

SEVENTH EDITION

Launching New Ventures

An Entrepreneurial Approach

Kathleen R. Allen

LAUNCHING NEW VENTURES

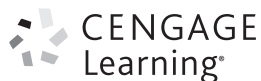
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LAUNCHING NEW VENTURES

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Kathleen R. Allen

University of Southern California



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PREFACE

The sixth edition of this book came out in 2011 (copyright 2012), three years after the financial crash and well into a global economic downturn. A strong turnaround has yet to materialize and so entrepreneurs, who tend to thrive in negative circumstances, are still the hope for the economic future of most nations around the globe. As I noted in the previous edition, the developing world has wholeheartedly embraced entrepreneurship as a way to pull itself out of this enduring economic malaise. The world we live in today is vastly different from the one that existed when I wrote the first edition of *Launching New Ventures* in 1995 as we headed toward the dot com boom and continuing economic prosperity. Nevertheless, I would argue that the future of the United States and certainly the world lies with entrepreneurs who start the innovative businesses that create jobs and produce products and services to fuel the economy. For the foreseeable future, we will live in a world characterized by high degrees of uncertainty rather than the more predictable risk with which we had grown comfortable for several decades. Entrepreneurs are comfortable with risk because they can calculate probabilities and outcomes for the risks they face. Uncertainty, on the other hand, has no probabilities associated with it; it can't be calculated or predicted. To survive in a world of uncertainty, entrepreneurs must develop businesses that are fast, lean, adaptable, and flexible. Whether a new venture operates in the Internet world, the life sciences, manufacturing, or services, entrepreneurs need to compress the product development timeline, get to an early prototype quickly and cheaply with the minimum number of features needed to meet the customer's requirements, continually refine their business models, and find ways to get traction as fast as possible. An uncertain business environment means more than ever that the winners will be those who launch businesses as entrepreneurs in the true Schumpeterian sense of the word: disrupting what has gone before, looking for the unexpected, and creating new value.

The evidence for the benefits of entrepreneurship is clear when we study its impact on society and on the economy. However, the evidence is not so clear when we look at entrepreneurship in the academy. As educators and practitioners, we assume more benefits than we can actually quantify. In the preface of the previous edition, I referred to an important article written by one of the early leaders in the field. It bears repeating here because the problem persists. Researcher and Professor Dale Meyer wrote about the field of entrepreneurship as a discipline in a provocative article for the *Journal of Small Business*

Management called “The Reinvention of Academic Entrepreneurship.” He lamented the lack of rigorous metrics for measuring the impact of entrepreneurship education on students and society, the heavy reliance on neoclassical economic paradigms, and the blurring of the boundaries between entrepreneurship and small business management. He called for more emphasis on creative, self-organizing processes that entrepreneurs employ to craft complex, adaptive business systems. I wholeheartedly agree with Meyer’s assessment. Today, the term *entrepreneurship* has been diluted by overuse in contexts that have nothing to do with new venture creation. *Entrepreneur* is being co-opted by everyone, including the media, to describe what is more traditionally referred to as a small business owner, a successful musician, or an effective product manager. The rationale for this dilution is that if you think like an entrepreneur, you’re an entrepreneur. I believe that this rationale confuses entrepreneurship with creativity and innovation. In every edition of *Launching New Ventures*, I have attempted to remain true to the Schumpeterian view of the entrepreneurial process as “creative destruction.” Now, more than ever before, the world needs entrepreneurs, in the strictest sense of the word—those who challenge the way we think about business, who create innovative business models that solve new problems, and who excel at sense-and-respond processes in the face of great uncertainty.

With all the knowledge we now have about how to operate effectively in a global market, how to build successful companies with extraordinary valuations, and how to innovate, we still have so much more to learn. And that is perhaps why so many of us enjoy the field of entrepreneurship because it is messy, chaotic, and in a constant state of change. We are continually challenged to revise our ideas—what we knew to be true—in the face of almost daily changes in the countless variables that affect the complex launch and growth of a new business.

Launching New Ventures, Seventh Edition, represents the most current thought, ideas, and practices in the field of entrepreneurship. In fact, ever since its first edition, *Launching New Ventures* has endeavored to extend the boundaries of what we know about entrepreneurship and to celebrate the uniqueness and creativity of entrepreneurs.

