

Small Business Management

18e

LAUNCHING AND GROWING ENTREPRENEURIAL VENTURES

Longenecker • Petty • Palich • Hoy





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Small Business Management: Launching & Growing Entrepreneurial Ventures, 18e

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Brief Contents



| | | |
|---------------|--|-----|
| Part 1 | Entrepreneurship: A World of Opportunity | |
| | 1 The Entrepreneurial Life | 1 |
| | 2 Integrity, Ethics, and Social Entrepreneurship | 36 |
| Part 2 | Starting from Scratch or Joining an Existing Business | |
| | 3 Starting a Small Business | 64 |
| | 4 Franchises and Buyouts | 95 |
| | 5 The Family Business | 122 |
| Part 3 | Developing the New Venture Business Plan | |
| | 6 The Business Plan: Visualizing the Dream | 145 |
| | 7 The Marketing Plan | 174 |
| | 8 The Organizational Plan: Teams, Legal Structures, Alliances, and Directors | 197 |
| | 9 The Location Plan | 229 |
| | 10 Understanding a Firm's Financial Statements | 258 |
| | 11 Forecasting Financial Requirements | 295 |
| | 12 A Firm's Sources of Financing | 319 |
| | 13 Planning for the Harvest | 351 |
| Part 4 | Focusing on the Customer: Marketing Growth Strategies | |
| | 14 Building Customer Relationships | 371 |
| | 15 Product Development and Supply Chain Management | 399 |
| | 16 Pricing and Credit Decisions | 430 |
| | 17 Promotional Planning | 453 |
| | 18 Global Opportunities for Small Businesses | 478 |
| Part 5 | Managing Growth in the Small Business | |
| | 19 Professional Management and the Small Business | 505 |
| | 20 Managing Human Resources | 534 |
| | 21 Managing Small Business Operations | 567 |
| | 22 Managing the Firm's Assets | 597 |
| | 23 Managing Risk | 624 |
| | Cases/Video Cases | 646 |
| | Index | 694 |

Contents



Part 1 Entrepreneurship: A World of Opportunity

Chapter 1 The Entrepreneurial Life

In the Spotlight: Table Occasions, Inc.

| | | |
|------|---|----|
| 1-1 | Small Size, Great Significance | 3 |
| 1-2 | Small Business and Entrepreneurial Opportunity: Is There a Difference? | 4 |
| 1-2a | What Is a Small Business? | 4 |
| 1-2b | What Is an Entrepreneurial Opportunity? | 6 |
| 1-3 | Entrepreneurial Qualities: Big Ego Not Required | 9 |
| 1-3a | Founders and Second-Stage Entrepreneurs | 10 |
| 1-3b | Franchisees | 10 |
| | <i>Living the Dream</i> Advice from Experienced Entrepreneurs | 11 |
| 1-3c | Entrepreneurial Teams | 12 |
| 1-3d | Social Entrepreneurs | 12 |
| 1-3e | Women Entrepreneurs | 13 |
| 1-3f | Be a Small Business Owner Who Thinks and Acts Like an Entrepreneur | 14 |
| | <i>Living the Dream</i> Honoring Women Entrepreneurs | 15 |
| | <i>Living the Dream</i> My First Step | 16 |
| 1-4 | Your Motivations for Owning a Business | 16 |
| 1-4a | Types of Entrepreneurial Motivations | 18 |
| 1-4b | Understanding Your Paradigm | 21 |
| | <i>Living the Dream</i> LeiLei Secor: NFIB Young Entrepreneur of the Year | 24 |
| 1-5 | The Entrepreneur's Competitive Edge | 25 |
| 1-5a | Integrity and Responsibility | 25 |
| 1-5b | Customer Focus | 25 |
| 1-5c | Quality Performance | 26 |
| 1-5d | Innovation | 26 |
| 1-5e | Niche Markets | 28 |
| 1-6 | Building an Entrepreneurial Legacy | 28 |
| | <i>Living the Dream</i> Watch Out for This Myth | 30 |
| 1-7 | Where To from Here? | 30 |

Chapter 2 Integrity, Ethics, and Social Entrepreneurship

In the Spotlight: The Home Grown Farm

| | | |
|-----|--------------------|----|
| 2-1 | What Is Integrity? | 38 |
|-----|--------------------|----|

| | | |
|------|---|----|
| 2-2 | Integrity and the Interests of Major Stakeholders | 39 |
| 2-2a | The “Big Three” Stakeholders—Owners, Customers, and Employees | 40 |
| 2-2b | Social Responsibility and Small Business | 42 |
| 2-2c | Integrity and Governmental Regulations | 44 |
| 2-3 | The Challenges and Benefits of Acting with Integrity | 44 |
| 2-3a | Small Companies and the Legitimacy Lie | 44 |
| 2-3b | Integrity and the Internet | 46 |
| 2-3c | Integrity and Doing Business Abroad | 47 |
| | <i>Living the Dream</i> Online Stalkers May Be Closer Than You Think! | 48 |
| 2-3d | The Integrity Edge | 49 |
| 2-4 | Building a Business with Integrity | 50 |
| 2-4a | The Foundations of Integrity | 50 |
| 2-4b | Leading with Integrity | 51 |
| 2-4c | An Ethical Organizational Culture | 51 |
| 2-4d | Better Business Bureaus | 53 |
| 2-4e | The Ethical Decision-Making Process | 53 |
| 2-5 | Social Entrepreneurship: A Continuing Trend | 55 |
| 2-5a | Social Entrepreneurship and the Triple Bottom Line | 55 |
| 2-5b | Small Business and the Natural Environment | 56 |
| | <i>Living the Dream</i> Green Ventures That Don't Go into the Red | 58 |



