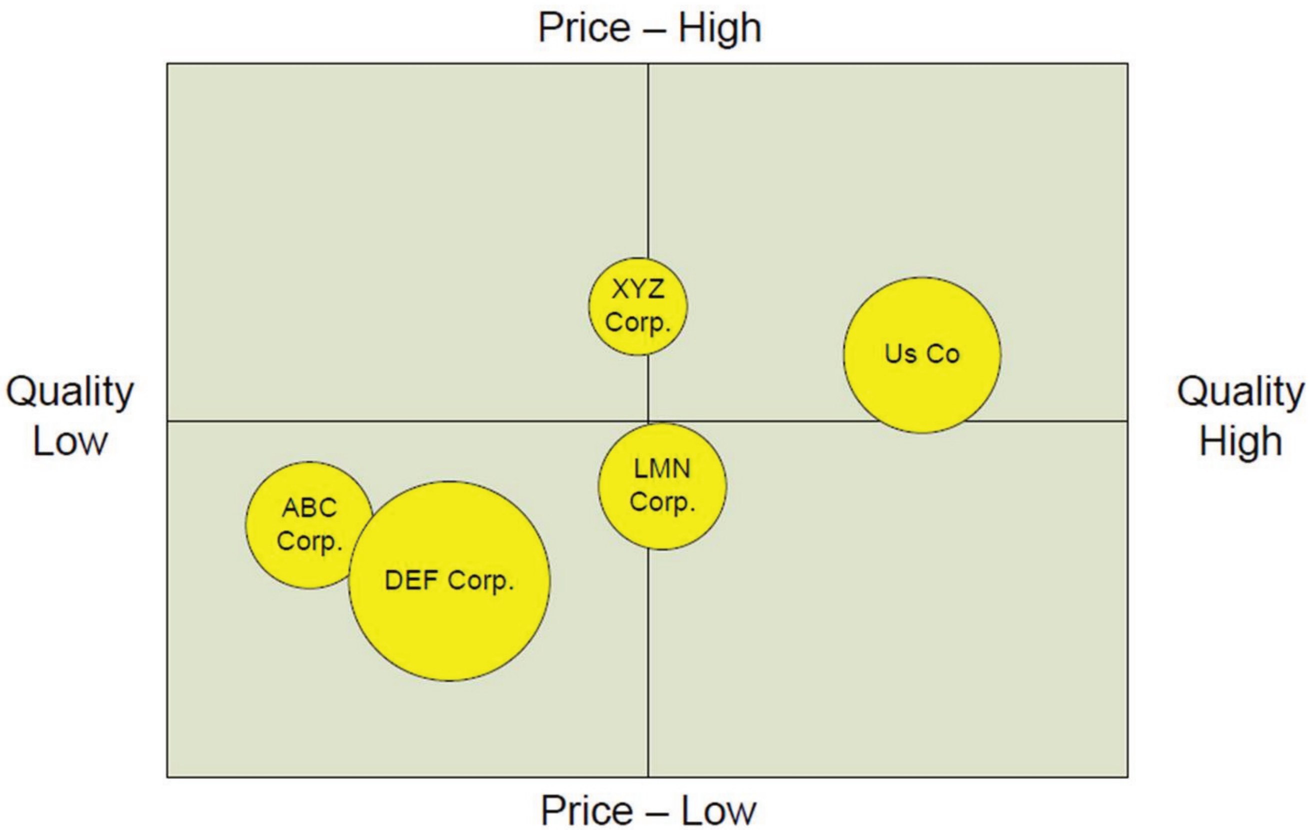


Figure 6 – Competitor Positioning Map (Illustration by Lee A. Swanson)

- Identifies your competitive advantage
    - What distinguishes your business from that of your competitors in a way that will ensure your sales forecasts will be met?
    - What is your venture's value proposition?
        - You must clearly communicate the answers to these questions in your business plan to attract the needed support for your business. One caution is that it may sound appealing to claim you will provide a superior service to the existing competitors, but the only meaningful judge of your success in this regard will be customers. Although it is possible some of your competitors might be complacent in their current way of doing things, it is very unlikely that all your competitors provide an inferior service to that which you will be able to provide.

Marketing Strategy

- Covers all aspects of the marketing mix including the promotional decisions you have made, product decisions, distribution decisions related to how you will deliver your product to the markets targeted, and pricing decisions

- Outlines how you plan to influence your targeted customers to buy from you (what is the optimum marketing mix, and why is this one better than the alternatives)

Organizational Analysis

- Leads in to your marketing strategy or is positioned elsewhere depending upon how your business plan is best structured
- Often applies a SWOT Analysis
  - If doing so, always ensure this analysis results in more than a simple list of internal strengths and weaknesses and external opportunities and threats. A SWOT analysis should always prove to the reader that there are organizational strategies in place to address each of the weaknesses and threats identified and to leverage each of the strengths and opportunities identified.
- An effective way to ensure an effective outcome to your SWOT Analysis is to apply a TOWS Matrix approach to develop strategies to take advantage of the identified strengths and opportunities while mitigating the weaknesses and threats. A TOWS Matrix evaluates each of the identified threats along with each of the weaknesses and then each of the strengths. It does the same with each of the identified opportunities. In this way strategies are developed by considering pairs of factors
- The TOWS Matrix is a framework with which to help you organize your thoughts into strategies. Most often you would not label a section of your business plan as a TOWS Matrix. This would not normally add value for the reader. Instead, you should describe the resultant strategies—perhaps while indicating how they were derived from your assessment of the strengths, weaknesses, opportunities, and threats. For example, you could indicate that certain strategies were developed by considering how internal strengths could be employed toward mitigating external threats faced by the business.

Product Strategy

- Identifies your product/service and why this particular product/service will appeal to your targeted customers more than the alternatives
  - If your product or service is standardized, you will need to compete on the basis of something else – like a more appealing price, having a superior location, better branding, or improved service. If you can differentiate your product or service you might be able to compete on the basis of better quality, more features, appealing style, or something else. When describing your product, you should demonstrate that you understand this.

Pricing Strategy

- Outlines your pricing strategies and explains what makes these strategies better than the alternatives
  - If you intend to accept payment by credit card (which is probably a necessity for most companies), you should be aware of the fee you are charged as a percentage of the value of

each transaction. If you don't account for this you risk overstating your actual revenues by perhaps one percent or more.

- Identifies your sales forecasts and explains why are these realistic
    - Sales forecasts must be done on at least a monthly basis if you are using a projected cash flow statement. These must be accompanied by explanations designed to establish their credibility for readers of your business plan. Remember that many readers will initially assume that your planned time frames are too long, your revenues are overstated, and you have underestimated your expenses. Well crafted explanations for all of these numbers will help establish credibility.

Distribution Strategy

- Describes your distribution strategies and explains what makes these strategies better than the alternatives
    - If you plan to use e-commerce, you should include all the costs associated with maintaining a website and accepting payments over the Internet.

Promotions Strategy

- Answers the following key questions:
    - As a new entrant into the market, must you attract your customers away from your competitors they currently buy from or will you be creating new customers for your product or service (i.e. not attracting customers away from your competitors)?
        - If you are attracting customers away from competitors, how will these rivals respond to the threat you pose to them?
        - If you intend to create new customers, how will you convince them to reallocate their dollars toward your product or service (and away from other things they want to purchase)?
        - In what ways will you communicate with your targeted customers? When will you communicate with them? What specific messages do you plan to convey to them? How much will this promotions plan cost?
- Outlines the anticipated responses that competitors will have to your entrance into the market, especially if your success depends upon these businesses losing customers to you
    - If your entry into the market will not be a threat to direct competitors, it is likely you must convince potential customers to spend their money with you rather than on what they had previously earmarked those dollars toward. In your business plan you must demonstrate an awareness of these issues.
- Maps out your promotional expenditures according to the method used and time frame

    - Consider listing the promotional methods in rows on a spreadsheet with the columns representing weeks or months over probably about 18 months from the time of your first promotional expenditure. This can end up being a schedule that feeds the costs into your projected cash flow statement and from there into your projected income statements.
    - If you phone or visit newspapers, radio stations, or television stations seeking advertising costs, you must go only after you have figured out details like on which days you would like to advertise, at what times on those days, whether you want your print advertisements in color, and what size of print advertisements you want.
    - Carefully consider which promotional methods you will use. While using a medium like television may initially sound appealing, it is very expensive unless your ad runs during the non-prime times. If you think this type of medium might work for you, do a serious cost-benefit analysis to be sure.
    - Some promotional plans are developed around newspaper ads, promotional pamphlets, printing business cards, and other more obvious mediums of promotion. Be certain to, include the costs of advertising in telephone directories, sponsoring a little league soccer team, producing personalized pens and other promotional client give-always, donating items to charity auctions, printing and mailing client Christmas cards, and doing the many things businesses find they do on-the-fly. Many businesses find it to be useful to join the local chamber of commerce and relevant trade organizations with which to network. Some find that setting a booth up at a trade fair helps launch their business.
    - If you are concerned you might have missed some of these promotional expenses, or if you want to have a buffer in place in case you feel some of these opportunities are worthwhile when they arise, you should add some discretionary money to your promotional budget. A problem some companies get into is planning out their promotions in advance only to reallocate some of their newspaper advertisement money, for example, toward some of these other surprise purposes resulting in less newspaper advertising than had been intended.

Financial Plan

- Outlines financial projections
    - It is nearly certain you will need to make monthly cash flow projections from business inception to possibly three years out. Your projections will show the months in which the activities shown on your fixed capital and working capital schedules will occur. This is nearly the only way to clearly estimate your working capital needs and, specifically, important things like the times when you will need to draw on or can pay down your operating loans and the months when you will need to take out longer-term loans with which to purchase your fixed assets. Without a tool like this you will be severely handicapped when talking with bankers about your expected needs. They will want to know how large of a line of credit you will need and when you anticipate needing to borrow longer-term money. It is

only through doing cash flow projections will you be able to answer these questions. This information is also needed to determine things like the changes to your required loan payments and when you can take owner draws or pay dividends.