CONTENT, ORGANIZATION, AND UNIQUE COVERAGE

Launching New Ventures is organized around the process of creating a startup, from the recognition of an opportunity to the launch of the business. It is designed to help readers organize and plan for venture creation by mentally (and sometimes physically) engaging in the various activities that entrepreneurs typically undertake. This book has never sought to be all things to all people. It has a very specific emphasis on pre-launch activities—those things that entrepreneurs do to prepare to start a business and secure their first customer. The reason for this emphasis is that the decisions made to prepare the business for launch will have a significant impact on how successful that launch is. So this book explores activities such as opportunity creation and feasibility analysis in

more depth than the average book on entrepreneurship. The book also takes a distinctly entrepreneurial view of new businesses as opposed to a small business perspective. In a complex, global world, new business owners, whether their business might be the next Google or simply a small restaurant, need to think like an entrepreneur. They need to be opportunity-focused, innovative, growth-oriented, and constantly looking for new ways to create and capture value for customers. Today the entrepreneurial mindset is essential for survival and growth.

Part One introduces the foundations of entrepreneurship and entrepreneurial opportunity, which are important to understanding the decisions that entrepreneurs make, the environment in which they make those decisions, and the tasks they must undertake before starting a new company. In Chapter 1, readers will learn the nature of entrepreneurial ventures and how they are distinct from other types of businesses as well as the role of entrepreneurship in the economy. Chapter 2 dispels many myths about entrepreneurs and helps readers understand the characteristics and behaviors that work for and against entrepreneurs. Readers also learn about the entrepreneurial mindset, which is so critical for a successful startup. Chapter 3 introduces the subject of opportunity and how entrepreneurs create and shape opportunities for themselves.

Part Two addresses the heart of entrepreneurial activity, the testing of a business model through feasibility analysis. It opens with Chapter 4, “Analyzing the Industry and Market” where readers will learn how to study an industry, the environment in which the new business will operate, and follows that with a discussion of how to effectively conduct market research to understand customer needs and levels of demand. Chapter 5 focuses on the design, development, and testing of a business model as well as how innovation happens in all the components of the business model. Chapter 6 explores the way entrepreneurs develop products and services; it considers product development using lean methodologies, prototyping, and the minimum viable product. Chapter 7 considers ways to protect a startup’s assets through intellectual property rights. Chapter 8 looks at how to build an effective founding team and also discusses how to determine what gaps in experience and expertise may exist in the management team and how to compensate for them with such solutions as strategic alliances and independent contractors. Chapter 9 closes this part by addressing the startup resources entrepreneurs must gather and how to calculate the required capital and other resources needed to launch the venture and operate it until it achieves a positive cash flow from the revenues it generates.

Part Three deals with business design, those activities that take place once you know you have a feasible venture. It begins with Chapter 10, which describes how to move from a feasibility analysis to preparing a business or execution plan. Chapter 11 deals with the design of an entrepreneurial company, considering how entrepreneurial businesses are organized, how entrepreneurs determine the best business location, and how they develop their initial human resource capability. Chapter 12 focuses on how products and services are produced and addresses issues related to planning the startup operations of a new business, such as production, quality control, customer service, outsourcing, and managing the supply chain. Chapter 13 looks at the legal form of the

business and discusses the advantages and disadvantages of sole proprietorships, partnerships, and corporate forms. Chapter 14 deals with the role and implementation of the startup marketing plan and how to promote new products and services effectively with limited resources. It pays particular attention to the role of new media, including social networks and search engine marketing. The chapter also addresses personal selling and customer relationship management. Chapter 15 explores the increasingly important topics of vision, ethics, and social responsibility. The value system of a new business shapes the culture of the business and the image it will have to live up to as it builds its reputation. Readers will be challenged to define a vision for a new venture based on the values they believe to be important. They will also gain a greater understanding of the need for ethics and social responsibility in any business. Part Four explores planning for growth and change in the new organization. It begins with Chapter 16, which looks at how to fund a startup as well as a rapidly growing venture, including the cost and process of raising capital, venture capital, and the IPO market. Chapter 17 deals with exploration and exploitation growth strategies for entrepreneurial ventures. It also pays particular attention to growing by going global and concludes with a discussion of harvest and exit strategies.

SPECIAL FEATURES IN THE SEVENTH EDITION

The seventh edition contains a variety of features of value to instructors and readers.