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Part 2

Starting from Scratch or Joining an Existing Business

Chapter 3 Starting a Small Business 64

In the Spotlight: SwipeSense 64

| | | |
|------|---|----|
| 3-1 | Developing Startup Ideas | 66 |
| 3-1a | Types of Startup Ideas | 66 |
| 3-1b | Common Sources of Startup Ideas | 67 |
| 3-2 | Using Innovative Thinking to Generate Business Ideas | 69 |
| | <i>Living the Dream</i> Shifting into High Gear through Diversification: Want a Latte to Go with That Bike? | 71 |
| | <i>Living the Dream</i> A Green Startup Mushrooms into a Huge Success | 74 |
| 3-3 | Using Internal and External Analyses to Assess New Business Ideas | 74 |
| 3-3a | Outside-In Analysis | 75 |
| 3-3b | Inside-Out Analysis | 78 |
| 3-3c | Integrating Internal and External Analyses | 79 |
| 3-4 | Selecting Strategies That Capture Opportunities | 81 |
| 3-4a | Broad-Based Strategy Options | 81 |
| 3-4b | Focus Strategies | 82 |
| 3-5 | Screening New Business Ideas | 84 |
| 3-6 | Is Your Startup Idea Feasible? | 86 |
| 3-6a | Market Potential | 88 |
| 3-6b | Industry Attractiveness | 88 |
| 3-6c | New Venture Leadership | 89 |

Chapter 4 Franchises and Buyouts 95

In the Spotlight: Castro Enterprises: The Innovative Franchisee 95

| | | |
|------|---|-----|
| 4-1 | What Is a Franchise? | 96 |
| 4-1a | Franchising Terminology | 97 |
| 4-1b | The Impact of Franchising | 98 |
| | <i>Living the Dream</i> Dawn Lafreeda—The Dream of Business Ownership | 99 |
| 4-2 | The Pros and Cons of Franchising | 100 |
| 4-2a | The Pros | 100 |
| 4-2b | The Cons | 102 |
| 4-2c | The Costs of Being a Franchisee | 104 |
| 4-3 | Evaluating Franchise Opportunities | 105 |
| 4-3a | Selecting a Franchise | 105 |
| 4-3b | Investigating the Potential Franchise | 105 |
| 4-3c | Becoming a Franchisor | 108 |
| 4-3d | Legal Issues in Franchising | 109 |
| 4-4 | Buying an Existing Business | 111 |
| 4-4a | Reasons for Buying an Existing Business | 111 |
| 4-4b | Finding a Business to Buy | 112 |



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| | | |
|------|--|-----|
| 4-4c | Investigating and Evaluating Available Businesses | 112 |
| | <i>Living the Dream</i> Reducing Risk or Adding Costs? | 113 |
| 4-4d | Quantitative Factors in Valuing the Business | 115 |
| 4-4e | Nonquantitative Factors in Valuing a Business | 115 |
| 4-4f | Negotiating and Closing the Deal | 116 |

Chapter 5 The Family Business 122

In the Spotlight: C.F. Martin & Co. 122

| | | |
|------|--|-----|
| 5-1 | What Is a Family Business? | 123 |
| 5-1a | Family and Business Overlap | 124 |
| 5-1b | Advantages and Disadvantages of a Family Business | 125 |
| 5-2 | Dynamic Family Businesses | 127 |
| 5-2a | The Imprint of Founders on the Family Business Culture | 127 |
| 5-2b | The Commitment of Family Members | 127 |
| 5-3 | Family Roles and Relationships | 129 |
| 5-3a | Co-Preneurs | 129 |
| 5-3b | Mom or Dad, the Founder | 130 |
| 5-3c | Sons and Daughters | 130 |
| 5-3d | Sibling Cooperation, Sibling Rivalry | 131 |
| | <i>Living the Dream</i> Nature or Nurture? | 132 |
| 5-3e | In-Laws In and Out of the Business | 133 |
| 5-3f | The Entrepreneur's Spouse | 133 |
| 5-4 | Good Governance in the Family Firm | 134 |
| 5-4a | Nonfamily Employees in a Family Firm | 134 |
| 5-4b | Family Retreats | 135 |
| 5-4c | Family Councils | 136 |
| 5-4d | Family Business Constitutions | 137 |
| 5-5 | The Process of Leadership Succession | 137 |
| 5-5a | Available Family Talent | 138 |
| 5-5b | Preparing for Succession | 139 |
| 5-5c | Transfer of Ownership | 140 |

Part 3

Developing the New Venture Business Plan

Chapter 6 The Business Plan: Visualizing the Dream

145

In the Spotlight: Maternova

145

| | | |
|------|---|-----|
| 6-1 | An Overview of the Business Plan | 146 |
| 6-2 | Will Writing a Plan Make a Difference? | 147 |
| 6-2a | The Balance Between Planning and Executing | 148 |
| 6-2b | What Form Will the Business Plan Take? | 149 |
| 6-3 | Begin with the Business Model | 150 |
| 6-3a | What Is a Business Model? | 151 |
| 6-3b | Developing a Business Model | 151 |
| | <i>Living the Dream</i> Changing the Business Model | 154 |
| 6-4 | Preparing a Business Plan: The Content and Format | 154 |
| 6-4a | Cover Page | 156 |
| 6-4b | Table of Contents | 157 |
| 6-4c | Executive Summary (Overview) | 157 |
| 6-4d | Company Description | 158 |
| 6-4e | Industry, Target Customer, and Competitor Analysis | 160 |
| 6-4f | Product/Service Plan | 160 |
| 6-4g | Marketing Plan | 160 |
| 6-4h | Operations and Development Plan | 160 |
| 6-4i | Management Team | 161 |
| 6-4j | Critical Risks | 161 |
| 6-4k | Offering | 161 |
| 6-4l | Exit Strategy | 162 |
| 6-4m | Financial Plan | 162 |
| 6-4n | Appendix of Supporting Documents | 163 |
| | <i>Living the Dream</i> Jania and Desmin Daniels Believe in Writing a Business Plan | 163 |
| 6-5 | Advice for Writing a Business Plan | 164 |
| 6-5a | Analyze the Market Thoroughly | 164 |
| 6-5b | Provide Solid Evidence for Any Claims | 164 |
| 6-5c | Think Like an Investor | 165 |
| 6-5d | Don't Hide Weaknesses—Identify Potential Fatal Flaws | 165 |
| 6-5e | Maintain Confidentiality | 166 |
| 6-5f | Pay Attention to Details | 166 |
| 6-6 | Pitching to Investors | 167 |
| 6-7 | Resources for Business Plan Preparation | 168 |
| 6-7a | Computer-Aided Business Planning | 168 |
| 6-7b | Professional Assistance in Business Planning | 168 |
| 6-8 | Keeping the Right Perspective | 169 |