- Your projected cash flows are also used to develop your projected income statements and balance sheets.

Pro forma Cash Flow Statements

Pro forma Income Statements

Pro forma Balance Sheets

Investment Analysis

Projected Financial Ratios and Industry Standard Ratios

Critical Success Factors (Sensitivity Analysis)

References

Appendices

Chapter 6 – Financing Entrepreneurship

Money is like gasoline during a road trip. You don't want to run out of gas on your trip, but you're not doing a tour of gas stations. – Tim O'Reilly, founder and CEO of O'Reilly Media

Chase the vision, not the money; the money will end up following you. – Tony Hsieh, CEO of Zappos

Learning Objectives

After completing this chapter you will be able to

- Describe the financing considerations for entrepreneurs
- Describe the advantages and disadvantages of debt financing and of equity financing
- List and describe the forms of financing appropriate for the different phases of business development

Overview

Securing needed financing is one of the most important functions related to starting a business. It is important, then, to understand what sources of financing exist at various stages of venture development. It is also important to determine what kinds of financing provide the most value for the entrepreneur and the new venture. Debt and equity financing decisions must be considered in relation to the cost of the financing and the amount of control that the owner is willing to sacrifice to get the needed resources.

Financing

Starting Capital

Entrepreneurs almost always require starting capital to move their ideas forward to the point where they can start their ventures. Determining the amount of money that is actually needed is tricky because that requirement can change as plans evolve. Other challenges include actually securing the amount desired and getting it when it is needed. If an entrepreneur is unable to secure the required amount or cannot get the funding when needed, they must develop new plans.

Once a venture begins to make cash sales or it starts to receive the money earned through credit sales, it can use those resources to fund some of its activities. Until then, it must get the money it needs through other sources.

Bootstrap financing is when entrepreneurs use their ingenuity to make their existing resources, including money and time, stretch as far as possible—usually out of necessity until they can transform their venture into one that outside investors will find appealing enough to invest in.

Personal Money

Entrepreneurs will almost always have to invest their own personal money into their start-up before others will give them any financial help. Sometimes entrepreneurs form businesses as partnerships or as multi-owner corporations with other individual entrepreneurs who also contribute their own personal funds to the venture.

Love Money

Love money refers to money provided by friends and family who want to support an entrepreneur, often when they have no other ready source of funding after using as much of their own personal money as possible to support their start-up.

Grants and Start-up Prize Money

In some cases, grants that do not need to be repaid might be provided by government or other agencies to support new venture start-ups. Sometimes entrepreneurs can enter business planning or similar competitions in which they might win money and other benefits, like free office or retail space, or free legal or accounting services for a set period of time.

Debt Financing

From an entrepreneur's perspective, the cost of debt financing is the interest that they pay for the use of the money that they borrow. From an investor's perspective, their reward, or return on debt financing, is the interest that they gain in addition to the return of the money that they lent to an entrepreneur or other borrower.

To provide some protection for the investor (lender) to enable them to accept an interest rate that is also acceptable for the entrepreneur (borrower), the borrower must often pledge collateral so that if they do not pay back the loan along with interest as arranged, the lender has a way to get all or some of the money they are owed. If a borrower defaults on a loan, the lender can become the owner of the property pledged as collateral. A key objective for an entrepreneur seeking debt financing is to provide sufficient collateral to get the loan, but not pledge so much that they put essential property at risk.

When entrepreneurs borrow money, they must pay it back subject to the terms of the loan. The loan terms include the specific interest rate that will be charged and the time period within which the loan needs to be repaid. Several other terms or features of the loan that can be negotiated between lender and borrowers. One such feature is whether the loan can be converted to equity at a particular point in time and according to certain criteria and subject to specific terms.

Sometimes debt financing can be in the form of trade credit, where a supplier provides product to a business but does not require payment for a specific length of time, or perhaps even until the business has sold the product to a customer. Another form of debt financing is customer advances. This might involve a customer paying in advance for a product or service so that the businesses has those funds available to use to pay its suppliers.

Advantages of Debt Financing

One advantage of debt financing is that the entrepreneur is not sacrificing ownership and some control of their venture when they take out a loan.

Another advantage of debt financing is the certainty of the payments the borrower needs to make during the term of the loan. If the borrower takes out a loan for $20,000 over a five-year term at a fixed interest rate of 6.2% with a monthly payment schedule designed to pay off the entire loan by the end of its five-year term, they know that each month they must pay $389 and that over the five years they will have paid back the entire $20,000 loan amount plus a total of $3,340 in interest. With this certainty, the business can accurately budget its payback amount for this loan over the five years.

Yet another advantage of debt financing is that it allows companies to *trade on equity*. Trading on equity enhances the rate of return on common shareholders' equity by using debt to financing asset purchases or to take other measures that are expected to cost less than the earnings generated by the action taken. For example, if a company borrows $20,000 at 6.2% interest and uses that money to purchase a machine it will use to increase its return on equity by 20%, then it is trading on equity. In this case, the company is financially better off than it would have been if it had not taken out the loan. Of course, the inherent risk involved with this strategy is lowered when income streams are relatively stable.

Disadvantages of Debt Financing

A disadvantage of borrowing money is the need to report to those from whom you borrowed the money. This might be particularly true when lenders, often bankers, have interests or incentives—mainly getting their money back plus at all of the interest owed to them during the loan term through regular monthly blended loan payments—that might not fully align with the interests and incentives of the borrower, which might include being able to pay the money back when they are best able to do so without also impacting other parts of their business, like the need to pay their employees or their facility lease payment at the end of a month when an expected customer payment did not arrive as planned.

Another disadvantage of borrowing is that the business's ownership of the property it pledged as collateral for the loan is placed at risk. For many new ventures, a loan is only possible to acquire if the owner provides their *personal guarantee* that the money will be paid back as determined in the loan agreement, thus putting personal property at risk.

Equity financing

From an entrepreneur's perspective, the cost of equity financing is the loss of some control over their venture as they must now share ownership of the business. From an investor's perspective, their reward in exchange for purchasing an ownership interest in the business is the potential to share in the business's anticipated future success by possibly receiving dividends (a portion of the profit that is distributed to owners) and by possibly being able to sell their ownership interest to another investor for more than the amount they purchased that ownership interest for originally.

The protection for the investor, who might be a shareholder if the ownership interest is represented in the form of shares in the business, is in the influence they can exert in the company's decision-making processes. This influence is normally proportionate to their share of the ownership in the overall business. Equity investors normally seek to earn a competitive return on their investment that is in line with the level of risk they assume by investing in the business. The riskier the investment, the higher the return the investor expects.

Public Offering

Stock investors might invest in a *public offering* where the company's shares are made available to the public—and by which the company becomes a *public company*. An *initial public offering* (IPO) is where a company's stock (its shares) are sold to institutional investors who then resell them to the public, usually through a securities exchange like the Toronto Stock Exchange (TSX).

When an IPO occurs, a company goes through a legal process to sell shares in its company for the purpose of raising capital. This is called *going public*. An important part of going public is setting the initial price for the shares being offered for sale (the *offering price*). The amount that the company will raise is the price they sell the new stock at multiplied by the number of shares they sell less any fees and other expenses incurred to make the sale. If they set the initial selling price of the shares too high, they might not sell all of the shares and the company won't raise as much capital as anticipated. If they happen to sell all of the overvalued shares, the share price will fall once it begins trading on the exchange. Setting the offering price too high indicates that the company and its agents helping it with its IPO, called *underwriters*, have valued the company higher than investors in the marketplace value it. If the company sets the offering price too low, it will raise the amount of money planned, but will find out too late that it could have raised much more capital by setting the offering price higher. In this case, the company and its underwriters have undervalued the company and the initial investors will make all of the gains that the company could have when they sell the shares on the exchange almost immediately after they purchased them for more money than they purchased them for.

Private Offering

Stock investors might also invest in a *private offering* (or *private placement*) where the shares are sold to a few investors rather than to the general public through an exchange. Institutional private placements involve selling the shares to institutional investors like insurance companies. Private offerings cost less and are subject to less stringent regulation than public offerings, mainly because it is expected that private investors will be more diligent on their own and require less regulatory protection than do public investors.

Venture Capital

Venture capital is raised when investors pool their money. The venture capital fund is then used to very carefully invest in existing but usually young companies that are expected to experience high growth. The venture capital company does not expect to invest for long and it expects to generate a large return. For example, it might expect to invest in an opportunity for a period of up to five years and then get out of the investment with five times the money it originally invested. Of course, only some investment opportunities will generate the returns hoped for and others will return far less than expected.

Venture capitalists might exert some ownership control by influencing some business decisions in cases where they believe that by doing so they can protect their investment or cause the investment to produce greater returns, but they generally prefer to invest in companies that are going to be well-run and will not require them to be involved in decisions. Venture capitalists might also provide some assistance, such as business advice, to the companies in which they invest.

A *venture round* refers to a phase of financing that institutional investors like venture capitalists provide to entrepreneurs. The first phase (sometimes following a *seed round* in which entrepreneurs themselves provide the start-up capital and then an *angel round* where angel investors invest in the company) is called *Series A*. Subsequent venture rounds are called *Series B*, *Series C*, and so on.

Angel Investors

Angel investors are wealthy individuals who on their own, or often along with other angel investors in a network—like the Saskatchewan Capital Network—invest in new ventures in exchange for an ownership interest in the business. Sometimes angels invest in companies in exchange for convertible debt, an investment that starts off as a loan, usually in the form of a bond, that they can exercise an option to convert to an equity interest in the company at a particular point in time for a pre-determined number of shares. Angel investors are generally less restricted in what kinds of investments they will consider as opposed to venture capitalists, who are using other people's pooled money. Like venture capitalists, however, they normally undertake a rigorous *due diligence* process to determine whether to invest in the opportunities they are considering.