1. *Chapter Objectives* highlight the key topics for each of the chapters.
2. Entrepreneur *Profiles* that begin each chapter provide real-life examples to illustrate the application of chapter concepts and to inspire readers. Smaller-scale examples are also scattered throughout the chapters to maintain the real-life tone of the book.
3. “*Global Insights*” and “*Social Entrepreneurship: Making Meaning*” boxed inserts highlight additional examples, companies, and organizations that have taken a global or a socially responsible approach to entrepreneurship.
4. The *New Venture Action Plan* serves as a reminder of the tasks that need to be completed at particular stages of the entrepreneurial process.
5. *Questions on Key Issues* at the end of each chapter provoke interesting discussions.
6. *Experiencing Entrepreneurship* is a series of activities at the end of each chapter that give readers a chance to learn about entrepreneurship by getting involved in entrepreneurial activities and interacting with entrepreneurs and others in an industry of special interest to the reader.
7. Four new *Case Studies* have been added to the seventh edition to reflect a wider variety of businesses and types of entrepreneurs. The cases are followed by discussion questions.

NEW TO THIS EDITION

The following are the major changes to the seventh edition.

Overall Changes

- The seventh edition has some changes in chapter order for better flow.
- Chapter 6 from the fifth edition has been split into two chapters to make way for a more in-depth treatment of prototyping and the minimum viable product (now Chapter 6) and a more in-depth treatment of intellectual property (now Chapter 7). Chapters 15 and 16 from the fifth edition have been combined to present a complete discussion of funding for both startup and growth (Chapter 16), and Chapters 17 and 18 from the fifth edition have been combined to reflect the natural relationship of growth and change (Chapter 17). The seventh edition now has 17 chapters.
- The seventh edition has eight cases, four of which are new to this edition and reflect companies started and built since 2006. Command Audio, Google Inc., Homerun.com and B2P were retained from the previous edition.
- More international and environmental/sustainability examples have been included.
- Examples and data have been updated; most of the beginning Profiles, as well as a most of the boxed inserts, are new or have been revised to reflect current company data.

Chapter by Chapter Changes

- Chapter 1: All statistics have been updated, as well as the inclusion of the most recent market trends: digital anonymity, the return to domestic manufacturing, big data, and the Lean Startup movement. The opening Profile on WhatsApp and the Social Entrepreneurship box on Angaza are new for this edition.
- Chapter 2: A new Global Insights box features Nordic entrepreneurs who started born global companies as well as new examples in all the chapter sections and updated statistics. Chapter 3: Profile 3.1 presents a new story of young British entrepreneur Nick D'Aloisio. The new chapter title, Creating an Opportunity, underscores the proactive nature of opportunity for entrepreneurs. They don't wait for opportunity; they create it. The chapter has been reorganized to include a new section on opportunity/ideation and a more substantial treatment of the problem-solving process.
- Chapter 4: This chapter now focuses on industry and market analysis, which was Chapter 5 from the sixth edition, to better prepare readers for the business model discussion in Chapter 5. The profile on Gemvara has been enhanced and updated and a new Social Entrepreneurship Box on Medic Mobile has been added. All resources have been updated, new examples included, and a new figure describing an ethnographical approach to customer discovery and solution validation has been included. Chapter 5: This chapter focuses exclusively on business model development. A new opening Profile

showcases Amazon.com as a business model innovator and a new Global Insights Box looks at business models in the developing world. The chapter features an in-depth treatment of hypothesis testing and adds a new section on innovating with business models. There are a number of new figures including a revised business model canvas that incorporates the work of both Alex Osterwalder and Ash Maurya.

