

Robert D. Hisrich • Michael P. Peters • Dean A. Shepherd

Tenth Edition

# *Entrepreneurship*

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# ENTREPRENEURSHIP

TENTH EDITION



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ENTREPRENEURSHIP, TENTH EDITION

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*To our wives,  
Tina, Debbie, and Suzie,  
and children,  
Kary, Katy, Kelly, Christa, Kimberly, Jack, and Meg,  
and grandchildren,  
Rachel, Andrew, Sarah and Jack,  
for their supportive entrepreneurial spirit*

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# PREFACE

Starting and operating a new business involves considerable risk and effort to overcome the inertia against creating something new. In creating and growing a new venture, the entrepreneur assumes the responsibility and risks for its development and survival and enjoys the corresponding rewards. This risk is compounded for entrepreneurs who go international or who are in fact born global. The fact that consumers, businesspeople, and government officials from every part of the world are interested in entrepreneurship is evident from the increasing research on the subject, the large number of courses and seminars on the topic, the more than two million new enterprises started each year (despite a 70% failure rate), the significant coverage and focus by the media, and the realization that this is an important aspect of the economics of the developed, developing, and even controlled economies.

Who is the focus of all this attention? Who is willing to accept all the risks and put forth the effort necessary to create a new venture? It may be a man or a woman, someone from an upper-class or lower-class background, a technologist or someone lacking technological sophistication, a college graduate, or a high school dropout. The person may be an investor, manager, nurse, salesperson, engineer, student, teacher, homemaker, or retiree. It is always someone able to juggle work, family, and civic responsibilities while meeting payroll.

To provide an understanding of this person and the process of creating and growing a new venture on an international basis, this 9th edition of *Entrepreneurship* is divided into five major sections.

**Part 1—The Entrepreneurial Perspective** introduces the entrepreneur and the entrepreneurial process from both a historical and research perspective. The role and nature of entrepreneurship as a mechanism for creating new ventures and affecting economic development are presented, along with career aspects and the future direction of entrepreneurship. The characteristics and background of entrepreneurs are discussed, as well as some methods for individual self-assessment. Following the presentation on corporate entrepreneurship, this part concludes with a discussion on strategies for generating and exploiting new entries.

**Part 2—From Idea to the Opportunity** focuses on the aspects of creativity and innovation and all the elements in the entrepreneurial process that are a part of creating the new venture. Focus is on the various sources of ideas as well as trends occurring through this decade. Specific attention is also paid to various creative problem-solving technologies, identifying domestic and international opportunities, as well as other legal concerns in forming and launching the venture.

**Part 3—From the Opportunity to the Business Plan** focuses on the all-important business plan. First, the overall business plan and its various aspects are presented. Then, a chapter is devoted to each of the major components of the business plan: the marketing plan, the financial plan, and the organizational plan.

**Part 4—From the Business Plan to Funding the Venture** focuses on the most difficult aspects of creating and establishing a new venture—raising capital. First, the aspects of debt versus equity and internal versus external funding are discussed. After a discussion of the alternative sources of capital (self, family and friends, suppliers and trade credit,

government grants and programs, private placements, and commercial banks), specific attention is given to three financing mechanisms: informal risk capital, venture capital, and going public.

**Part 5—From Funding the Venture to Launching, Growing, and Ending the New Venture** presents material related to establishing, developing, and ending the venture. Particular attention is paid to developing the entrepreneurial strategy, establishing strategies for growth, managing the new venture during growth, early operations, expansion, and accessing external resources for growth. Managerial skills that are important to the successful performance and growth of the new venture are included in this part, which also addresses methods for ending the venture. Specific topics examined include mergers and acquisitions, franchising, joint ventures, and human and financial resources needed for growth.

To make *Entrepreneurship*, 9th edition, as meaningful as possible to students, each chapter begins with chapter learning objectives and a profile of an entrepreneur whose career is especially relevant to the chapter material. Numerous business examples occur throughout each chapter along with important Web sites to assist the reader in getting started. Boxed summaries of articles in the news (As Seen in *Business News*) that illustrate the chapter discussion and Ethics boxes discussing ethical issues are found in all the chapters. Each chapter concludes with research tasks, class discussion questions, and selected readings for further research and study.

At the end of the book is a selection of Cases that can be used along with any chapter, as well as listing of other appropriate cases on a chapter-by-chapter basis.