Equity Crowd Funding

Equity crowd funding is a relatively new way for entrepreneurs to raise capital. It involves using online methods to promote equity interests in ventures to potential investors.

Due Diligence

Investors follow due diligence processes to assess the risk and potential return associated with the investments they are considering. As such, entrepreneurs should maintain a due diligence file or binder that they can quickly draw upon when a desirable potential investor expresses an interest in their venture.

A due diligence file or binder will include copies of many of the legal papers and other important documents that a venture has accumulated that tell the story of the enterprise. These documents will include those related to incorporation, securities it has issued or is in the process of issuing, loans, important contracts, intellectual property documents, tax information, financial statements, and other important documentation.

Advantages of Equity Financing

One important benefit to equity financing is that it does not normally require a regular payback from cash flow. Unlike with debt financing, equity investments do not usually give rise to a regular encumbrance that can increase the difficulty a young company might have in meeting its regular monthly expenses.

Second, when a firm uses equity financing, it does not need to pledge collateral, which means that the company's assets are not placed at risk.

A potential advantage with equity financing is that, depending upon the form of financing and who the investors are, a firm might gain valued advisers. In addition, investors who exercise their ownership rights to have a say in the operations of the company, or who otherwise provide advise and mentorship to entrepreneurs starting ventures, are usually highly motivated to help the company succeed. Investors expect to benefit only when the companies they invest in succeed, meaning that their financing incentives are aligned with those of the entrepreneur and other owners.

Disadvantages of Equity Financing

Equity financing is often more difficult to raise than debt financing. Second, when they share ownership in exchange for investment into their business, entrepreneurs give up a portion of the value that they create. If things do not go as planned, entrepreneurs can lose control of their companies to their investors.

Sources of Financing for Different Phases of Development

Different financing sources are used at different phases of business development. The appropriate and available financing sources depend upon the risks and opportunities available to both the entrepreneur and to the investors.

Idea Development Phase

- Personal sources (savings and other income)
- Extended personal sources (family, friends, employees, partners)
- Angel investors (possibly)

    - also called informal investors
    - wealthy individuals interested in investing their own money in early-stage companies as convertible debt holders or equity investors
    - convertible debt (convertible bond, convertible note, convertible debenture) allows the bondholder to convert their debt into an equity interest at an agreed-upon price
    - can be a win-win arrangement
        - If the company is successful, investor has opportunity to participate as equity investor, but if company is only marginally successful, they get their money back with interest.
        - If entrepreneurs have difficulty borrowing money, they can add the convertible feature as a sweetener.
- Strategic partners
    - might include potential customers or potential suppliers who want to have access to a business like the one proposed (and therefore might fund part of its development)—i.e. a building owner (supplier) might help a business develop which will be a tenant
    - might include complementary businesses who feel helping the new business get started might help their own businesses—i.e. a hotel investing in a spa next door to their facility

Start-Up Phase

- Angel investors
- Strategic partners
- Customers (possibly)
    - They might place orders for services or products and pay for them up-front, thereby providing financing for the new business.
    - They might want your business to succeed so it can support their business. For example, a general contractor (future customer) might help a new plumber get started if there is now a shortage of plumbers affecting the building industry.
- Venture Capitalists (possibly)
    - These organizations acquire pools of money to invest, so they *differ from angel investors* in that those making the decisions are not investing their own money; this means they usually consider investment options which have shown some success already (which isn't usually the case in the start-up phase).
- Asset-Based lenders
    - lend money secured by the assets of the borrower – i.e. plant and equipment

    - sometimes this can be done quite creatively – i.e. secure a loan with assets that will turn into money … like through accounts receivable or inventories, etc.
- Equipment Leasing Companies
- Suppliers

Early Operations

- Venture Capitalists (possibly)
- Asset-Based Lenders
- Equipment Leasing Companies
- Suppliers
- Small Business Investment Companies
    - U.S. term – developed to bridge the gap between when small businesses need money and the time later on when venture capitalists might provide financing to small businesses
    - SBICs are privately owned companies in the United States that are licensed by the Small Business Administration (U.S. Government) to supply equity capital, long-term loans, and management assistance to qualifying small businesses
    - Canadian equivalent = Community Futures Corporations
- Trade Credit
    - The supplier provides product now *on terms* so the retailer does not need to pay the supplier for perhaps 30 or 60 or 90 days
    - The retailer can then sell the product and collecting the money from the customer before the retailer needs to pay supplier for it the product.
- Factoring
    - when a business sells its accounts receivable (its invoices) to a third party (called a factor) at a discount in exchange for immediate money
    - differs from bank loan in three ways
        - The factor is interested in the value of the receivables; a bank is interested in the firm's creditworthiness.
        - Factoring is not a loan; it is the purchase of a financial asset (the receivables).
        - A bank loan involves two parties (lender and borrower); factoring involves three (the business, the factor, and those who owe the money).

Growth Phase

- Venture Capitalists
- Asset-Based Lenders
- Equipment Leasing Companies
- Suppliers
- Small Business Investment Companies
- Trade Credit
- Factoring
- Mezzanine Lenders
    - used to fill the financing gap between relatively expensive equity financing and less expensive forms of financing like secured loans
    - structured either as an unsecured or subordinated debt instrument or as preferred stock
    - represents a claim on assets which is senior only to that of the common shares
    - mezzanine debt holders require a higher return than is the case with holders of secured debt (maybe close to 20% or more – because the risk is higher)
    - usually issued as private placements (i.e. fewer legal requirements than with public placements)
    - can be used by smaller companies
    - mezzanine lenders might have right to convert the debt instrument to an equity instrument
    - mezzanine lenders work with companies to ensure the high return they require doesn't cripple the company, so they might take an equity interest or might defer loan payments until the end of loan term or until the company is sold

Exit or Harvest Phase

- Mezzanine Lenders
- Public Debt
- Initial Public Offerings (IPOs)
    - issuing common stock or shares to the public
    - used by companies seeking capital to expand (or by privately-owned companies wanting to become publicly traded)
    - a major challenge is to figure out how to value the shares offered so underwriting firms are often used to help deal with this challenge

        - if the price is set too high maybe all the shares will not be sold (and the desired amount of money will not be raised)
        - if the price is set too low the company might lose out on money it could have had (if all the shares sold had of been sold at a higher price)
    - money from initial sale of shares goes to the company, but after that the shares are traded between shareholders (the company doesn't get any of this money)
    - the money never has to be repaid, but the owners of the shares have a right to any distributed profits (dividends declared) and to residual dissolution proceeds (what is left over after the debt holders and everyone else is paid off if the company assets are sold)
- Acquisition, Leveraged Buy-Outs (LBO), Management Buy-Outs (MBO)
    - LBOs are when the controlling interest in the company is purchased using mainly borrowed money (the assets of the company being purchased are often used as the loan collateral).
    - MBOs are often a form of LBOs where the purchasers are the current managers of the company.

Chapter 7 – Business Set-Up, Start-Up, and Growth

Twenty years from now you will be more disappointed by the things that you didn't do than by the ones you did do. So throw off the bowlines. Sail away from the safe harbor. Catch the trade winds in your sails. Explore. Dream. Discover. – Mark Twain

This defines entrepreneur and entrepreneurship—the entrepreneur always searches for change, responds to it, and exploits it as an opportunity. – Peter Drucker

Learning Objectives

After completing this chapter you will be able to

- Explain the considerations entrepreneurs face during the set-up phase of their business development
- Explain the considerations entrepreneurs face during the start-up phase of their business development
- Explain the considerations entrepreneurs face during the growth phase of their business development

Overview

This chapter introduces entrepreneurship topics related to the business set-up phase, start-up phase, and growth phase. These phases are relevant for most start-ups other than those that follow the lean start-up approach in which the elements of the phases described in this chapter are blended together in a process that involves releasing and continually revising product or service prototypes in response to customer feedback.

Set-Up

The goal of the venture set-up phase is to implement the plans needed to start the business prior to its actual start-up. This might include developing and testing the products or services the entrepreneur anticipates selling. It also includes planning around protecting any intellectual property that the venture might have and determine how to gain competitive advantages over its rivals.

Protecting Intellectual Property

Intellectual property refers to the ideas, goods, and services that can be legally protected by copyrights, patents, trade secrets, and trademarks.

Copyright

Copyrights provide protection to original software created by someone. They also protect music, literature, and dramatic and other artistic works for the life of the author of the work plus another 50 years (there are some modifications to this rule for some works). Copyright arises when someone creates a work whether or not they register the copyright. It is also not required in Canada to indicate that a work is copyrighted, although works—like this book—might include the © symbol to remind people that they are copyrighted (even if they are not registered). A copyright can be registered in Canada for a nominal fee—around $50—but most works that are created are not registered.

The Canadian Intellectual Property Office provides a searchable Copyrights Database (http://www.ic.gc.ca/app/opic-cipo/cpyrghts/dsplySrch.do?lang=eng) of the copyrights that have been registered.