- Chapter 6: This chapter was renamed “Prototyping and Validating a Solution” to reflect an emphasis on product design and development issues. Intellectual property now has its own chapter. New box features include Profile 6.1 about an online social learning company Grockit and a Global Insights box on APOPO. In addition to updating examples, the chapter features a new chapter section and associated figure on product development tradeoffs as well as an in-depth discussion of the minimum viable product.
- Chapter 7: This chapter is devoted to intellectual property and ways to protect the startup’s assets. It opens with a new profile on the trademark infringement case between Pinterest and Pintrips and includes a new Global Insights Box on intellectual property in China. All statistics and laws have been updated with more current examples.
- Chapter 8: This chapter is now about the founding team. It opens with a new profile on Fandevor and includes a new Social Entrepreneurship Box on Vera Solutions. The chapter incorporates important research on founding teams conducted by Noam Wasserman and addresses the issue of entrepreneur scalability. Chapter 9: Now titled “Calculating Startup Capital Requirements,” has been completely reorganized to move more effectively through the process of determining the amount of funding required to launch the business. A new profile on Barefoot Winery and a new Global Insights Box on migration as a source of entrepreneurship have been added. A new section on risk mitigation is also included.
- Chapter 10: This chapter opens Part III on business design by discussing the preparation of a business plan. A new profile about the failure of a South African startup and an in-depth discussion of proof of concept demonstrations are included. The chapter also includes a new approach to the elevator pitch as well as a discussion of TAM, SAM, and SOM, the various markets being addressed. Chapter 11: Profile 11.1 focuses on culture and has been enhanced and updated for this edition. A new Global Insights Box about Chinese entrepreneurship has also been added.
- Chapter 12: Opening Profile 12.1 on an entrepreneur who turned the wine industry upside down is new, as is the Social Entrepreneurship box featuring five socially responsible startups. A more in-depth treatment of supply chain management has been added and the chapter has been complete refreshed.
- Chapter 13: Profile 13.1 opens with a new story about an entrepreneur whose success came when she fought back after a major lawsuit. A Global Insights box on the legal forms of organization in the UK is also new. All laws have been updated

- Chapter 14: Profile 14.1 is new with an interesting startup experiment in marketing. A new section on journey mapping the customer experience has been added as well as social media marketing through video. The social media metrics section has been enhanced to reflect the latest tactics. The chapter has been completely refreshed with new examples. Chapter 15: This chapter closes the part on Business Design and is now the chapter on ethics and social responsibility. A new profile on a socially responsible for-profit business, Hearsay Social, opens the chapter and an updated Global Insights box on Turkish company AirTies is included. The entire chapter has been refreshed with new examples.
- Chapter 16: Opening Profile is new about a software company that makes big data analytics easily accessible to smaller businesses, and the Social Entrepreneurship box on Room to Read has been updated. The chapter has been reorganized to begin with the topic of financial planning. All statistics on investment have been updated and an expanded section on crowd funding has been added. The valuation section has been completely reworked and a new section on the concepts of divergence and dilution has been added. Chapter 17: The final chapter opens with a new profile story on Annie's Homegrown and its bumpy growth path. The Global Insights box is also new and looks at the growth of startups in Africa. This chapter now combines the topics of growth and change because they normally occur together, and the chapter has been tightened up to discuss only the most important topics from the original two chapters.

SUPPLEMENTAL MATERIALS

Key instructor ancillaries (Instructor's Manual, Test Bank, and PowerPoint slides) are available on the support website located at www.cengagebrain.com, giving instructors the ultimate tool for customizing lectures and presentations.

The Instructor's Manual is a comprehensive and valuable teaching aid, featuring chapter summaries and author notes, chapter objectives, brief chapter outlines, answers to end-of-chapter questions, suggestions to end-of-chapter activities, supplementary lecture materials, and Case Study teaching notes.

The Test Bank, revised and updated, includes a variety of true/false, multiple choice, and short answer questions in varying levels of difficulty, which emphasize the important concepts presented in each chapter.

The PowerPoint® Presentation provides instructors with comprehensive visual aids for each chapter in the book. These slides include outlines of each chapter, highlighting important figures, concepts, and discussion points.

Visit the text Web site at www.cengagebrain.com to find instructor's support materials and study resources to help students practice and apply the concepts they learned in class. The password-protected site contains resources for both students and instructors. For students it provides online interactive quizzes and flashcards. For instructors it includes downloadable Instructor's Manual and Test Bank files, as well as downloadable PowerPoint® Presentations.

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Kathleen Allen, PhD is a professor of entrepreneurship at the USC Marshall School of Business and founding director of the Marshall Center for Technology Commercialization. Allen works with scientists and engineers to identify markets and applications for their technologies, develop commercialization teams, and prepare them to launch ventures and seek funding. Her expertise in technology commercialization is now being applied in projects with the U.S. Navy and the U.S. Department of Homeland Security. She is the author of more than 15 books in the field of entrepreneurship and technology commercialization. Her personal entrepreneurial endeavors include co-founding two successful companies in commercial real estate brokerage, development, and investment, and two technology-based businesses that commercialized patented technologies. Dr. Allen served as entrepreneur-in-residence to a major aerospace firm, currently serves as advisor to several private companies, and is director of a NYSE company. In 2014, she was selected as Entrepreneurship Educator of the Year by the U.S. Association for Small Business and Entrepreneurship. Allen holds a PhD with a specialty in entrepreneurship, an MBA, an MA in Romance Languages, and a BA in music.