Chapter 7 The Marketing Plan

174

In the Spotlight: Checkerboard Ltd.: Building a Bigger Share of a Shrinking Market

174

| | | |
|------|---|-----|
| 7-1 | What Is Small Business Marketing? | 175 |
| 7-1a | Marketing Philosophies Make a Difference | 176 |
| 7-1b | A Consumer Orientation—The Right Choice | 176 |
| 7-2 | The Formal Marketing Plan | 177 |
| 7-2a | Market Analysis | 177 |
| 7-2b | The Competition | 179 |
| 7-2c | Marketing Strategy | 179 |
| | <i>Living the Dream</i> Direct Sales? | 182 |
| 7-3 | Marketing Research for the Small Business | 183 |
| 7-3a | The Nature of Marketing Research | 183 |
| 7-3b | Steps in the Marketing Research Process | 184 |
| 7-4 | Understanding Potential Target Markets | 187 |
| 7-4a | Market Segmentation and Its Variables | 187 |
| 7-4b | Marketing Strategies Based on Segmentation Considerations | 188 |
| 7-5 | Estimating Market Potential | 189 |
| 7-5a | The Sales Forecast | 190 |
| 7-5b | Limitations of Forecasting | 191 |
| 7-5c | The Forecasting Process | 192 |

Chapter 8 The Organizational Plan: Teams, Legal Structures, Alliances, and Directors

197

In the Spotlight: FlexPro, uBreakiFix, and GreenCupboards

197

| | | |
|------|--|-----|
| 8-1 | Building a Management Team | 199 |
| 8-1a | Achieving Balance | 200 |
| 8-1b | The Solo Startup Is Still an Option | 200 |
| | <i>Living the Dream</i> Taking Team Formation to Heart | 201 |
| 8-1c | Expanding Social Networks | 202 |
| | <i>Living the Dream</i> Entrepreneurs Get By with a Little Help from Their Network Friends | 203 |
| 8-2 | Common Legal Forms of Organization | 204 |
| 8-2a | The Sole Proprietorship Option | 204 |
| 8-2b | The Partnership Option | 206 |
| 8-2c | The C Corporation Option | 209 |
| 8-3 | Considerations in Choosing an Organizational Form | 211 |
| 8-4 | Specialized Legal Forms of Organization | 213 |
| 8-4a | The Limited Partnership | 214 |

| | | | |
|---|------------|---|------------|
| 8-4b The S Corporation | 214 | 10-1 The Income Statement | 263 |
| 8-4c The Limited Liability Company | 214 | <i>Living the Dream</i> The Little Things Are the Big Things When It Comes to Managing Finances | 268 |
| 8-4d The Professional Corporation | 215 | 10-2 The Balance Sheet | 268 |
| 8-4e The Nonprofit Corporation | 215 | 10-2a Assets | 269 |
| 8-4f The B Corporation | 216 | 10-2b Debt and Equity | 271 |
| 8-5 Forming Strategic Alliances | 216 | 10-3 Viewing the Income Statement and Balance Sheet Together | 276 |
| 8-5a Strategic Alliances with Large Companies | 217 | 10-4 The Cash Flow Statement | 276 |
| 8-5b Strategic Alliances with Small Companies | 218 | <i>Living The Dream</i> Surviving Tough Times Means Effectively Managing Your Finances | 277 |
| 8-5c Setting Up and Maintaining Successful Strategic Alliances | 218 | 10-4a Profits versus Cash Flows | 278 |
| 8-6 Making the Most of a Board of Directors | 219 | 10-4b Measuring a Firm's Cash Flows | 278 |
| 8-6a Selection of Directors | 220 | 10-5 Evaluating a Firm's Financial Performance | 284 |
| 8-6b Contributions of Directors | 221 | 10-5a Liquidity (Ability to Pay Debt) | 285 |
| 8-6c Compensation of Directors | 221 | 10-5b Profitability on Assets | 286 |
| 8-6d An Alternative: An Advisory Board | 222 | 10-5c Use of Debt Financing | 287 |
| | | 10-5d Return on Owners' Equity | 287 |
| Chapter 9 The Location Plan | 229 | | |
| <i>In the Spotlight: The Icebreaker</i> | 229 | Chapter 11 Forecasting Financial Requirements | 295 |
| 9-1 Locating the Brick-and-Mortar Startup | 231 | <i>In the Spotlight: GSM Nation: The Need to Manage Growth</i> | 295 |
| 9-1a The Importance of the Location Decision | 231 | 11-1 The Purpose of Financial Forecasting | 296 |
| 9-1b Key Factors in Selecting a Good Location | 231 | 11-2 Forecasting Profitability | 297 |
| 9-2 Designing and Equipping the Physical Facilities | 237 | 11-3 Forecasting Asset and Financing Requirements | 301 |
| 9-2a Challenges in Designing the Physical Facilities | 237 | <i>Living the Dream</i> Financial Planning Makes a Difference at REEcycle | 302 |
| 9-2b Challenges in Equipping the Physical Facilities | 237 | 11-3a Determining Asset Requirements | 304 |
| 9-2c Business Image | 239 | 11-3b Determining Financing Requirements | 305 |
| <i>Living the Dream</i> Hanging Out with the Right People Makes a Big Difference! | 240 | 11-4 Forecasting Cash Flows | 310 |
| 9-3 Locating the Startup in the Entrepreneur's Home | 241 | 11-4a Pro Forma Statement of Cash Flows | 311 |
| 9-3a The Attraction of Home-Based Businesses | 241 | 11-4b The Cash Budget | 312 |
| 9-3b The Challenges of Home-Based Businesses | 242 | 11-5 Use Good Judgment When Forecasting | 314 |
| 9-4 E-Commerce: Locating a Startup on the Internet | 243 | | |
| 9-4a Benefits of E-Commerce for Startups | 243 | Chapter 12 A Firm's Sources of Financing | 319 |
| <i>Living the Dream</i> In the Zone or Out of Bounds? | 244 | <i>In the Spotlight: Emmy's Organics</i> | 319 |
| 9-4b E-Commerce Business Models | 245 | 12-1 Firm Characteristics and Sources of Financing | 320 |
| 9-4c Internet-Based Businesses and the Part-Time Startup Advantage | 252 | 12-1a Firm's Economic Potential | 320 |
| | | 12-1b Company Size and Maturity | 321 |
| Chapter 10 Understanding a Firm's Financial Statements | 258 | 12-1c Nature of Firm's Assets | 322 |
| <i>In the Spotlight: J&S Construction Company</i> | 258 | 12-1d Owners' Preferences for Debt or Equity | 322 |
| The Lemonade Kids | 259 | 12-2 Debt or Equity Financing? | 322 |
| Setting Up the Business | 260 | 12-2a Potential Profitability | 322 |
| Opening Day | 261 | 12-2b Financial Risk | 325 |
| Collecting Accounts Receivable | 262 | 12-2c Voting Control | 326 |
| Strategic Planning for the Following Saturday | 262 | | |
| The Second Saturday of Business | 262 | | |