Many people—students, business executives, entrepreneurs, professors, and publishing staff—have made this book possible. Of great assistance were the detailed and thoughtful comments of our reviewers:

**Kristopher Blanchard**

*Upper Iowa University*

**Rachel Collins Wilson**

*Middle Tennessee State University*

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**Robert D. Hisrich**

**Michael P. Peters**

**Dean A. Shepherd**

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# 1

## THE ENTREPRENEURIAL PERSPECTIVE

### CHAPTER 1

The Entrepreneurial Mind-Set

### CHAPTER 2

Corporate Entrepreneurship

### CHAPTER 3

Generating and Exploiting New Entries





# 1

## THE ENTREPRENEURIAL MIND-SET

### LEARNING OBJECTIVES

1

To introduce the concept of entrepreneurship and explain the process of entrepreneurial action.

2

To describe how structural similarities enable entrepreneurs to make creative mental leaps.

3

To highlight bricolage as a source of entrepreneurs' resourcefulness.

4

To introduce effectuation as a way expert entrepreneurs sometimes think.

5

To develop the notion that entrepreneurs cognitively adapt.

6

To introduce sustainable entrepreneurship as a means of sustaining the natural environment and communities and developing gains for others.

## OPENING PROFILE

### EWING MARION KAUFFMAN

Born on a farm in Garden City, Missouri, Ewing Marion Kauffman moved to Kansas City with his family when he was eight years old. A critical event in his life occurred several years later when Kauffman was diagnosed with a leakage of the heart. His prescription was one year of complete bed rest; he was not even allowed to sit up.

[www.kauffman.org](http://www.kauffman.org)

Kauffman's mother, a college graduate, came up with a solution to keep the active 11-year-old boy lying in bed—reading. According to Kauffman, he “sure read! Because nothing else would do, I read as many as 40 to 50 books every month. When you read that much, you read anything. So I read the biographies of all the presidents, the frontiersmen, and I read the Bible twice and that's pretty rough reading.”

Another important early childhood experience centered on door-to-door sales. Since his family did not have a lot of money, Kauffman sold 36 dozen eggs collected from the farm or fish he and his father had caught, cleaned, and dressed. His mother was very encouraging during these formative school years, telling young Ewing each day, “There may be some who have more money in their pockets, but Ewing, there is nobody better than you.”

During his youth, Kauffman worked as a laundry delivery person and was a Boy Scout. In addition to passing all the requirements to become an Eagle Scout and a Sea Scout, he sold twice as many tickets to the Boy Scout Roundup as anyone else in Kansas City, an accomplishment that enabled him to attend, for free, a two-week scout summer camp that his parents would not otherwise have been able to afford. According to Kauffman, “This experience gave me some of the sales techniques which came into play when subsequently I went into the pharmaceutical business.”

Kauffman went to junior college from 8 to 12 in the morning and then walked two miles to the laundry where he worked until 7 p.m. Upon graduation, he went to work at the laundry full time for Mr. R. A. Long, who eventually became one of his role models. His job as route foreman involved managing 18 to 20 route drivers, where he would set up sales contests, such as challenging the other drivers to get more customers on a particular route than he could obtain. Kauffman says, “I got practice in selling and that proved to be beneficial later in life.” R. A. Long made money not only at the

laundry business but also on patents, one of which was a form fit for the collar of a shirt that would hold the shape of the shirt. He showed his young protégé that one could make money with brains as well as brawn. Kauffman commented, “He was quite a man and had quite an influence on my life.”

Kauffman’s sales ability was also useful during his stint in the Navy, which he joined shortly after Pearl Harbor on January 11, 1942. When designated as an apprentice seaman, a position that paid \$21 per month, he responded, “I’m better than an apprentice seaman, because I have been a Sea Scout. I’ve sailed ships and I’ve ridden in whale boats.” His selling ability convinced the Navy that he should instead start as a seaman first class, with a \$54 monthly salary. Kauffman was assigned to the admiral’s staff, where he became an outstanding signalman (a seaman who transmitted messages from ship to ship), in part because he was able to read messages better than anyone else due to his previous intensive reading. With his admiral’s encouragement, Kauffman took a correspondence navigator’s course and was given a deck commission and made a navigation officer.

After the war was over in 1947, Ewing Kauffman began his career as a pharmaceutical salesperson after performing better on an aptitude test than 50 other applicants. The job involved selling supplies of vitamin and liver shots to doctors. Working on straight commission, without expenses or benefits, he was earning pay higher than the president’s salary by the end of the second year; the president promptly cut the commission. Eventually, when Kauffman was made Midwest sales manager, he made 3 percent of everything his salespeople sold and continued to make more money than the president. When his territory was cut, he eventually quit and in 1950 started his own company—Marion Laboratories. (Marion is his middle name.)