PART I

ENTREPRENEURSHIP AND OPPORTUNITY

CHAPTER 1

Understanding Entrepreneurship

CHAPTER 2

Preparing for the Entrepreneurial Journey

CHAPTER 3

Creating Opportunity

The Road to Startup

Simplified



Find a Problem
Make sure it's significant and compelling



Engage with Potential Customers
Observe
Listen
Focus on problems



Develop
The solution in a physical form—a prototype
Test it with customers



Build the Product and Get It Ready to Sell
Include feedback from customers in the design and development



Develop and Test
How will you make money?
If necessary, whom do you know who can contribute capital to your business?



Look for Partners
Who can share resources and help you get to market faster?



Develop a Marketing Plan
What is the best way to reach customers?



Decide on the Legal Form for the Company?
How to split equity?
Roles and responsibilities



Hit the Market and Learn If Your Business Model Works
Get market feedback and revise if needed
Retest the model



Understanding Entrepreneurship

“I think a good entrepreneur has a very clear grasp of what the goal is, an unwavering sense of the goal, an utterly agile approach of getting there.”

JOHN KATZMAN, CEO NOODLE EDUCATION

CHAPTER OBJECTIVES

- Define entrepreneurship.
- Explain the role of entrepreneurship in economic growth.
- Distinguish entrepreneurial ventures from small businesses in terms of their purpose and goals.
- Describe the evolution of entrepreneurship.
- Identify today’s broad trends in entrepreneurship.

PROFILE

1.1

WHATSAPP: FROM DAVID TO GOLIATH

On February 19, 2014, social networking giant Facebook acquired WhatsApp, a texting service, for \$19 billion in the largest acquisition of a venture-backed company in history. At \$19 billion, WhatsApp now exceeded the value of American Airlines, Marriott International, and a host of other iconic companies. Needless to say, the startup world was energized even if they didn't completely understand why Facebook needed to pay such a premium.

Jan Koum, a 38-year-old Ukrainian immigrant who began his life in the United States on food stamps, was not your typical New Millennial app developer in an accelerator waiting to be acquired. Born in Kiev, Ukraine, he grew up in a small village where his father was a construction manager. Their home had no hot water and they used the phone only when they had to because it was monitored by the government. At the age of 16, during a difficult time politically, Koum and his mother fled to the United States where she became a babysitter and Koum swept floors at a grocery store. By the age of 18, Koum had taught himself how to program and he joined a hacker group. Eventually he enrolled at San Jose State University, and in 1997, he met what would be his co-founder, Brian Acton, who worked at Yahoo!. Through nine years at Yahoo!, the two discovered that they did not enjoy advertising platforms—"dealing with ads is depressing." As a result, in 2007 they left the company.

The idea for WhatsApp was inspired by Apple's App Store and the potential for a whole new industry. Drawing on his experiences in the Ukraine where close friends stayed in regular contact but were charged exorbitant fees for texting and then they were monitored, Koum wanted to find a way to provide free and open access

to people to communicate via text messages. In 2009, WhatsApp was born. By the end of 2009, the duo had updated the app to enable sending photos and their user growth increased, even when they decided to charge \$1 for the app. By early 2011, WhatsApp found itself in the Top 20 of all apps in the Apple Store as their app went viral. It was at that point that Koum agreed to take \$8 million from Sequoia Capital with the promise that he wouldn't be forced to use an advertising model. By 2013 with 200 million active users, they did a second round of funding in which Sequoia invested another \$50 million, bringing WhatsApp's valuation to \$1.5 billion. Interestingly enough, because Koum had stuck to a subscription model, their accumulated revenues now exceeded their Series A funding.

Koum did not set out to be acquired by Facebook; however, once you take venture capital, those decisions are not yours alone. It's easy to see why Facebook wanted WhatsApp. Slow to embrace the mobile platform, Facebook's users were demanding a more mobile friendly version of Facebook. What's more, both Facebook and WhatsApp are big drivers of smartphone use in India, Latin America, and Southeast Asia, so it was a natural alliance. However, there is one issue that users worry about going forward. Will Facebook respect WhatsApp's privacy policy, which is much different than Facebook's? Because its voracious appetite for customer information is well known in the industry, Facebook has been accused of slippage when it comes to user privacy. Koum is adamant that the values that inspired WhatsApp in the first place will not change. The company will not store customer information—not even phone numbers—or any messages. They only store undelivered messages and only for 30 days.