The Canadian Intellectual Property Office (2015a) website lists the following categories of copyright protection:

> Copyright applies to all original literary, dramatic, musical and artistic works provided the conditions set out in the Copyright Act have been met. Each of these general categories covers a wide range of creations, including:
>
> - literary works such as books, pamphlets, computer programs and other works consisting of text
> - dramatic works such as motion picture films, plays, screenplays and scripts
> - musical works such as compositions with or without words
> - artistic works such as paintings, drawings, maps, photographs, sculptures and plans
>
> Copyright also applies to other subject-matter consisting of:
>
> - performers' performances, meaning any of the following:
> - a performance of an artistic, dramatic or musical work, whether or not the work was previously recorded and whether or not the work's term of copyright protection has expired
> - a recitation or reading of a literary work, whether or not the work's term of copyright protection

has expired

- an improvisation of a dramatic, musical or literary work, whether or not the improvised work is based on a pre-existing work
- sound recordings, meaning recordings consisting of sounds, whether or not a performance of a work, but excluding any soundtrack of a cinematographic work where it accompanies the cinematographic work
- communication signals, meaning radio waves transmitted through space without any artificial guide, for reception by the public (Canadian Intellectual Property Office, 2015a)

Patents

Patents provide protection for 20 years (from date of filing patent application) to inventors by giving them recourse if others make, use, or sell their invention without permission: “Patents apply to newly developed technology as well as to improvements on products or processes. Patents provide a time-limited, legally protected, exclusive right to make, use and sell an invention. In this way, patents serve as a reward for ingenuity” (Canadian Intellectual Property Office, 2015d).

Patents must be filed in order to provide patent protection to new inventions. It can be time-consuming and expensive to file patents. The Canadian Intellectual Property Office (2015d) says the following about them:

> Patents can have a great deal of value. You can sell them, license them or use them as assets to attract funding from investors.
>
> In exchange for these benefits, you must provide a full description of the invention when you file a patent. This helps enrich technical knowledge worldwide. Details of patent applications filed in Canada are disclosed to the public after an 18-month period of confidentiality.
>
> To be eligible for patent protection, your invention must be:
>
> - new—first in the world
> - useful—functional and operative
> - inventive—showing ingenuity and not obvious to someone of average skill who works in the field of your invention
>
> The invention can be:
>
> - a product (e.g., door lock)
> - a composition (e.g., chemical composition used in lubricants for door locks)
> - a machine (e.g., for making door locks)
> - a process (e.g., a method for making door locks)

- an improvement on any of these (Canadian Intellectual Property Office, 2015d)

You can search the Canadian Patents Database from the Canadian Intellectual Property Office website. If you use this search engine, notice the level of detail included with each patent entry.

Trademarks

When registered, trademark protection lasts for 15 years and can be often be renewed for another term. The Canadian Intellectual Property Office (2015c) website lists the three kinds of trademarks:

- An ordinary mark is made up of words, sounds, designs or a combination of these used to distinguish the goods or services of one person or organization from those of others. For example, suppose you started a courier business that you chose to call Giddy-up. You could register these words as a trademark (if you met all the legal requirements) for the service that you offer.
- A certification mark can be licensed to many people or companies for the purpose of showing that certain goods or services meet a defined standard. For example, the Woolmark design, owned by Woolmark Americas Ltd., is used on clothing and other goods.
- A distinguishing guise is about the shape of goods or their containers, or a way of wrapping or packaging goods that shows they have been made by a specific individual or firm. For example, if you manufactured butterfly-shaped candy you could register the butterfly shape as a distinguishing guise. (Canadian Intellectual Property Office, 2015c)

Industrial Designs

Original industrial designs can be registered for up to 10 years. They “are about how things look. More technically speaking, they are the visual features of shape, configuration, pattern or ornament, or any combination of these features, applied to a finished article. For example, the shape of a table or the shape and decoration of a spoon may be industrial designs” (Canadian Intellectual Property Office, 2015b).

Product/Process/Trade Secrets

Product/process/trade secrets come into play when patents are not filed, but instead innovations are kept secret. For example, the formula for Coca-Cola and the recipe for the KFC herbs and spices are not registered anywhere, but instead are kept secret by their owners. This protection lasts for as long as the secret is kept.

Competitive Performance

While entrepreneurs must always strive to establish competitive performance advantages, it is particularly important when the potential protection afforded by patents, copyrights, trade secrets, or trademarks is weak. In these cases the best protection is to out-compete rivals with production, pricing, distribution, selling, and other strategies.

Other Set-Up Considerations

Among the other set-up activities for new ventures are the following:

- Attract purchase orders or otherwise line up initial sales
- Set up organizational and legal structure
    - Sole Proprietorship
    - Partnership
    - Limited Partnership
    - Corporation
    - Cooperative
- Set up control systems
- Set up relationships with suppliers and others
- Set up everything else in preparation for start-up
    - Choose name
    - Check zoning, equipment prices, suppliers, etc.
    - Choose location
    - Arrange lease terms, leasehold improvements, signage, pay deposits, etc.
    - Get business license, permits, etc.
    - Set up banking arrangements
    - Set up legal and accounting systems (or professionals)
    - Order equipment, locks and keys, furniture, etc.
    - Recruit employees, set up payroll system, benefit programs, etc.
    - Decide on graphics, logos, promotional methods, etc.
    - Order business cards, letterhead, etc.
    - Set up supplier agreements
    - Buy inventory, insurance, etc.
    - Revise business plan

Start-Up

The goal of the venture start-up phase is to implement the plans needed to sustain the venture from the time when it begins making sales until when the business has moved beyond the point where the entrepreneur must continually fight for the business's survival and persistence. It ends when the entrepreneur can instead shift emphasis toward business growth or maintaining the venture's stability.

A major consideration during the start-up phase is making the needed sales to establish an adequate cash flow.

Another important consideration is ensuring that the venture is adaptable enough to productively respond to when things do not proceed as planned. Part of this involves implementing appropriate leadership and management strategies.

Growth

The goal during the growth phase is to grow or maintain the venture until the time when the entrepreneur chooses to harvest the value they generated by starting and running the venture. To do this entrepreneurs must continually monitor their operating environment at all levels: at the societal level using analysis tools like a PESTEL analysis; at the industry level using a tool like Porter's Five Forces Model; at the market level using tools like market profile analyses; and at the firm level using tools like a SWOT Analysis/TOWS Matrix, VRIO, financial analysis methods, and stakeholder analyses. They must also continually strive to be innovative to generate new ideas and to maintain their competitive advantages.

Chapter 8 – Strategic Entrepreneurship

However beautiful the strategy, you should occasionally look at the results. – Winston Churchill

Strategy is about making choices, trade-offs; it's about deliberately choosing to be different. – Michael Porter

All men can see these tactics whereby I conquer, but what none can see is the strategy out of which victory is evolved. – Sun Tzu

Learning Objectives

After completing this chapter you will be able to

- Describe the considerations associated with a variety of strategic approaches to entrepreneurship

Overview

There are many strategic considerations for entrepreneurs, including a few big strategic issues like determining their exit strategies, planning for succession, and embracing ideas like sustainable entrepreneurship.

Exit Strategies

When entrepreneurs decide to exit their business, they follow one or more of the following *exit strategies*, sometimes called *harvest methods*. As any chosen exit strategy will have major implications for the decisions an entrepreneur makes regarding almost all other aspects of their business, it is important to determine the exit strategy early.

Private Sale

A private sale involves selling a business to another individual or group. They can be done quite informally, although it is prudent to seek legal, financial, and sales help to ensure the sale goes smoothly. Selling an ongoing business can be a fairly complex process that requires expertise that only experienced professionals, like a business broker, have. One challenge in selling any business is to determine its valuation.

Depending upon when an entrepreneur plans to sell their business, the exit strategy may mean that the business owner will want to take actions designed to increase the value of the enterprise prior to the sale. It might also impact the forms of financing the entrepreneur is willing to pursue. For example, an entrepreneur might want to borrow money to purchase machinery needed to expand the business and increase its value. This might be more appealing than raising the desired capital by selling ownership interests in the company because, if the entrepreneur is sharing ownership, they won’t get as much of the sale proceeds when the company is sold.

Public sale

During a public sale, the business is sold to anyone in the general public who can and wants to purchase an ownership interest in the company.

An initial public offering (IPO) transforms a private company into a public one when shares of stock in the company are created through a legal process and are sold to members of the general public through a securities exchange. IPOs are used to raise needed capital for a company. They can also be used to transfer the value that an entrepreneur has built up in a company into cash for the entrepreneur in exchange for ownership interests for the investors. In other words, an IPO can be used to sell all or part of a company. Using an IPO to transform a private company into a public company can also be done for other reasons, like to gain increased exposure.

An IPO process is time-consuming and expensive because of the legal requirements to produce and disclose all of the required information so that the public can make informed choices when they consider buying the shares. Working with an underwriter through an investment banking company is essential to try to set the best share price. If the initial share price is set too high, not all of the shares will be sold and the company won’t raise as much capital as it had planned. If the initial share price is set too low, the company will end up giving value away. This happens when the purchasers of the shares buy them at the low initial price and then immediately sell them in the market at the higher price the market is willing to pay. That profit made by the initial purchaser of the shares could have instead been realized by the company had the initial share price been set at the right level.

Like with a private sale strategy, a strategy to sell all or part of a business publicly might lead an entrepreneur to pursue other strategies to increase the value of the firm in the eyes of potential buyers. As public sales usually apply to companies that are larger in size, it might be possible to for owners to sell part of their company prior to when they want to sell all of it while retaining control—provided they keep at least 51% of the shares for themselves.

Hold

A hold situation might involve setting up systems so that the venture can operate without the day-to-day involvement of the entrepreneur. This often means that the owner must hire and train the right people to operate the business in their absence.

Unlike a private or public sale where the owner might sell the entire company in exchange for cash, a hold situation often means that the owner retains some or all of the ownership interest and continues to receive their share of the distributed profits along with complete or partial say in how the company runs. Sometimes hold situations are most appropriate for family businesses that intend to stay family businesses when new generations of family members take over the business operations.

Combination Sale and Hold

Sometimes it is prudent and advantageous for a business owner to sell some of the business and hold some of it. This might form part of a succession planning strategy.