When reflecting on founding the new company, Ewing Kauffman commented, “It was easier than it sounds because I had doctors whom I had been selling office supplies to for several years. Before I made the break, I went to three of them and said, ‘I’m thinking of starting my own company. May I count on you to give me your orders if I can give you the same quality and service?’ These three were my biggest accounts and each one of them agreed because they liked me and were happy to do business with me.”

Marion Laboratories started by marketing injectable products that were manufactured by another company under Marion’s label. The company expanded to other accounts and other products and then developed its first prescription item, Vicam, a vitamin product. The second pharmaceutical product it developed, oyster shell calcium, also sold well.

To expand the company, Kauffman borrowed \$5,000 from the Commerce Trust Company. He repaid the loan, and the company continued to grow. After several years, outside investors could buy \$1,000 worth of common stock if they loaned the company \$1,000 to be paid back in five years at \$1,250, without any intermittent interest. This initial \$1,000 investment, if held until 1993, would have been worth \$21 million.

Marion Laboratories continued to grow and reached over \$1 billion per year in sales, due primarily to the relationship between Ewing Kauffman and the people in the

company, who were called associates, not employees. “They are all stockholders, they build this company, and they mean so much to us,” said Kauffman. The concept of associates was also a part of the two basic philosophies of the company: Those who produce should share in the results or profits and treat others as you would like to be treated.

The company went public through Smith Barney on August 16, 1965, at \$21 per share. The stock jumped to \$28 per share immediately and has never dropped below that level, sometimes selling at a 50 to 60 price/earnings multiple. The associates of the company were offered a profit-sharing plan, where each could own stock in the company. In 1968, Kauffman brought Major League Baseball back to Kansas City by purchasing the Kansas City Royals. This boosted the city’s economic base, community profile, and civic pride. When Marion Laboratories merged with Merrill Dow in 1989, there were 3,400 associates, 300 of whom became millionaires as a result of the merger. The new company, Marion Merrill Dow, Inc., grew to 9,000 associates and sales of \$4 billion in 1998 when it was acquired by Hoechst, a European pharmaceutical company. Hoechst Marion Roussel became a world leader in pharmaceutical-based health care involved in the discovery, development, manufacture, and sale of pharmaceutical products. In late 1999, the company was again merged with Aventis Pharma, a global pharmaceutical company focusing on human medicines (prescription pharmaceuticals and vaccines) and animal health. In 2002, Aventis’s sales reached \$16.634 billion, an increase of 11.6 percent from 2001, while earnings per share grew 27 percent from the previous year.

Ewing Marion Kauffman was an entrepreneur, a Major League Baseball team owner, and a philanthropist who believed his success was a direct result of one fundamental philosophy: Treat others as you would like to be treated. “It is the happiest principle by which to live and the most intelligent principle by which to do business and make money,” he said.

Ewing Marion Kauffman’s philosophies of associates, rewarding those who produce, and allowing decision making throughout the organization are the fundamental concepts underlying what is now called *corporate entrepreneurship* in a company. He went even further and illustrated his belief in entrepreneurship and the spirit of giving back when he established the Kauffman Foundation, which supports programs in two areas: youth development and entrepreneurship. Truly a remarkable entrepreneur, Mr. K, as he was affectionately called by his employees, will now produce many more successful “associate entrepreneurs.”

Like Ewing Marion Kauffman, many other entrepreneurs and future entrepreneurs frequently ask themselves, “Am I really an entrepreneur? Do I have what it takes to be a success? Do I have sufficient background and experience to start and manage a new venture?” As enticing as the thought of starting and owning a business may be, the problems and pitfalls inherent to the process are as legendary as the success stories. The fact remains that more new business ventures fail than succeed. To be one of the few successful entrepreneurs requires more than just hard work and luck. It requires the ability to think in an environment of high uncertainty, be flexible, and learn from one’s failures.