Facebook now owns WhatsApp, but Koum sits on the board of directors of Facebook while running WhatsApp somewhat independently. His commitment to privacy remains strong, but with the disclosure that some encryption flaws that exposed chat histories on the Android phone and a finding that messages sent over Wi-Fi or other public channels can be decrypted using known methods, that commitment is being severely tested.

Sources: Olson, P. (February 19, 2014). “The Rags-to-Riches Tale of How Jan Koum Built WhatsApp into Facebook’s New \$19B Baby,” *Forbes*, <http://www.forbes.com/sites/parmyolson/2014/02/19/exclusive-inside-story-how-jan-koum-built-whatsapp-into-facebooks-new-19-billion-baby/>; Bjarin, B. (March 17, 2014). “The Value of Facebook and WhatsApp: Connecting the Unconnected,” *Time*, <http://time.com/27337/the-value-of-facebook-and-whatsapp-connecting-the-unconnected/>; Johnston, C. (March 18, 2014). “WhatsApp’s Idealism and Facebook Realism: A Study in Contrast,” *ARS Technica*, <http://arstechnica.com/business/2014/03/whatsapp-says-privacy-is-a-promise-it-can-keep/>.

The WhatsApp story in Profile 1.1, although a rare event by any measure, clearly illuminates the excitement of entrepreneurship today and goes a long way toward explaining why so many people want to become entrepreneurs. The lure of success and wealth is enticing, but the reality is that most entrepreneurial businesses do not end up like WhatsApp. In fact, WhatsApp is only one example of what success looks like in the world of entrepreneurship.

What is entrepreneurship? Today the term is being applied to all types of businesses, from the one-person, home-based business to the Fortune 500 company. Because the term *entrepreneur* carries with it a positive connotation, there is a tendency to attach it to any activity that involves starting or innovating. Frequently, people say “I’m being entrepreneurial” when what they mean to say is that they’re being creative. From one of the earliest definitions of entrepreneurship, proposed by Austrian economist Joseph Schumpeter, we learn that entrepreneurship is a form of “creative destruction.” Breaking down old ways of doing things to create new value.¹ In the early years of the field of entrepreneurship as a discipline, the focus was on the startup of new ventures and the associated activities that defined those ventures.² Some research tackled the psychological and sociological traits of the entrepreneur in an attempt to define *who* the entrepreneur is, whereas other research asserted that what the entrepreneur *does* is more important.³ Later, many definitions focused on the pursuit of opportunity and its exploitation.⁴ One definition by Harvard professor Howard Stevenson that still embodies the essence of entrepreneurship is: The process by which individuals—either on their own or inside organizations—pursue opportunities without regard to the resources they currently control.⁵

This definition suggests that entrepreneurship is more than simply starting a business; it also encompasses a mindset or way of thinking and a set of behaviors. That way of thinking is usually opportunity-focused, risk taking, innovative, and growth-oriented. Although entrepreneurship is still most commonly thought of in the context of starting a business, the entrepreneurial mindset can be found within large corporations, in socially responsible non-profit organizations, and anywhere that individuals and teams desire to differentiate themselves and apply their passion and drive to executing a business

opportunity. The behaviors that entrepreneurs undertake include creating opportunity, gathering the resources required to act on that opportunity, and driving the opportunity to completion. At its core, entrepreneurship is about a novel entry into new or established markets and about exploiting new or existing products and services.⁶

Entrepreneurship is not unique to any country, gender, race, age, or socioeconomic sector. Entrepreneurs can be found in some form in every country, in every age group, and (increasingly) in women as often as in men. The entrepreneurial fever does not distinguish between the rich and the poor; in fact, it touches anyone who has the passion to be self-employed or anyone who is determined to be independent and to take charge of his or her life. The entrepreneurial way of thinking can be understood and practiced, and the skills and behaviors of the entrepreneur can be learned and applied. The only characteristic of entrepreneurs that is arguably intrinsic is passion, the drive to achieve something. Passion cannot be taught or practiced; it simply exists when the right elements come together—for example, when an entrepreneur creates a business opportunity and devotes his or her full attention and resources to bringing it to life. Passion is found in successful people in all disciplines—great musicians, artists, writers, scientists, and teachers. It is what drives a person to go beyond expectations and to be the best that person can be.