Succession Planning

A good succession plan will help make the transfer of a business go smoothly, and allow the entrepreneur to maintain good relationships with employees and business partners. Succession planning helps

- Protect the legacy of your business
- Maintain a service to your community
- Build value for your business
- Provide financial security for your family and your stakeholders
- Deal with unexpected events (illness, accident or death)
- Prepare for the future (Canada Business Network, 2013)

Business owners should begin their succession planning as soon as they are able because the process takes time and the decisions made now can affect the opportunities for achieving succession and exit strategy goals later. The process for succession planning should include the following considerations (Canada Business Network, 2013):

- The owner should establish their goals for the business up to and post-retirement, including whether they wants to retain an ownership interest in the company after stepping aside from the day-to-day operations of the business.
- Decision-making processes should be established, especially for when or if the current owner decides to pass the business on to a successor.
- Any potential successors should be trained in the business operations.
- The owner should prepare a good estate plan so that all income tax and financial factors and

implications are considered.

- The owner should have a contingency plan in place in case the original plans do not turn out as intended.
- The owner should plan how to transfer the business, should valuate it, and should determine their exit strategy.

Sustainable Entrepreneurship

The relatively recent focus by businesses on their corporate social responsibility initiatives began as a defensive reaction to societal pressures to become better corporate citizens, but has evolved to become a more proactive approach by managers. This evolution has given rise to the *sustainable entrepreneurship* management concept (Weidinger, Fischler, & Schmidpeter, 2014):

> The term “Sustainable Entrepreneurship” recently emerged in the business world to describe this latest very entrepreneurial and business-driven view on business and society. Current definitions for Sustainable Entrepreneurship focus on new solutions or sustainable innovations that aim at the mass market and provide value to society. Entrepreneurs or individuals or companies that are sustainability-driven within their core business and contribute towards a sustainable development can be called sustainable entrepreneurs, according to Schaltegger and Wagner (2011). Others argue that sustainable entrepreneurship stands for a unique concept of sustainable business strategies that focuses on increasing social as well as business value – shared value (Porter and Kramer 2011) – at the same time (Weidinger et al., 2014, p. 1).

Chapter 9 – Innovation and Entrepreneurship

> *While the idea of the entrepreneur and entrepreneurship has evolved to include the attributes of innovation, opportunity discovery (or construction) and value creation, my sense of the basic gist of the term continues to focus on this facet of human behavior: initiative taking. The process of entrepreneurship invariably involves an individual or individuals investing effort into something they had not previously done before. – Fayolle (2007, p. ix)*

Learning Objectives

After completing this chapter you will be able to

- Describe how innovation and entrepreneurship are interrelated concepts
- Describe the building blocks for both innovation and successful entrepreneurship
- Explain the elements of innovation

Overview

This chapter introduces the building blocks for both innovation and successful entrepreneurship while describing how innovation and entrepreneurship are interrelated concepts. It continues with a discussion about competencies—and specifically core competencies—as necessary building blocks for both innovation and successful entrepreneurship. The elements of innovation are also discussed.

Innovation and Entrepreneurship

The concepts of innovation and entrepreneurship are undeniably interrelated:

> Innovation is the specific tool of entrepreneurs, the means by which they exploit change as an opportunity for a different business or a different service. It is capable of being presented

> as a discipline, capable of being learned, capable of being practiced. Entrepreneurs need to search purposefully for the sources of innovation, the changes and their symptoms that indicate opportunities for successful innovation. And they need to know and to apply the principles of successful innovation (Drucker, 1985, p. 19).

Drucker (1985) argued that innovation should be viewed as an economic or social phenomenon rather than a technological term. Innovation is not about making new inventions, but rather about recognizing how to take advantage of opportunities and changes: "Systematic innovation therefore consists in the purposeful and organized search for changes, and in the systematic analysis of the opportunities such changes might offer for economic or social innovation" (p. 35). This is consistent with Schumpeter's (1934) view that innovation arises from new combinations of materials and forces.

To better understand the interrelationship between innovation and entrepreneurship, we will consider some of the building blocks for both innovation and successful entrepreneurship.

Competencies and Core Competence

Competencies are the necessary ingredients for entrepreneurial competence:

> *Individual competencies* are the combination of learnable behaviors that encompass attitudes (wanting to do), skills (how to do), knowledge (what to do), practical experiences (proven learning), and natural talents of a person in order to effectively accomplish an explicit goal within a specific context.
>
> *Collective competencies* are the synergistic combination of the individual competencies of team members within organizations. There is a continuum that exists from low-functioning teams to high-functioning teams. High-functioning teams, although very rare, are those that apply collective competencies the most effectively (Matthews & Brueggemann, 2015, p. 10).

Core competencies are those that are collectively held and that include "the learnable behaviors the entire organization must practice in order to achieve competence in relation to the organization's purpose and its competitive environment. A core competency encompasses the knowledge, skills, and technology that create unique customer value" (Matthews & Brueggemann, 2015, p. 11):

> Organizations need to identify what core competencies they need to cultivate in their precious human resources in order to meet a competence level that rises above the competition. The three tests to identify a core competence are:
>
> 1. First, a core competence provides potential access to a wide variety of markets.
>
> 2. Second a core competence should make a significant contribution to the perceived benefit of the end product.
>
> 3. Finally a core competence should be difficult for competitors to imitate (Matthews & Brueggemann, 2015, p. 12).

Entrepreneurs must assess their and their organization's individual competencies to better understand how to fill competency gaps and build collective and core competencies.

Elements of Innovation

Matthews and Brueggemann (2015) identified the following 12 *elements of innovation*. They argued that innovation is best understood by first examining each of the following elements.

Innovation Degrees

Incremental innovations are small-scale improvements on what is already being done, often with the intention to improve efficiencies to reduce costs, or improve products or services offered: "Both Six Sigma and Lean are well-regarded managerial quality improvement programs that explicitly target the removal of many types of organizational waste and variability…. An incremental innovation can be used to differentiate products for marketing purposes" (Matthews & Brueggemann, 2015, p. 34).

Evolutionary innovations involve doing new things for existing customers and markets, and also doing things that extend product offerings to new customers and new markets (Matthews & Brueggemann, 2015).

Revolutionary innovations are when businesses pursue new products, businesses, customers, and markets. The impacts from these types of innovations can be much higher than from either incremental or evolutionary innovations (Matthews & Brueggemann, 2015).

Innovation Types

There are many types of innovations. "Organizing innovation into types makes it is easier to understand how you can use multiple types of innovation simultaneously. The fundamental innovation types include products, customer experiences, solutions, systems, processes, and business and managerial models" (Matthews & Brueggemann, 2015, p. 37). Matthews and Brueggemann (2015) combined the innovation degrees with the innovation types to develop The Innovation Matrix.

Innovation Direction

> Innovation direction is a concept that encompasses forward and reverse innovation. Innovation direction is a notion that is based on the source and target of the innovation. A forward innovation would have its source in country X and the target in country X. A reverse innovation would have its source in country Y and later targeted to a different country such as country X. Country X or Y could be a developed or developing country (Matthews & Brueggemann, 2015, p. 40).

Innovation Risk

The entrepreneurial ecosystem described earlier in this book indicated that individuals, firms, and organizations are interconnected in ways that impact each other. According to Matthews and Brueggemann (2015), *co-innovation risk* occurs when multiple actors in the ecosystem attempt to innovate, which leads to the possibility that a new innovation developed by one company is ready at a different time than a dependent second innovation developed by another firm. For example, it can be disastrous for a computer hardware company to release a new product that is dependent upon new software if the company developing that software does not make it available on time.

Adoption chain risk also occurs when multiple firms in the value chain are simultaneously developing new products and services. If one firm, for example, releases a product that must be serviced by a different company before that other company is prepared to offer that service, the product release can fail (Matthews & Brueggemann, 2015).

Innovation Principles and Tenets

Both non-profit and for-profit organizations are governed by principles that dictate how they operate. Non-profits often strive to alleviate social problems while for-profits attempt to satisfy the desires of their shareholders. An increasing number of organizations are adopting alternative measures of performance that include not only economic outcomes, but also social and environmentally responsible results: a triple bottom line (Kneiding & Tracey, 2009). This can—and should—lead to organizations redefining themselves as pursuing the creation of *shared value* rather than just profits (Matthews & Brueggemann, 2015; Porter & Kramer, 2011):

> Companies must take the lead in bringing business and society back together. The recognition is there among sophisticated business and thought leaders, and promising elements of a new model are emerging. Yet we still lack an overall framework for guiding these efforts, and most companies remain stuck in a "social responsibility" mindset in which societal issues are at the periphery, not the core.
>
> The solution lies in the principle of shared value, which involves creating economic value in a way that also creates value for society by addressing its needs and challenges. Businesses must reconnect company success with social progress. Shared value is not social responsibility, philanthropy, or even sustainability, but a new way to achieve economic success. It is not on the margin of what companies do but at the center. We believe that it can give rise to the next major transformation of business thinking. …
>
> The purpose of the corporation must be redefined as creating shared value, not just profit per se. This will drive the next wave of innovation and productivity growth in the global economy. It will also reshape capitalism and its relationship to society. Perhaps most important of all, learning how to create shared value is our best chance to legitimize business again (Porter & Kramer, 2011, p. 4).

Innovation Thresholds

Organizations should strive to achieve their *innovation threshold:*

> An innovation threshold is a marker that each business sector needs to achieve in order to be competitive. To thrive, an organization cannot under-innovate, while over-innovation would be wasteful and ineffectual. Innovation thresholds range from low to high, and are different for each business sector. Once an organization achieves the innovation threshold, additional innovation may not matter (Matthews & Brueggemann, 2015, p. 52).

After achieving their innovation threshold such that more innovation might not generate enough extra value to make the effort worthwhile, organizations must rely on other innovation competencies. For example, some industries like insurance and airlines have a relatively low product innovation threshold, so after reaching it they must rely on other forms of innovation and entrepreneurship competencies "such as creativity, culture, strategy, leadership, and technology" (Matthews & Brueggemann, 2015, p. 53) to further advance their goals. Higher technology fields normally have higher product innovation thresholds and can gain much by striving for more product innovations.