## THE NATURE OF ENTREPRENEURSHIP

**entrepreneurial opportunities** Those situations in which new goods, services, raw materials, and organizing methods can be introduced and sold at greater than their cost of production

**entrepreneurial action** Action through the creation of new products/processes and/or the entry into new markets, which may occur through a newly created organization or within an established organization

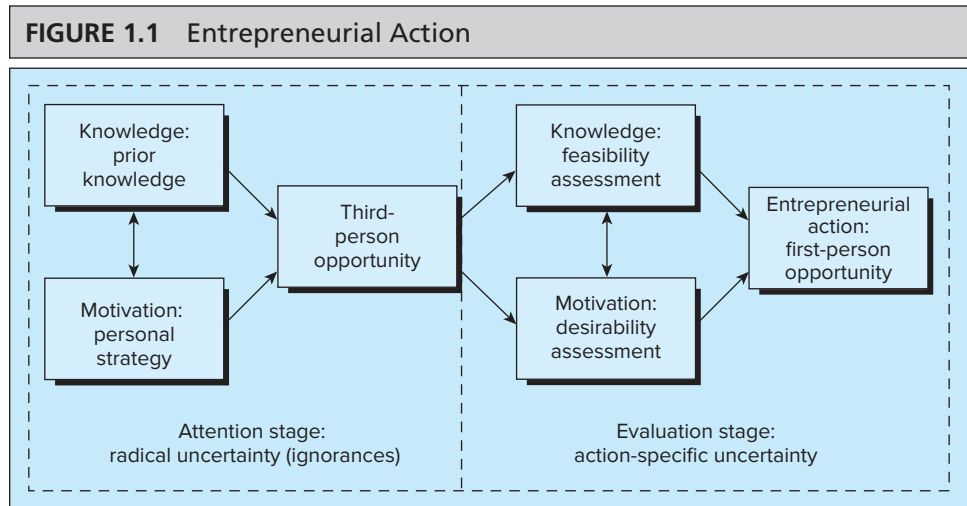
**entrepreneurial thinking** Individuals' mental processes of overcoming ignorance to decide whether a signal represents an opportunity for someone and/or reducing doubt as to whether an opportunity for someone is also an opportunity for them specifically, and/or processing feedback from action steps taken

Entrepreneurship plays an important role in the creation and growth of businesses, as well as in the growth and prosperity of regions and nations. These large-scale outcomes can have quite humble beginnings; entrepreneurial actions begin at the nexus of a lucrative opportunity and an enterprising individual.<sup>1</sup> *Entrepreneurial opportunities* are “those situations in which new goods, services, raw materials, and organizing methods can be introduced and sold at greater than their cost of production.”<sup>2</sup> For example, an entrepreneurial opportunity could stem from introducing an existing technological product used in one market to create a new market. Alternatively, an entrepreneurial opportunity could be creating a new technological product for an existing market or creating both a new product/service and a new market. The recurring theme is that an entrepreneurial opportunity represents something new. However, such possibilities require an enterprising individual or a group of enterprising individuals to recognize, evaluate, and exploit these situations as possible opportunities. Therefore, entrepreneurship requires action—*entrepreneurial action* through the creation of new products/processes and/or the entry into new markets, which may occur through a newly created organization or within an established organization.

Entrepreneurs act on what they believe is an opportunity. Because opportunities exist in (or create and/or generate) high uncertainty, entrepreneurs must use their judgment about whether or not to act. However, doubt can undermine entrepreneurial action. Therefore, a key to understanding entrepreneurial action is being able to assess the amount of uncertainty perceived to surround a potential opportunity and the individual's willingness to bear that uncertainty. The individual's prior knowledge can decrease the amount of uncertainty, and his or her motivation indicates a willingness to bear uncertainty.

As illustrated in Figure 1.1, the McMullen-Shepherd model explains how knowledge and motivation influence two stages of entrepreneurial action. Signals of changes in the environment that represent possible opportunities will be noticed by some individuals but not others. Individuals with knowledge of markets and/or technology are more capable of detecting changes in the external environment, and if they are also motivated, they will allocate further attention to processing this information. Others, however, will remain ignorant of the possibility. The result of Stage 1 is an individual's realization that an opportunity exists for someone. The individual then needs to determine whether it represents an opportunity for him or her (Stage 2). This involves assessing whether it is feasible to successfully exploit the opportunity given one's knowledge and whether it is desirable given one's motivation. In other words, does this opportunity for someone (third-person opportunity belief) represent an opportunity for me (first-person opportunity belief)? If the individual overcomes enough doubt to form (1) the belief that the situation represents an opportunity for someone in general, and then (2) the belief that the opportunity for someone is an opportunity for himself or herself personally, this individual may act.