| | | | |
|---|-----|--|------------|
| 12-3 Sources of Early Financing | 326 | 12-9 Where Else to Look | 345 |
| 12-3a Personal Savings | 327 | 12-9a Large Corporations | 345 |
| 12-3b Friends and Family | 328 | 12-9b Stock Sales | 346 |
| 12-3c Credit Cards | 328 | | |
| 12-4 Bank Financing | 329 | Chapter 13 Planning for the Harvest | 351 |
| 12-4a Types of Loans | 329 | <i>In the Spotlight: Tapestry Medical, Inc.</i> | 351 |
| 12-4b Understanding a Banker's Perspective | 330 | 13-1 The Importance of the Harvest | 353 |
| 12-4c Selecting a Banker | 333 | 13-2 Methods of Harvesting a Business | 353 |
| 12-4d Negotiating the Loan | 333 | 13-2a Selling the Firm | 353 |
| <i>Living the Dream</i> Able Lending | 334 | 13-2b Distributing the Firm's Cash Flows | 357 |
| 12-5 Business Suppliers and Asset-Based Lenders | 336 | 13-2c Initial Public Offering (IPO) | 358 |
| 12-5a Accounts Payable (Trade Credit) | 336 | <i>Living the Dream</i> Two Friends Build and Successfully | |
| 12-5b Equipment Loans and Leases | 337 | Exit Their Business | 359 |
| 12-5c Asset-Based Lending | 337 | 13-2d Private Equity Recapitalization | 360 |
| 12-6 Private Equity Investors | 338 | 13-3 Firm Valuation and Payment Methods | 362 |
| 12-6a Business Angels | 338 | 13-3a The Harvest Value | 362 |
| 12-6b Venture Capital Firms | 339 | 13-3b The Method of Payment | 362 |
| <i>Living the Dream</i> "Shark Tank": Changing the Game | | <i>Living the Dream</i> Why My Exit Strategy Failed | 363 |
| of Angel Investing | 340 | 13-4 Developing an Effective Harvest Plan | 363 |
| 12-7 Crowdfunding | 341 | 13-4a Anticipate the Harvest | 364 |
| <i>Living the Dream</i> Parke New York: A Success at | | 13-4b Expect Conflict—Emotional and Cultural | 364 |
| Crowdfunding | 342 | 13-4c Get Good Advice | 365 |
| 12-8 Government Loan Programs | 343 | 13-4d Understand What Motivates You | 366 |
| 12-8a The Small Business Administration | 344 | 13-4e What's Next? | 366 |
| 12-8b State and Local Government Assistance | 345 | | |
| 12-8c Community-Based Financial Institutions | 345 | | |

Part 4

Focusing on the Customer: Marketing Growth Strategies

| | | | |
|---|------------|---|-----|
| Chapter 14 Building Customer Relationships | 371 | 14-4a Need Recognition | 386 |
| <i>In the Spotlight: The Cut and Color Room</i> | 371 | 14-4b Information Search and Evaluation | 387 |
| 14-1 What Is Customer Relationship Management? | 372 | 14-4c Purchase Decision | 388 |
| 14-1a Benefits of CRM to a Small Firm | 373 | 14-4d Post-Purchase Evaluation | 388 |
| 14-1b Essential Materials for a CRM Program | 374 | <i>Living the Dream</i> Little Brother Is Watching—But He | |
| 14-2 Outstanding Customer Relationships through | | Only Wants to Help | 389 |
| Extraordinary Service | 374 | 14-5 Understanding Psychological Influences | 390 |
| 14-2a Managing Customer Satisfaction | 375 | on Customers | 390 |
| <i>Living the Dream</i> When It Comes to Posting Online | | 14-5a Needs | 390 |
| Reviews, Some Customers Can't Yelp Themselves | 378 | 14-5b Perceptions | 391 |
| 14-2b Evaluating a Firm's Customer Service Health | 379 | 14-5c Motivations | 391 |
| 14-3 Using Technology to Support Customer | | 14-5d Attitudes | 392 |
| Relationship Management | 381 | 14-6 Understanding Sociological Influences on | 392 |
| 14-3a Creating a CRM Database | 383 | Customers | 392 |
| 14-3b Using a CRM Database | 384 | 14-6a Cultures | 392 |
| 14-3c Data Use and Privacy Concerns | 385 | 14-6b Social Classes | 392 |
| 14-4 Customers as Decision Makers | 386 | 14-6c Reference Groups | 393 |
| | | 14-6d Opinion Leaders | 393 |