Innovation Criteria

Matthews and Bruggemann (2015) argue that a design should be judged based on its desirability, feasibility, and viability: "An innovative design needs to be desirable, feasible, and aligned with a sustainable business model" (Matthews & Brueggemann, 2015, p. 53).

Innovation Processes

Another element of innovation is the set of planned innovation processes that are required to make innovation happen. These processes must balance the need to provide customers with what they want with what is technologically feasible and financially viable. One example of an innovation process is *design thinking*.

Innovation Diffusion

Lundblad (2003) defined *diffusion of innovation* as "the adoption and implementation of new ideas, processes, products, or services" as she studied the diffusion of innovation "within and across organizations" (p. 51). This concept is particularly important because many sectors of the economy strive for organizational improvement, but "innovations often are not diffused within and across organizations to achieve improvement" (p. 51). To illustrate her point, she described how research in the healthcare sector has led to the development of new advancements in clinical practice and process improvements, yet—despite the relatively low cost to implement many of these process innovations—it often takes many years before these improvements are adopted into practice, if they ever are. This means that often there is a gap between when an innovation is developed and when it is implemented in practice.

The *Theory of the Diffusion of Innovation* can help us understand what we must do in terms of implementing steps and processes for innovations to be diffused into the areas of practice where they are needed. There are four main elements of the theory.

The first element of the theory is *the innovation* itself, whether that be an idea, a product, a process, or something else that is new to the potential adopters. The theory says that there are several characteristics of the innovation that affect its rate of adoption, including its complexity and its compatibility with whatever it will be connected within some manner (Lundblad, 2003).

The second element is *communication*, specifically the processes used by people to share the information needed to develop a common understanding. The rate of adoption will depend upon the sources of communication, even more so than the technical information contained in the messages (Lundblad, 2003).

Time is the third element of the theory. According to Rogers (2003), who developed the Theory of the Diffusion of Innovation, three considerations are related to the time element. The first is the *innovation-decision process* that describes the gap in time between when a potential early adopter learns about an innovation and either adopts it or doesn't. There are several stages that the potential adopter goes through during this time frame. Second, Rogers (2003) classified potential adopters as "innovators, early adopters, early majority, late majority, and laggards" (Lundblad, 2003, p. 54) based upon how early they were likely to adopt an innovation. Finally, the *rate of adoption* describes how quickly the innovation is adopted. As Lundblad (2003) noted,

> Innovation adoption tends to follow an S-shaped curve, meaning that only a few individuals initially adopt the innovation; but as time moves on and more and more individuals adopt, the rate increases. Eventually, though, the adoption rate levels off and begins to decline. (p. 54)

The final element of the theory is *social system*. Rogers (2003) said that diffusion of innovation occurs within a social system, which might be somewhat limited, like the members of an organization, or widespread, like all of the consumers in a country. Some members within a social system, such as "opinion leaders, change agents, and champions" (Lundblad, 2003, p. 55), influence others.

Innovation Pacing

Innovation pacing refers to the speed with which an organization delivers innovations, and how that impacts its ability to compete: "Pacing is influenced by your innovation capability and the ability of your customers to adopt those innovations" (Matthews & Brueggemann, 2015, p. 60).

Innovation Value

Red ocean strategies focus on competing with other players for market share within industries that currently exist. This type of thinking can be a constraint if it restricts organizations' abilities to adapt to change and to figure out ways to pursue *blue ocean strategies,* namely entirely new markets, business models, industries, and other opportunities that others have not yet been conceptualized or pursued. Blue ocean strategies are not about competing with others; they are about rendering competitors irrelevant because they are not playing in the same field as your organization, and, more importantly, they are not matching the value that you create for customers in the new market that you opened up: "Value without innovation is an improvement that may not be sufficient for organic growth. Innovation without value does not provide the utility that customers would be willing to purchase.

Innovation needs to be aligned with value comprised of utility, price, and cost" (Matthews & Brueggemann, 2015, p. 62).

Disruptive Innovation

The last element is *disruptive innovation*:

> Disruptive innovations are different than incremental, evolutionary, and revolutionary innovation degrees. A disruptive innovation is not a revolutionary innovation that makes other innovations, such as products and services, better. Rather, a disruptive innovation transforms any type of innovation that historically was expensive and complicated into an innovation that is affordable, simple, and available to broader markets (Matthews & Brueggemann, 2015, p. 63).

Chapter 10 – The Entrepreneurial Environment

Entrepreneurs adopt the ways of the adept and adapt to a changing environment. Actually, entrepreneurs are more entrepreneurs, because they are forever entering into new territory. – Jarod Kintz

Entrepreneurship rests on a theory of economy and society. The theory sees change as normal and indeed as healthy. And it sees the major task in society—and especially in the economy—as doing something different rather than doing better what is already being done. That is basically what Say, two hundred years ago, meant when he coined the term entrepreneur. It was intended as a manifesto and as a declaration of dissent: the entrepreneur upsets and disorganizes. As Joseph Schumpeter formulated it, his task is "creative destruction. – Peter Drucker

Learning Objectives

After completing this chapter you will be able to

- Explain what an entrepreneurial ecosystem is as a form of complex adaptive system while explaining its relevance to the study of entrepreneurship
- Describe various entrepreneurship concepts, such as intrapreneurship and social entrepreneurship, while explaining their relevance to the study of entrepreneurship

Overview

In this chapter several entrepreneurship topics are introduced, including: entrepreneurial ecosystems, intrapreneurship, social entrepreneurship, Indigenous entrepreneurship, community-based entrepreneurship, and family business. This overview of just a few of the branches of entrepreneurship thought and research is intended to provide the reader with an idea of the breadth of this field of study. There are many other categories of entrepreneurship, from women entrepreneurs to technology entrepreneurs, which provide interesting and important study topics.

The Entrepreneurial Environment

Entrepreneurial Ecosystems

An *entrepreneurial ecosystem* might be viewed as a *complex adaptive system* that can be compared to a natural ecosystem, like a forest. This complexity theory perspective can help us better understand the nature of an entrepreneurial ecosystem.

A forest is a *complex adaptive system* made up of many, many different elements, including the plants and animals that live in it or otherwise influence how it works. Those many different elements behave autonomously from each other in most ways; but as they do what is necessary to ensure their own survival—and as they attempt to thrive—the end result of their collective behaviours is a forest that exists in a somewhat stable state of being.

The forest is in a somewhat stable state because it is ever evolving and changing to some degree as variables change. Changing variables include new insect species that move in and out, new plants that try to establish roots there, and similar changes that regularly happen to cause some change, but that don't necessarily change the fundamental nature of the forest.

Sometimes, however, a *parameter change* occurs when something more substantial happens, like a forest fire. When a fire burns down the plants and chases many of the animals away, the forest fundamentally changes to a very different state (the change from the first state to a new and very different one is called *bifurcation*).

An *entrepreneurial ecosystem* is similar in that the nature of entrepreneurship—thriving or not—across a geographic region remains in a somewhat stable state of being even though it is made up of a complex network of independent elements that continually adapt to the organizational environments in which they operate; it is a complex adaptive system. The variable changes, including new leaders that replace the old ones, new rules and regulations, and entrepreneurial support systems that come and go do not necessarily change the fundamental nature of the entrepreneurial ecosystem (although the residents of the region might actually want substantial change leading to a more vibrant economic situation). A parameter change, however, might cause a bifurcation that leaves the system in a very different state—maybe one where entrepreneurship thrives and prosperity prevails much more than it did before. The introduction of a major new project that, in turn, spawns new spin-off businesses and gives the region a needed economic boost, and maybe even leaves it with a new entrepreneurial culture, is an example of a parameter change.

In a more formal sense, an entrepreneurial ecosystem can be described as

> a set of interconnected entrepreneurial actors (both potential and existing), entrepreneurial organisations (e.g. firms, venture capitalists, business angels, banks), institutions (universities, public sector agencies, financial bodies) and entrepreneurial processes (e.g. the business birth rate, numbers of high growth firms, levels of 'blockbuster entrepreneurship', number of serial entrepreneurs, degree of sell-out mentality within firms and levels of entrepreneurial ambition) which formally and informally coalesce to connect, mediate and govern the performance within the local entrepreneurial environment (Mason & Brown, 2014, p. 5).

Definitions of entrepreneurial ecosystems can include the suppliers, customers and others that any particular firm in that ecosystem directly interacts with as well as other individuals, firms, and organizations that the firm might not directly interact with, but that play a role in shaping the ecosystem. While framing it as an innovation ecosystem rather than an entrepreneurial ecosystem, Matthews and Brueggemann (2015) described an internal ecosystem as a company's activities that are independent of other companies and an external ecosystem that includes all of the other actors that the company is dependent upon in some way.

While some researchers have studied how entrepreneurial ecosystems can generate geographic clusters of technology-based ventures, like in Silicon Valley (Cohen, 2006) or how these ecosystems can facilitate growth in entrepreneurship in cities and similarly defined regions (Neck, Meyer, Cohen, & Corbett, 2004), Mason and Brown (2014) suggest that even traditional industries can "provide the platform to create dynamic, high-value-added entrepreneurial ecosystems" (p. 19).

Types of Entrepreneurship

Intrapreneurship

According to Martiarena (2013) "the recognition of intrapreneurial activities has widened the notion of entrepreneurship by incorporating entrepreneurial activities undertaken within established organisations to the usual view of entrepreneurship as new independent business creation." (p. 27). Intrapreneurship, then, is a form of entrepreneurship that occurs within existing organizations, but intrapreneurs are generally considered to be "significantly more risk-averse than entrepreneurs, earn lower incomes, perceive less business opportunities in the short term and do not consider that they have enough skills to succeed in setting up a business" (Martiarena, 2013, p. 33).