Therefore, to be an entrepreneur is to act on the possibility that one has identified an opportunity worth pursuing.<sup>3</sup> It involves *entrepreneurial thinking*—individuals' mental processes of overcoming ignorance to decide whether a signal represents an opportunity for someone and/or reducing doubt as to whether an opportunity for someone is also an opportunity for them specifically, and/or processing feedback from action steps taken. To explain these processes more fully, we now turn to different forms of entrepreneurial thinking.



Reprinted with permission from McMullen, J., and Shepherd, D. A. (2006). Entrepreneurial Action and the Role of Uncertainty in the Theory of the Entrepreneur. *Academy of Management Review*. 31: 132–142.

## HOW ENTREPRENEURS THINK

Entrepreneurs think differently from nonentrepreneurs. Moreover, an entrepreneur in a particular situation may think differently from when faced with some other task or decision environment. Entrepreneurs must often make decisions in highly uncertain environments where the stakes are high, time pressures are immense, and there is considerable emotional investment. We all think differently in these strained environments than we do when the nature of a problem is well understood and we have time and rational procedures at hand to solve it. Given the nature of an entrepreneur's decision-making environment, he or she must sometimes (1) think structurally, (2) engage in bricolage, (3) effectuate, and (4) cognitively adapt.

### Think Structurally

Forming opportunity beliefs often requires creative mental leaps. These creative mental leaps are launched from a source—one's existing knowledge. In the case of entrepreneurial opportunities, an example of a creative mental leap is from knowledge about existing markets to a new technology that could lead to products/services that satisfy that market. Alternatively, the creative mental leap could be from knowledge about a technology to a new market that could benefit from its introduction. Making these connections between a new product (or new service, new business model, or new technology) and a target market where it can be introduced is aided by the superficial and structural similarities between the source (e.g., the market) and the destination (e.g., technology). *Superficial similarities* exist when the basic (relatively easy to observe) elements of the technology resemble (match) the basic (relatively easy to observe) elements of the market. In contrast, *structural similarities* exist when the underlying mechanisms of the technology resemble (or match) the underlying mechanisms of the market. The entrepreneurial challenge often lies in making creative mental leaps based on *structural* similarities. This is best illustrated with an example based on a real case that Denis Gregoire from Syracuse University and me (Dean Shepherd from Indiana University) used as part of a study of entrepreneurial thinking.<sup>4</sup>

#### *superficial similarities*

Exist when the basic (relatively easy to observe) elements of the technology resemble (match) the basic (relatively easy to observe) elements of the market

#### *structural similarities*

Exist when the underlying mechanisms of the technology resemble (or match) the underlying mechanisms of the market

The example is a technology developed by space and computer engineers at NASA's Langley Research Center. It involves big and bulky flight simulators used by space shuttle pilots. As such, the technology's superficial elements are very similar to a market for airline pilots training in flight simulators. In contrast, it has little superficial similarity with a target market of K–12 school children and their parents. The technology underlying the superficial situations includes attaching sensors to individuals' forefingers to monitor the electric conductivity of their skin to send signals to computer processors in another machine with which the individual interacts. Ultimately, these one-to-one relationships (skin to sensor and sensor to computer) culminate into a network of higher-order relationships that reflect the overall capabilities of the technology, its aims, and/or its uses. Therefore, the technology is capable of helping shuttle pilots (or airline pilots or teenage drivers) improve their abilities to focus, pay attention, and concentrate for an extended period. Looked at in a new light, however, the technology shares high levels of structural similarities with the target market of parents who seek nonpharmaceutical alternatives to treat attention deficit (ADHD). This opportunity to apply the technology to the market of parents seeking nonpharmaceutical alternatives to treat ADHD was not obvious to individuals who were distracted from the deeper structural similarities by the superficial mismatch between the technology and the new market.

Thus, individuals who can see or create structural matches between a technology and a target market, especially in the presence of superficial mismatches, are more likely to recognize entrepreneurial opportunities. Knowledge specific to a technology and/or a market can facilitate this ability,<sup>5</sup> and the good news is that this skill can also be enhanced through practice and training.

## Bricolage

Entrepreneurs often lack resources. As a result, they either seek resources from others to provide the “slack” necessary to experiment and generate entrepreneurial opportunities or they engage in bricolage. By *bricolage* we mean that some entrepreneurs make “do by applying combinations of the resources at hand to new problems and opportunities.”<sup>6</sup> This involves taking existing resources (those at hand) and experimenting, tinkering, repackaging, and/or reframing them so they can be used in a way for which they were not originally designed or conceived.<sup>7</sup> From this process of “making do,” entrepreneurs can create opportunities. Baker and Nelson (2005: 341–42) offer the following example of bricolage.