Chapter 15 Product Development and Supply Chain Management

In the Spotlight: Nest Labs

| | |
|---|-----|
| 15-1 To Grow or Not to Grow | 401 |
| 15-2 Innovation: A Path to Growth | 402 |
| 15-2a Gaining a Competitive Advantage | 402 |
| 15-2b Achieving Sustainability | 403 |
| 15-3 The Product Life Cycle and New Product Development | 405 |
| 15-3a The Product Life Cycle | 405 |
| 15-3b The New Product Development Process | 407 |
| 15-4 Building the Total Product | 409 |
| 15-4a Branding | 410 |
| <i>Living the Dream</i> What's in a (Quirky) Name? Plenty, Especially for Online Startups | 412 |
| 15-4b Packaging | 413 |
| 15-4c Labeling | 414 |
| 15-4d Warranties | 414 |
| 15-5 Product Strategy | 415 |
| 15-5a Product Marketing versus Service Marketing | 415 |
| 15-5b Product Strategy Options | 416 |
| 15-6 The Legal Environment | 417 |
| 15-6a Consumer Protection | 417 |
| 15-6b Protection of Marketing Assets | 418 |
| <i>Living the Dream</i> Banding Together to Fight Patent Infringement | 420 |
| 15-7 Supply Chain Management | 421 |
| 15-7a Intermediaries | 421 |
| 15-7b Channels of Distribution | 421 |
| 15-7c The Scope of Physical Distribution | 423 |

Chapter 16 Pricing and Credit Decisions 430

In the Spotlight: Johnny Cupcakes: It's a Brand, Not a Fad!

| | |
|--|-----|
| 16-1 Setting a Price | 431 |
| 16-1a Pricing Starting with Costs | 432 |
| 16-1b Pricing Starting with Customers | 434 |
| 16-2 Applying a Pricing System | 435 |
| 16-2a Break-Even Analysis | 435 |
| <i>Living the Dream</i> Have You Had Your Brick for the Day? | 436 |
| 16-2b Markup Pricing | 439 |
| 16-3 Selecting a Pricing Strategy | 439 |
| 16-3a Penetration Pricing | 439 |
| 16-3b Price Skimming | 440 |
| 16-3c Follow-the-Leader Pricing | 440 |
| 16-3d Variable Pricing | 440 |
| 16-3e Price Lining | 440 |
| 16-3f Optional Product and Service Pricing | 440 |

399

399



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| | |
|---|-----|
| 16-4 Offering Credit | 441 |
| 16-4a Benefits of Credit | 441 |
| 16-4b Factors That Affect Selling on Credit | 442 |
| 16-4c Types of Credit | 443 |
| 16-5 Managing the Credit Process | 444 |
| 16-5a Evaluation of Credit Applicants | 445 |
| 16-5b Sources of Credit Information | 446 |
| 16-5c Aging of Accounts Receivable | 447 |
| 16-5d Billing and Collection Procedures | 447 |
| 16-5e Credit Regulation | 449 |

Chapter 17 Promotional Planning 453

In the Spotlight: Telesian Technology Inc.

| | |
|---|-----|
| 17-1 Promotion Is Communication | 454 |
| 17-2 Determining the Promotional Budget | 456 |
| 17-2a Budgeting a Fixed Percentage of Sales | 456 |
| 17-2b Deciding How Much Is Left Over after Other Expenses Are Covered | 456 |
| 17-2c Spending at the Same Level as Competitors | 456 |
| 17-2d Determining How Much Is Needed to Achieve Objectives | 457 |
| 17-3 Promotion Using the Internet and Social Media | 457 |
| 17-3a The Small Business Website | 457 |
| 17-3b Social Media | 459 |
| <i>Living the Dream</i> An e-Commerce Revolutionary | 463 |
| 17-4 Personal Selling in the Small Firm | 463 |
| 17-4a The Importance of Product Knowledge | 464 |
| 17-4b The Sales Presentation | 464 |
| 17-4c Cost Control in Personal Selling | 466 |
| 17-4d The Compensation Program for Salespeople | 467 |
| 17-5 Advertising Practices | 468 |
| 17-5a Advertising Objectives | 468 |
| 17-5b Types of Advertising | 468 |
| 17-5c Advertising Specialists | 469 |
| 17-5d Frequency of Advertising | 469 |
| 17-5e Where to Advertise | 469 |

| | | | |
|--|------------|---|-----|
| 17-6 Sales Promotion | 471 | 18-3 Strategy Options for Global Firms | 488 |
| 17-6a Specialties | 471 | 18-3a Exporting | 489 |
| 17-6b Trade Show Exhibits | 471 | 18-3b Importing | 490 |
| 17-6c Coupons | 472 | 18-3c Foreign Licensing | 491 |
| 17-6d Publicity | 473 | 18-3d International Franchising | 492 |
| 17-6e When to Use Sales Promotion | 473 | 18-3e International Strategic Alliances | 492 |
| | | 18-3f Locating Facilities Abroad | 493 |
| Chapter 18 Global Opportunities for Small Businesses | 478 | 18-4 Challenges to Global Businesses | 493 |
| <i>In the Spotlight: Combat Flip Flops in Afghanistan</i> | 478 | 18-4a Political Risk | 494 |
| 18-1 Small Businesses as Global Enterprises | 479 | 18-4b Economic Risk | 494 |
| 18-2 The Forces Driving Global Businesses | 482 | <i>Living the Dream</i> Having the Energy to Take Daring Risks | 495 |
| 18-2a Expanding Markets | 482 | 18-4c The Ease of Doing Business Index | 496 |
| 18-2b Gaining Access to Resources | 484 | 18-5 Assistance for Global Enterprises | 497 |
| 18-2c Cutting Costs | 485 | 18-5a Analyzing Markets and Planning Strategy | 497 |
| <i>Living the Dream</i> Making the Most of Chinese Partnerships | 486 | 18-5b Connecting with International Customers | 498 |
| 18-2d Capitalizing on Special Features of Location | 487 | 18-5c Financing | 499 |