This chapter explores entrepreneurship as a phenomenon and lays the groundwork for the skills and behaviors that are fundamental to the remainder of the text.

1.1 THE ROLE OF ENTREPRENEURSHIP IN THE ECONOMY

To understand the role that entrepreneurship plays in the economy, it is important to describe the process that entrepreneurs undertake as they create and exploit opportunity. Figure 1.1 depicts a view of this entrepreneurial process. As displayed, it is not a linear process but rather something more like a dynamic system with complex moving parts. Entrepreneurs initially work in Phase 1 to find a problem in a market or an industry. Once a significant problem or need is discovered, they do initial research to understand the industry, the potential market, and any issues they might face in the areas of intellectual property, regulation, or in developing a technology in the case of a technology solution. However, these preliminary activities do not occur in a vacuum. Instead, they are often intertwined with the activities in Phase 2, which focus on validating the hypotheses the entrepreneur has made about the customer, the solution, and the proposed business model. The results of these efforts to research and validate hypotheses will ultimately provide important information about sources of revenue and major drivers of cost. When the activities in Phases 1 and 2 give the entrepreneur sufficient confidence that this business is feasible, it's time to consider the design of the business and to create a plan for execution of the concept. This means having the right team and partners in place as well as choosing the best time to launch the business.

FIGURE 1.1 The Entrepreneurial Process

Phases	PHASE 1: Environment, Discovery & Opportunity	PHASE 2: Business Model Development and Testing	PHASE 3: Business Design, Planning, and Execution
RESEARCH	Critical Industry Forces Suppliers, Buyers, Competitive Rivalry, Barriers to Entry, Threat of Substitutes Trends: Technological, Political, and Social	Value Proposition: The Solution Applications, Product/Service Offerings Benefits to Customer	Business Process Flow Customer Acquisition to Delivery Business Activities
	Market: Pains/Problems Market Size and Growth Competition Trends	Customer Segment Identification and Validation Addressable Market Segments Benefits to Each Customer First Customer Customer Channels	Key Resources Required and Timing Physical—Plant and Equipment Capital—Working and Investment Human—Headcount
	Intellectual Property, Regulatory, and Technology Validation Patent Decisions, Regulatory Impact Technology PlatForm Development Field Tests and Pre-Clinical tests Technology validation	Technology Application Validation Field Tests with Customers Animal Trials Clinical Trials	Operations Manufacturing/Operations Plan Marketing Plan Management Plan Contingency Plan Execution Plan
OUTCOMES	Revenue Sources and Drivers Number of Sources Type Size Speed to achieve		Strategic Partners Independent Contractors Strategic Alliances Investors
	Cost and Profitability Drivers Type Size Importance		Launch Strategy License Start a Business Sell Joint Venture
	Startup Capital Requirements		
EXECUTION	Management Team Board of Directors/Advisors Expertise, Experience, Network		Market Timing When to launch

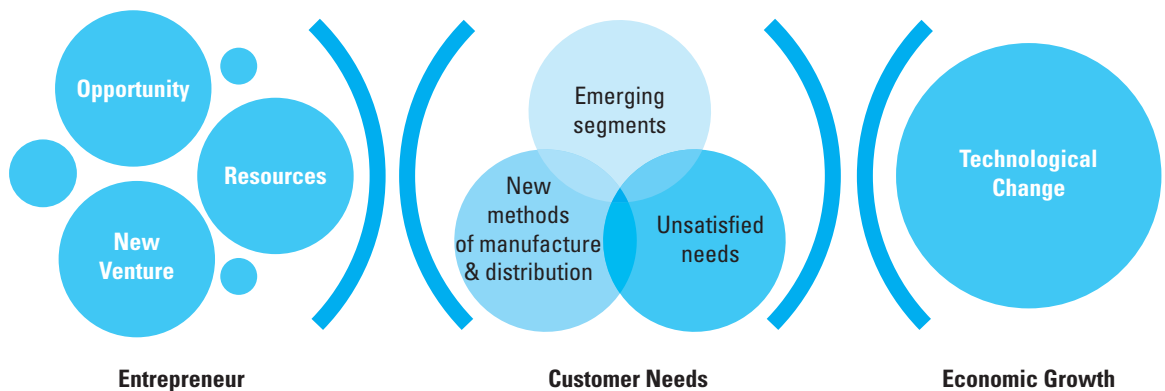
The successful execution of the entrepreneurial process results in a new venture; however, the process of testing and validation continues as the new business responds to a dynamic environment that includes all the variables external to the business that can impact its growth. Some of those external variables include the economic environment, competition, new laws and regulations, labor supply, and sources of capital, to name a few. As the leader, an entrepreneur essentially plays two roles—that of the catalyst, initiating and driving the process, and that of a ringmaster in a three-ring (or more) circus, managing the process through all its changes as the business grows.