Tim Grayson was a farmer whose land was crisscrossed by abandoned coal mines. He knew that the tunnels—a nuisance to farmers because of their tendency to collapse, causing mammoth sinkholes in fields—also contained large quantities of methane. Methane is another nuisance, a toxic greenhouse gas that poisons miners and persists in abandoned mines for generations. Grayson and a partner drilled a hole from Grayson's property to an abandoned mine shaft, then acquired a used diesel generator from a local factory and crudely retrofitted it to burn methane. During the conversion process, Grayson was repeatedly blown off his feet when the odorless, colorless gas exploded. His bricolage produced electricity, most of which he sold to the local utility company using scavenged switchgear. Because Grayson's generator also produced considerable waste heat, he built a greenhouse for hydroponic tomatoes, which he heated with water from the generator's cooling system. He also used electricity generated during off-peak hours to power special lamps to speed plant growth. With the availability of a greenhouse full of trenches of nutrient-rich water that were heated “for free,” Grayson realized he might be able to raise tilapia, a tropical delicacy increasingly popular in the United States. He introduced the fish to the waters that bathed the tomato roots and used the fish waste as fertilizer. Finally, with abundant methane still at hand, Grayson began selling excess methane to a natural gas company. As you

*bricolage* Entrepreneurs making do by applying combinations of the resources at hand to new problems and opportunities

can see from this example, bricolage is a resourceful way of thinking and behaving that represents an important source of entrepreneurial opportunities.

## Effectuation

As potential business leaders, you are trained to think rationally and perhaps admonished if you do not. This admonishment might be appropriate given the nature of the task, but it appears that there is an alternate way of thinking that entrepreneurs sometimes use, especially when thinking about opportunities. Professor Saras Sarasvathy (from Darden, University of Virginia) has found that entrepreneurs do not always think through a problem in a way that starts with a desired outcome and focuses on the means to generate that outcome. Such a process is referred to as a *causal process*. But, entrepreneurs sometimes use an *effectuation process*, which means they take what they have (who they are, what they know, and whom they know) and select among possible outcomes. Professor Sarasvathy is a great cook, so it is not surprising that her examples of these thought processes revolve around cooking.

**causal process** A process that starts with a desired outcome and focuses on the means to generate that outcome

**effectuation process** A process that starts with what one has (who they are, what they know, and whom they know) and selects among possible outcomes

Imagine a chef assigned the task of cooking dinner. There are two ways the task can be organized. In the first, the host or client picks out a menu in advance. All the chef needs to do is list the ingredients needed, shop for them, and then actually cook the meal. This is a process of causation. It begins with a given menu and focuses on selecting between effective ways to prepare the meal.

In the second case, the host asks the chef to look through the cupboards in the kitchen for possible ingredients and utensils and then cook a meal. Here, the chef has to imagine possible menus based on the given ingredients and utensils, select the menu, and then prepare the meal. This is a process of effectuation. It begins with given ingredients and utensils and focuses on preparing one of many possible desirable meals with them.<sup>8</sup>

## Sarasvathy's Thought Experiment #1: Curry in a Hurry

In this example I [Sarasvathy] trace the process for building an imaginary Indian restaurant, "Curry in a Hurry." Two cases, one using causation and the other effectuation, are examined. For the purposes of this illustration, the example chosen is a typical causation process that underlies many economic theories today—theories in which it is argued that artifacts such as firms are inevitable outcomes, given the preference orderings of economic actors and certain simple assumptions of rationality (implying causal reasoning) in their choice behavior. The causation process used in the example here is typified by and embodied in the procedures stated by Philip Kotler in his *Marketing Management* (1991: 63, 263), a book that in its many editions is considered a classic and is widely used as a textbook in MBA programs around the world.

Kotler defines a market as follows: "A market consists of all the potential customers sharing a particular need or want who might be willing and able to engage in exchange to satisfy that need or want" (1991: 63). Given a product or a service, Kotler suggests the following procedure for bringing the product/service to market (note that Kotler assumes the market exists):

1. Analyze long-run opportunities in the market.
2. Research and select target markets.
3. Identify segmentation variables and segment the market.
4. Develop profiles of resulting segments.
5. Evaluate the attractiveness of each segment.
6. Select the target segment(s).
7. Identify possible positioning concepts for each target segment.
8. Select, develop, and communicate the chosen positioning concept.
9. Design marketing strategies.