Merriam-Webster (n.d.) defines an *intrepreneur* as "a corporate executive who develops new enterprises within the corporation" (Intrapreneur, n.d.); however some might consider some employees who are not corporate executives to also be intrapreneurs if they demonstrate entrepreneurial behaviour within the company they work for.

Social Entrepreneurship

Social entrepreneurship involves employing the principles of entrepreneurship to create organizations that address social issues.

Martin and Osberg (2007) defined a social entrepreneur as an individual who

> targets an unfortunate but stable equilibrium that causes the neglect, marginalization, or suffering of a segment of humanity; who brings to bear on this situation his or her inspiration, direct action, creativity, courage, and fortitude; and who aims for and ultimately affects the establishment of a new stable equilibrium that secures permanent benefit for the targeted group and society at large. (p. 39)

Martin and Osberg's (2007) definition encompasses for-profit and not-for-profit organizations created by these entrepreneurs and also some government initiatives, but it excludes entities that exist solely to provide social services and groups formed to engage in social activism.

An idealized definition of social entrepreneurship developed by Dees (2001) is informative in that it supports Martin and Osberg's (2007) definition while complementing it with a set of criteria against which organizations can be assessed to determine whether they are socially entrepreneurial.

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

- adopting a mission to create and sustain social value (not just private value)
- recognizing and relentlessly pursuing new opportunities to serve that mission
- engaging in a process of continuous innovation, adaptation, and learning
- acting boldly without being limited by resources currently in hand
- exhibiting heightened accountability to the constituencies served and for the outcomes created (Dees, 2001, p. 4)

Social entrepreneurs "use their skills not only to create profitable business ventures, but also to achieve social and environmental goals for the common good" (Zimmerer & Scarborough, 2008, p. 25). They are "people who start businesses so that they can create innovative solutions to society's most vexing problems, see themselves as change agents for society" (Scarborough, Wilson, & Zimmer, 2009, p. 745).

Social entrepreneurship

- addresses social problems or needs that are unmet by private markets or governments
- is motivated primarily by social benefit
- generally works with—not against—market forces (Brooks, 2009, p. 4)

A social entrepreneur might

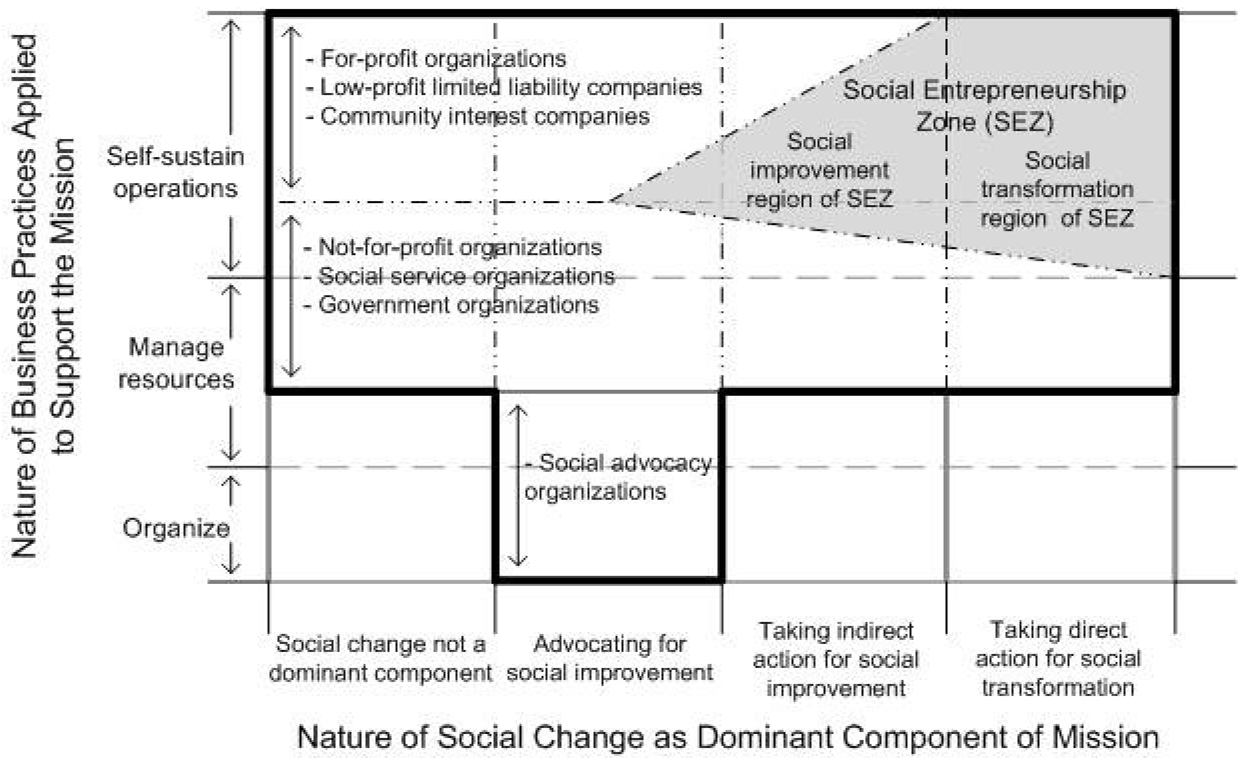
- start a new product or service
- expand an existing product or service
- expand an existing activity for a new group of people
- expand an existing activity to a new geographic area
- merge with an existing business (Brooks, 2009, p. 8)

What social entrepreneurship is not: it is not anti-business:

- Many social entrepreneurs came from the commercial business world.
- Sometimes commercial and nonprofit missions align for mutual benefit.

- The difference between it and commercial entrepreneurship *is not* greed.
- There is no evidence commercial entrepreneurs are especially greedy—they are more likely to be goal-obsessed than money-obsessed.
- Social entrepreneurs are also commercial entrepreneurs.
- Social entrepreneurs do not only run non-profits.
- Social entrepreneurship can occur in any sector and with any legal status. (Brooks, 2009, pp. 16-17)

The social entrepreneurship zone:



From Swanson and Zhang (2010, 2011, 2012)

Figure 7 – The Social Entrepreneurship Zone (Illustration by Lee A. Swanson)

Aboriginal (Indigenous) Entrepreneurship

Swanson and Zhang (2014) described a range of perspectives on what Indigenous entrepreneurship means and what implications it holds for social and economic development for Indigenous people.

Indigenous entrepreneurship might simply be entrepreneurship carried out by Indigenous people (Peredo & Anderson, 2006), but it can also refer to the common situation where Indigenous entrepreneurs—sometimes through community-based enterprises—start businesses that are largely intended to preserve and promote their culture and values (Anderson, Dana, & Dana, 2006; Christie & Honig, 2006; Swanson & Zhang, 2011). Dana and Anderson (2007) expanded upon that notion when they described Indigenous entrepreneurship as follows:

> There is rich heterogeneity among Indigenous peoples, and some of their cultural values are often incompatible with the basic assumptions of mainstream theories. Indigenous entrepreneurship often has non-economic explanatory variables. Some Indigenous communities' economies display elements of egalitarianism, sharing and communal activity. Indigenous entrepreneurship is usually environmentally sustainable; this often allows Indigenous people to rely on immediate available resources and, consequently, work in Indigenous communities is often irregular. Social organization among Indigenous peoples is often based on kinship ties, not necessarily created in response to market needs. (p. 601)

Lindsay (2005) described Indigenous entrepreneurship as something even more complex:

> Significant cultural pressures are placed on Indigenous entrepreneurs. These pressures will manifest themselves in new venture creation and development behavior that involve the community at a range of levels that contribute toward self-determination while incorporating heritage, and where cultural values are an inextricable part of the very fabric of these ventures. Thus, the Indigenous "team" involved in new venture creation and development may involve not only the entrepreneur and the business' entrepreneurial team but also the entrepreneur's family, extended family, and/or the community. Thus, in Indigenous businesses, there are more stakeholders involved than with non-Indigenous businesses. For this reason, Indigenous businesses can be regarded as more complex than non-Indigenous businesses and this complexity needs to be reflected in defining entrepreneurship from an Indigenous perspective. (p. 2)

Community-Based Enterprises and Community-Based Entrepreneurship

Peredo and Chrisman (2006) described community-based enterprises (CBEs) as emerging from "a process in which *the community* acts entrepreneurially to create and operate a new enterprise embedded in its existing social structure" (p. 310). CBEs emerge when a community works collaboratively to "create or identify a market opportunity and organize themselves in order to respond to it" (p. 315). These ventures "are managed and governed to pursue the economic and social goals of a community in a manner that is meant to yield sustainable individual and group benefits over the short and long term" (p. 310). CBEs are positioned in a sector of the economy that is not dominated by a profit motive, often because there is little profit to be made, or by government. As illustrated in the next paragraphs, they also serve what we can refer to as the *social commons*.

Modern societies are comprised of three distinct, but overlapping sectors (Mook, Quarter, & Richmond, 2007; Quarter, Mook, & Armstrong, 2009; Quarter, Mook, & Ryan, 2010). Businesses operating in the private sector primarily strive to generate profits for their owners by providing goods and services in response to market demands. "While this sector provides jobs, innovation, and overall wealth, it is not suited to addressing most social problems because there is usually no profit to be made by doing so" (Swanson & Zhang, 2012, p. 177). The public sector redistributes the money it collects in taxes to provide public goods and to serve needs not met by the private sector. "While this sector provides defence, public safety, education and a range of other public needs and social services, it has limited capacity to recognize and solve all social needs" (Swanson & Zhang, 2012, p. 177). The remaining sector—referred to by a variety of names including the third sector, the citizens' sector, the voluntary sector, the non-profit sector, and more recently by Mintzberg, the plural sector (Mintzberg, 2013; Mintzberg & Azevedo, 2012)—is comprised of organizations that deliver goods and services the other sectors do not provide and are either owned by their members (with limited or no potential for individuals or small groups to gain a controlling interest in the organization) or not owned by any individuals, governments, businesses, other organizations, or any particular entity at all.