Part 5 Managing Growth in the Small Business

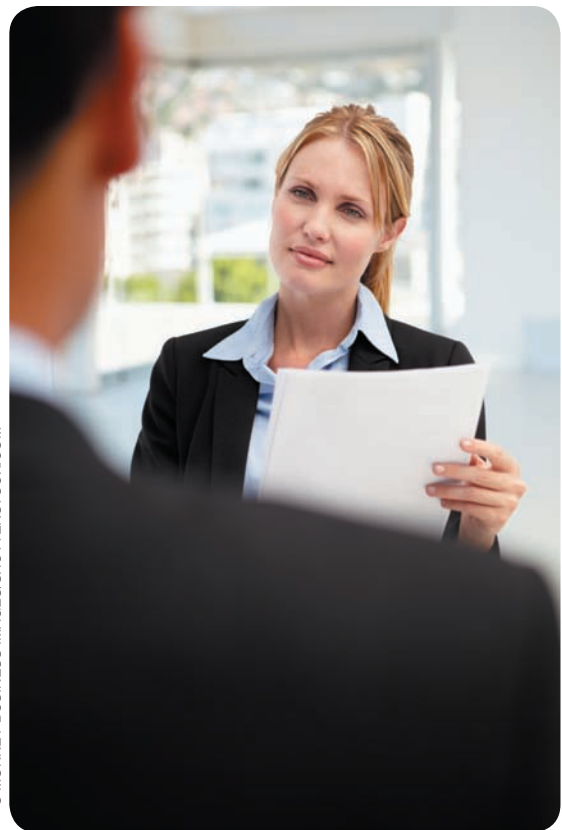
| | | | |
|--|------------|--|------------|
| Chapter 19 Professional Management and the Small Business | 505 | 19-4b Time Savers for Busy Managers | 522 |
| <i>In the Spotlight: Effective Delegation at Staff.com</i> | 505 | <i>Living the Dream</i> Cluttered Desk, Creative Mind? | 524 |
| 19-1 Small Business Leadership | 506 | 19-5 Outside Management Assistance | 525 |
| 19-1a What Is Leadership? | 507 | 19-5a The Need for Outside Assistance | 525 |
| 19-1b Leadership Qualities of Founders | 507 | 19-5b Sources of Management Assistance | 525 |
| 19-1c What Makes a Leader Effective? | 507 | <i>Living the Dream</i> Piecemeal Professionals: Renting Management Talent on the Cheap | 528 |
| 19-1d Leadership Styles | 508 | Chapter 20 Managing Human Resources | 534 |
| 19-1e Shaping the Culture of the Organization | 509 | <i>In the Spotlight: Hired.com</i> | 534 |
| 19-2 The Small Firm Management Process | 511 | 20-1 Recruiting Personnel | 536 |
| 19-2a From Founder to Professional Manager | 511 | 20-1a The Need for Quality Employees | 536 |
| 19-2b Firm Growth and Managerial Practices | 513 | <i>Living the Dream</i> Knowing When It's Time to Turn to a Hire Power | 537 |
| 19-3 Managerial Responsibilities of Entrepreneurs | 515 | 20-1b The Lure of Entrepreneurial Firms | 538 |
| 19-3a Planning Activities | 515 | 20-1c Sources of Employees | 539 |
| 19-3b Creating an Organizational Structure | 515 | 20-1d Diversity in the Workforce | 542 |
| 19-3c Delegating Authority | 517 | <i>Living the Dream</i> Where in the World Did All of the Talent Go? | 543 |
| 19-3d Controlling Operations | 518 | 20-1e Job Descriptions | 544 |
| 19-3e Communicating | 519 | 20-2 Evaluating Prospects and Selecting Employees | 544 |
| 19-3f Negotiating | 520 | 20-2a Step 1: Use Application Forms | 545 |
| 19-4 Personal Time Management | 522 | | |
| 19-4a The Problem of Time Pressure | 522 | | |

| | | |
|-------|---|-----|
| 20-2b | Step 2: Interview the Applicant | 545 |
| 20-2c | Step 3: Check References and Other Background Information | 547 |
| 20-2d | Step 4: Test the Applicant | 548 |
| 20-2e | Step 5: Require Physical Examinations | 549 |
| 20-3 | Training and Developing Employees | 549 |
| 20-3a | Basic Components of Training and Development | 550 |
| 20-3b | Orientation for New Personnel | 550 |
| 20-3c | Employee Training | 551 |
| 20-3d | From Training to Implementation | 553 |
| 20-3e | Development of Managerial and Professional Employees | 554 |
| 20-4 | Compensation and Incentives for Employees | 555 |
| 20-4a | Wage and Salary Levels | 555 |
| 20-4b | Financial Incentives | 555 |
| 20-4c | Stock Incentives | 556 |
| 20-4d | Employee Benefits | 556 |
| 20-5 | Special Issues in Human Resource Management | 557 |
| 20-5a | Co-Employment Agreements | 557 |
| 20-5b | Legal Protection of Employees | 558 |
| 20-5c | Labor Unions | 560 |
| 20-5d | Formalizing Employer-Employee Relationships | 560 |
| 20-5e | The Need for a Human Resource Manager | 561 |