This complex entrepreneurial process provides many benefits to society. Chief among these benefits are economic growth, new industry formation, and job creation. The following sections offer some insight into these contributions.

1.1a Economic Growth

Early economists recognized that technology is the primary force behind rising standards of living⁷ and that technological innovation would determine the success of nations in the future. For many years, economic growth was explained solely in terms of inputs of labor and capital. However, in the 1980s—referred to by many as the Decade of Entrepreneurship—the work of Paul Romer and others identified technological change as a critical element of a growth model that responds to market incentives.⁸ Romer asserted that technological change happens when an entrepreneur identifies new customer segments that appear to be emerging, new customer needs, existing customer needs that have not been satisfied, or new ways of manufacturing and distributing products and services. (See Figure 1.2.) Identifying these needs offers the opportunity to invent new technology solutions that change the way we do things. Clearly the Internet was one of those technologies, as were fiber optics and the artificial heart. However, it is not just the invention of new-to-the-world technologies that spurs economic growth. Innovators who find ways to improve on existing products, services, and business models or help customers become more efficient also contribute to a vibrant economy.

FIGURE 1.2 Entrepreneurship and Technological Change



Another way that new technologies have produced huge economic benefits is by lowering the cost of information and transportation, enabling a broader range of goods and services to be traded anywhere in the world. In fact, today very few markets enjoy freedom from competition in the global arena. For example, where local markets in Florida and California once dominated the market for fresh fruits, today consumers are frequently unaware that much of their fresh produce comes from Chile, New Zealand, and other parts of the world. Even service companies cannot escape the impact of the global economy. Russia, China, and India, for example, are dominant players in the software programming industry by transmitting their services electronically and economically to anywhere in the world.

1.1b New Industry Formation

New industries are another important outcome of entrepreneurship and technological change. An industry is simply the people and companies that engage in a category of business activity such as semiconductors, medical devices, or food services. New industries are born when technological change produces a novel opportunity that enterprising entrepreneurs seize. For example, Apple's iPhone, introduced on January 9, 2007, spurred the development of the mobile app industry, which is now one of the fastest growing sectors in the broader software industry. In 2013 alone, the industry grew 115 percent.⁹ The iPhone itself was an innovation built on the know-how of many earlier inventions. Nevertheless, Apple saw the opportunity to change the way we use phones by essentially putting a very powerful computer into everyone's hands and then encouraging developers to create unique programs exclusively for the device.

Industries don't last forever. Much like humans, they have life cycles—they're born, they grow, they decline, and they die. Figure 1.3 depicts the generic life cycle of an industry. The earliest stage of an industry is a time of rapid innovation and change as young firms struggle to become the industry standard bearers with their technology. As these entrepreneurial firms achieve noticeable levels of success, more and more firms desiring to capitalize on the potential for success enter the industry. As the industry grows, it generally becomes more fragmented as a result of so many firms competing for position. Then, at some point consolidation begins to occur as the stronger firms begin to acquire the smaller firms and the weaker firms die out. Eventually, the number of firms in the industry stabilizes and the firms mature. If innovation in the industry ceases to occur, the industry output may actually begin to decline. However, if new, disruptive technology is introduced, the industry may now have a new platform on which to innovate and grow again.

Why are so many more firms created than an industry can support? The answer lies in not knowing which new firms will be successful in securing adoption of their new technologies, products, or services. In the case of incremental innovations, or improvements on existing products, research has shown that incumbent firms are generally more successful than new firms, but, with disruptive, new-to-the-world technologies, it is anyone's guess who the survivors will be.¹⁰ When a disruptive technology wins the standards war in an industry, it can