Bollier (2002) used the term *the commons* to distinguish the collaborative community-based concern for particular kinds of resources from the management interests in resources assumed by the markets and governments. He pointed out that "people have interests apart from those of government and markets" (p. 12). One of his categories of the commons is the social commons, which involves "pursuing a shared mission as a social or civic organism" (p. 12). The social commons is comprised of community members who contribute energy and resources as they work together to create value.

Scholars have studied CBEs' role in promoting socio-economic development in developing countries (Manyara & Jones, 2007; Torri, 2010) and some have conceptualized Indigenous entrepreneurship as based on a community-based orientation (Kerins & Jordan, 2010; Peredo & Anderson, 2006; Peredo, Anderson, Galbraith, Honig, & Dana, 2004). Social enterprises are sometimes considered to be a form of CBE (Leadbeater, 1997); however, Somerville and McElwee (2011) interpreted Peredo and Chrisman's (2006) work to mean that a CBE is "a special kind of community enterprise where the community itself is the enterprise and is also the entrepreneur. Consequently, a CBE is an enterprise whose social base (the social structure of the community) lies in the CBE itself" (Somerville & McElwee, 2011, p. 320). This interpretation might distinguish CBEs from some types of social enterprises.

Some scholars refer to CBEs as being owned by the community while others indicate they can be owned by individuals or groups of people on behalf of the communities they serve. Lehman and Lento (1992) referred to "owners and managers" (p. 70) of CBEs when they argued that the value generated by these types of enterprises often benefit neighbouring residents and businesses more so than the direct owners.

While CBEs in the form of cooperatives have proven to be both prominent and resilient in many parts of the world (Birchall & Hammond Ketilson, 2009), there are also other forms of community-based or mutually owned enterprises as described by Woodin, Crook, and Carpentier (2010). They identified five general models of community-based or mutual ownership while explaining that new models continue to develop.

CBEs involved with housing developments, energy production initiatives, financial services, retail and wholesale trade, health care and social services, education, and other types of activities is relatively well documented (Woodin et al., 2010). There are also examples of symphony orchestras (Boyle, 2003) and other arts organizations that are community-based, sometimes through direct community ownership. Examples of community-owned sports franchises in Canada include the Saskatchewan Roughriders (Saskatchewan Roughrider Football Club Inc., 2012), Edmonton Eskimos (Edmonton Eskimos, 2011), and Winnipeg Blue Bombers (Winnipeg Blue Bombers, 2012) of the Canadian Football League. The Green Bay Packers, a professional American football team in the United States is also community-owned (Green Bay Packers, 2012). In the association football (soccer) world, the Victoria Highlanders' F. C. (Dheensaw, 2011) and F. C. Barcelona (Schoenfeld, 2000) are examples of community-owned teams.

The Role of Community-Based Enterprises

According to Gates (1999), the free enterprise system that has dominated the economic landscape of many developed countries since the end of the Cold War has often proven to be insensitive to the needs of communities. "The result is to endanger sustainability across five overlapping domains: fiscal, constitutional, civil, social and environmental" (p. 437). He suggested that the policy environment should be adjusted to encourage more connection between people and the results from the investments they make. With a revised capitalist goal to improve societal well-being rather than the current imperative to maximize financial returns with little or no regard for the associated public outcomes, the current and growing divide between our richest and poorest should narrow and we should end up with a more sustainable economic system.

Gates (1999) suggested that one approach to establishing a closer connection between people and the effects from their investments is to re-engineer capitalism in a way that encourages a shift in ownership types toward more members of society directly and collectively owning elements of the organizations that affect their lives through the social, environmental, and other impacts they have. CBEs appear to be one form of organization that can fulfill part of the role advocated by Gates (1999).

Community context plays an important role in how entrepreneurial processes evolve and in their resulting outcomes. According to Hindle (2010), to understand the community context requires an "examination of the nature and interrelationship of three generic institutional components of any community: physical resources, human resources and property rights, and three generic human factors: human resources, social networks and the ability to span boundaries" (p. 599). When communities face social and economic challenges, some are able to mobilize physical and human resources, particularly when these communities "are rich in social capital and are able to learn from collective experiences" (Ring, Peredo, & Chrisman, 2010, p. 5). Communities within this context are often equipped to identify opportunities and capitalize on them. This can give rise to CBEs that can contribute to capacity building in their communities (Peredo & Chrisman, 2006).

Community Capacity Building through Community-Based Enterprises

Similar to *entrepreneurial capacity* in that it refers to evaluating and capitalizing upon the potential to create value (Hindle, 2007), *community capacity* "is the interaction of human capital, organizational resources, and social capital existing within a given community that can be leveraged to solve collective problems and improve or maintain the well-being of a given community" (Chaskin, 2001, p. 295). Borch et al. (2008) indicated that CBEs play a community-capacity-building role when they mobilize physical, financial, organizational and human resources. Their role in organizing "voluntary efforts and other non-market resources" (p. 120) is also of particular importance in this regard.

Economists have generally suggested that for-profit, privately held organizations occupy different market segments than publicly funded and community-based organizations. For-profit entities normally seek markets that are easiest to access and profit from, but their activities in these markets do not necessarily generate social return beyond that provided by increased employment and the services that are funded by the taxes they pay. On the other hand, publicly funded and community-based organizations generally serve a different market segment focused on generating some sort of social return (Abzug & Webb, 1999).

For-profit entities are usually subject to significant influence from the suppliers of the capital used to support the organization's operations. Sometimes these *supply-side stakeholders* have little interest in the service or product delivered provided that it generates an adequate financial return for them. CBEs and not-for-profit organizations primarily answer to *demand-side stakeholders* who might use the products or services these organizations deliver or who will benefit from their provision. This can mean that CBEs play an important role in building community capacity when their demand-side stakeholders turn to them when "for-profit organizations fail to provide products and services that stakeholders trust; and where they provide insufficient quantity or quality, and government provision fails to compensate for this market failure" (Abzug & Webb, 1999, p. 421).

One major difference between for-profit and CBEs and not-for-profit organizations is in the distribution of the accounting profit. Unlike for-profits, CBEs and non-profits generally do not distribute profits to equity holders and they enjoy some competitive advantages, including tax exemptions and the ability to receive private donations (Sloan, 2000). Transparency in reporting financial returns is especially important in community-held entities. These entities must report to a vast group of stakeholders who evaluate the organization's success based on social return as well as financial efficiency (De Alwis, 2012).

CBEs can also represent an extension of the private sector that plays an important role in supporting them (Abzug & Webb, 1999). In the case of the Lloydminster Bobcats, the private sector supported the team by providing volunteers, advertising dollars, financial resources, and management and board expertise because it believed the team made the community more attractive. The team provided a form of entertainment that could help attract private sector employees to the community and retain them after they arrived.

Family Businesses

Chua, Chrisman, and Steier (2003) reported that "family-owned firms account for a large percentage of the economic activities in the United States and Canada. Estimates run from 40 to 60 percent of the U.S. gross national product (Neubauer & Lank, 1998), in addition to employment for up to six million Canadians (Deloitte & Touche, 1999). Their influence is likely even larger elsewhere" (p. 331). Besides the significant component of Canadian and other economies that are made up of family-owned businesses, these entities might be distinct from other forms of entrepreneurship in several ways. While more research is required to better understand the distinctions, family businesses might be characterized by the unique influences family members have on how their firms operate and by the distinctive challenges they face that make them behave and perform differently than other categories of businesses (Chua et al., 2003).

One of the unique and most important challenges faced by family businesses is managing succession so that leadership can be transferred to future generations to preserve family ownership while maintaining family harmony. This is particularly important as the survival rate of family businesses decline as new generations take over (Davis & Harveston, 1998).

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The Language of Entrepreneurship

Glossary

Effectuation (and effectual reasoning)

Sarasvathy (2001) distinguished between *effectuation* and causation when examining how entrepreneurs approached entrepreneurial challenges. He found that the uncertainty surrounding entrepreneurship–particularly with respect to challenges involving undefined end goals, like how starting a business might turn our relative to what was originally envisioned–led to what he called *effectual reasoning*.

Entirepreneur

Bolton and Thompson (2015) coined a new term, *entirepreneurs*, in response to what they described as today's *new normal* characterized by turbulence and uncertainty in the world. In this environment they claim that success is not easily achieved by an entrepreneur starting a business, then passing it on to a manager to run who eventually may need to give way to a strategic leader to ensure the venture's continuing success (or perhaps to save it from failing). Entirepreneurs embody the attributes of all of those categories of individuals.

Entirepreneurs successfully combine the attributes we conventionally associate with entrepreneurs, leaders and managers. They make an all-round contribution. Significantly, they appreciate the needs of different circumstances and challenges and flexibly adjust their style and approach. Sometimes they behave in a way we would conventionally describe as entrepreneurial; on other occasions they exhibit conventional leadership; at other times they are 'managerial' (Bolton & Thompson, 2015, p. 24).

Innovation

Innovation is "the implementation of a new or significantly improved product (good or service), or process, a new marketing method, or a new organizational method in business practices, workplace organisation or external relations" (Organisation for Economic Co-Operation and Development, 2005).

Internal Locus of Control

The term *internal locus of control* refers to a belief by an individual that they are in control of their own destiny.

Self-Efficacy

Self-efficacy refers to a belief by an individual in their personal capability to be an effective entrepreneur. Self-efficacy is different than self-confidence because self-efficacy is generally based upon past successes that lead to a heightened belief in abilities whereas an individual might be self-confident even without that confidence resulting from a history of successes.