Chapter 21 Managing Small Business Operations

In the Spotlight: Big Shot Bikes

| | | |
|-------|---|------------|
| | | 567 |
| | | 567 |
| 21-1 | Competing with Operations | 569 |
| 21-2 | The Operations Process | 570 |
| 21-2a | The Operations Process in a Service Business | 570 |
| 21-2b | The Operations Process in a Manufacturing Business | 571 |
| 21-2c | Capacity Considerations | 572 |
| 21-2d | Planning and Scheduling | 573 |
| 21-3 | Inventory Management and Operations | 573 |
| 21-3a | Objectives of Inventory Management | 574 |
| 21-3b | Inventory Cost Control | 575 |
| 21-3c | Inventory Recordkeeping Systems | 577 |
| 21-4 | Quality and Operations Management | 577 |
| 21-4a | Quality as a Competitive Tool | 578 |
| 21-4b | The Customer Focus of Quality Management | 578 |
| | <i>Living the Dream</i> Five Guys Gets Five Stars on Food Quality | 580 |
| 21-4c | “The Basic Seven” Quality Tools | 581 |
| 21-4d | Quality Inspection versus Poka-Yoke | 582 |
| 21-4e | Statistical Methods of Quality Control | 582 |



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| | | |
|-------|---|------------|
| 21-4f | International Certification for Quality Management | 583 |
| 21-4g | Quality Management in Service Businesses | 584 |
| 21-5 | Purchasing Policies and Practices | 584 |
| 21-5a | The Importance of Purchasing | 585 |
| 21-5b | Measuring Supplier Performance | 587 |
| 21-5c | Building Good Relationships with Suppliers | 588 |
| 21-5d | Forming Strategic Alliances | 588 |
| | <i>Living the Dream</i> Saving Face and Saving Money | 589 |
| 21-5e | Forecasting Supply Needs | 590 |
| 21-5f | Using Information Systems | 590 |
| 21-6 | Lean Production and Synchronous Management | 591 |
| 21-6a | Lean Production | 591 |
| 21-6b | Synchronous Management | 591 |
| | | |
| | Chapter 22 Managing the Firm's Assets | 597 |
| | <i>In the Spotlight: The Cutting Edge Elite, Inc.</i> | 597 |
| 22-1 | The Working Capital Cycle | 598 |
| 22-1a | The Timing and Size of Working Capital Investments | 600 |
| 22-1b | Examples of Working Capital Management | 601 |
| 22-2 | Managing Cash Flows | 605 |
| | <i>Living the Dream</i> Cash Flow Matters—A Lot | 606 |

| | | | | |
|-------------------|--|------------|--------------|--|
| 22-3 | Managing Accounts Receivable | 607 | Cases | 646 |
| 22-3a | How Accounts Receivable Affect Cash | 607 | 1 | DashLocker 646 |
| 22-3b | The Life Cycle of Accounts Receivable | 608 | 2 | PortionPac Chemicals 647 |
| 22-3c | Accounts Receivable Financing | 610 | 3 | The Kollection: From Music Hobby to Startup and Beyond 649 |
| 22-4 | Managing Inventory | 610 | 4 | Two Men and a Truck®/International, Inc. 652 |
| 22-4a | Reducing Inventory to Free Cash | 611 | 5 | Iaccarino & Son 654 |
| 22-4b | Monitoring Inventory | 611 | 6 | Hyper Wear, Inc. 656 |
| 22-4c | Controlling Stockpiles | 612 | 7 | ReadyMade Magazine 657 |
| | <i>Living The Dream</i> Taking Stock of Inventory Management | 612 | 8 | Couchsurfing International 658 |
| 22-5 | Managing Accounts Payable | 613 | 9 | Cookies-N-Cream 661 |
| 22-6 | Cash Conversion Period Revisited | 615 | 10 | Harper & Reiman, LLC 662 |
| 22-7 | Capital Budgeting Techniques | 615 | 11 | Ashley Palmer Clothing, Inc. 665 |
| 22-7a | Accounting Return on Investment | 616 | 12 | Moonworks 668 |
| 22-7b | Payback Period | 617 | 13 | Network Collie 670 |
| 22-7c | Discounted Cash Flows | 618 | 14 | Numi Tea 675 |
| 22-8 | Capital Budgeting Practices in Small Firms | 618 | 15 | Graeter's Ice Cream 677 |
| | | | 16 | Dynamic Network Services, Inc. 679 |
| | | | 17 | HubSpot, Inc. 681 |
| | | | 18 | Auntie Anne's Pretzels in China 682 |
| | | | 19 | Andrew Mason and the Rise and Fall of Groupon 685 |
| | | | 20 | Jason Fried and Hiring Practices at 37signals 688 |
| | | | 21 | River Pools & Spas 689 |
| | | | 22 | Pearson Air Conditioning & Service 690 |
| | | | 23 | Jack's Restaurant 693 |
| Chapter 23 | Managing Risk | 624 | | |
| | <i>In the Spotlight: Homestead Interior Doors</i> | 624 | | |
| 23-1 | What Is Business Risk? | 625 | | |
| 23-2 | Basic Types of Pure Risk | 626 | | |
| 23-2a | Property Risks | 626 | | |
| 23-2b | Liability Risks | 627 | | |
| 23-2c | Personnel Risks | 630 | | |
| 23-3 | Risk Management | 631 | | |
| 23-3a | The Process of Risk Management | 632 | | |
| 23-3b | Risk Management in the Small Business | 633 | | |
| | <i>Living the Dream</i> Ten Security Tips for Small Businesses | 634 | | |
| 23-4 | Basic Principles of a Sound Insurance Program | 635 | | |
| 23-5 | Common Types of Business Insurance | 636 | | |
| 23-5a | Property and Casualty Insurance | 636 | | |
| | <i>Living the Dream</i> Sweet Dreams Can End Quickly | 640 | | |
| 23-5b | Life and Health Insurance | 641 | | |
| | | | Index | 694 |

Preface



Welcome to the 18th edition of *Small Business Management: Launching and Growing Entrepreneurial Ventures*, which continues to be the leading textbook in the field of small business management. As the authors, we attribute its success to our decision to approach each new edition as though we were writing the book for the very first time. By doing so, we are certain that you will be provided with the best and most recent advice on running your business.

We completely agree with the age-old saying that you can't judge a book by its cover. But you can learn a lot about a textbook and its success simply by knowing how many students have chosen to keep it rather than sell it at the end of a semester. *Small Business Management* has become a part of many students' permanent library. As one student explained, "*Small Business Management* is one of the few books from my college days that I have kept for future reference."

Why do so many consider the book to be a "keeper"? We believe that they find in its pages practical ways of thinking and acting that help them achieve their dreams of starting and building successful enterprises. For example, readers have described how the chapters on finance helped them to understand financial statements and to make better decisions based on that information. Others have said that the business plan chapter, with the real-life examples it presents, provides an excellent guide for writing their own plans. Readers have also described how the chapters on managing the business have kept them from making the kinds of mistakes that Andrew Mason and others have made.

Small Business Management lays out, step by step, the knowledge and insights needed to lead and manage a small business. Our aim is to provide instruction and guidance that will greatly improve your odds for success as you take your own entrepreneurial journey. In this edition, we present the best information available today about launching and growing small businesses. Furthermore, we offer examples throughout the text to demonstrate that there is not a single path to success. The goal is to help you to find one that will work best for you.

It is our hope that the information presented in this book—and in the ancillaries that accompany it—will support the varied goals of those seeking independent business careers, either directly or indirectly. Most of all, we encourage you to continue learning

I didn't realize how hard it was to run a small business.

**—Andrew Mason,
former CEO of Groupon**

Andrew Mason, the founder of Groupon, is featured in the case for Chapter 19. Even though Mason created the company, he was eventually fired by the board. He clearly had a creative idea but discovered too late that building and running a successful business require more than having a good idea—this concept, along with many others, will be explored in more depth throughout this latest edition of *Small Business Management: Launching and Growing Entrepreneurial Ventures*.

every day, building on the foundation provided by this text. This advice is supported by the words of Richard Branson, founder and chairman of the Virgin Group, which comprises more than 400 companies: “My biggest motivation? Just to keep challenging myself. Everyday I’m learning something new.”

Throughout the text, we emphasize the importance of building relationships along the way. Managing a business is a team sport. As the owner, you are the key to making the basket, reaching the goal line, crossing home plate (or whatever analogy you want to use)—but you cannot do it alone. Even if you are the company’s only employee, working alone in your own apartment or basement or in your parents’ garage, you still have relationships with and depend on others, including your family, a banker, suppliers, and customers. And you must be effective in your relationships with other people. The bottom line: You cannot accomplish anything of any real significance by yourself!

Follow Your Dreams

As you will see, *Small Business Management* focuses on teaching you the essential concepts and building skills that you will need to grow and manage a business successfully. It also considers a much broader concern—the pursuit of entrepreneurial dreams. Entrepreneurs build businesses to fulfill dreams—for themselves, their families, their employees, and their communities. Your journey will always be about more than the money. Entrepreneurs are individuals whose business lives have an impact on a wide range of people. For most entrepreneurs, what they do matters.

Many students enroll in colleges and universities to gain qualifications that will help them to get a job. In fact, most colleges spend the bulk of the curriculum teaching students how to work for someone else. But the best way to achieve your goals, no matter what your major is, may be through owning a business of your own. If so, why not make it something special—something that solves a problem that makes life better for others, that builds wealth while at the same time providing a way for you to give back to your community and to nonprofit organizations that you believe in.

There are definite advantages to initially working for someone else. It may allow you to learn an industry, build relationships, and develop important skills for the future. But many individuals choose to start their own company early in life:

- Michael Dell started assembling computer parts and selling personal computers when he was a premed student at the University of Texas.
- Fred DeLuca opened a submarine sandwich shop when he was 17 years old to earn money to pay his tuition at the University of Bridgeport. Today, his legacy, SUBWAY, has more locations worldwide than any other franchise organization.
- Jeremy Hitchcock started Dyn, a global leader in software as a service (SaaS), when he was a management information systems major at Worcester Polytechnic Institute. (Chapter 16, “Pricing and Credit Decisions,” and the case for the chapter present more information about this company.)

This list could go on for pages. We all know entrepreneurs and small business owners who will not be the next Bill Gates, but who will build or already own small businesses that create value and make a difference in the community. These small companies are the heart and soul of our economy. We challenge you to give serious thought to joining them—and if you do, *dream big*. Follow a dream that you really care about, and enjoy a life that you truly want to live! *Our best wishes to you for a challenging and successful learning experience!*

MindTap

MindTap is an online, highly personalized learning experience built upon Cengage Learning content. MindTap combines student learning tools—readings, multimedia, activities, and assessments—in a singular Learning Path that guides students through the course. Instructors personalize the experience by customizing authoritative Cengage Learning content and learning tools, including the ability to add their own content to the Learning Path via apps that integrate the MindTap framework seamlessly with Learning Management Systems. For the 18th edition of *Small Business Management*, MindTap has been expanded and vastly improved to include the following:

Lead, Choose, Learn. This engaging exercise places students firmly in the driver’s seat of a business’s future. Given a scenario, students decide how to proceed and then see how that decision impacts the business and future decisions. Students travel different paths and the scenarios change based on each student’s decisions. The unique and practical learning model provides students with the valuable opportunity to practice managerial analysis and crucial decision-making skills.

Experiential Exercises. Leveraging third party technology, YouSeeU is an innovative experience that provides students a critical platform for self, peer or instructor review—whether it be in the form of a sales pitch or the polishing of a presentation. Live or recorded video exercises, which include both individual and group work projects, allow for collaboration and engagement similar to what students will experience in the business world.

Video Cases. New documentary-style videos highlight such entrepreneurs and small businesses as Theo Chocolate, Camp Bow Wow, and Honest Tea. Candid interviews provide insight into marketing, financial forecasting, and product development, among many other topics, appropriately marrying chapter concepts with real-world examples.

Whiteboard Videos. We’re excited to offer for the first time “whiteboard” videos. These fun and relevant stories capture key terms, important topics, and overarching themes. By creating a narrative independent from any particular company, we’ve constructed a more flexible and yet more tailored experience. The result is crucial lessons for future entrepreneurs to digest and apply.

What’s New?

A primary purpose of *Small Business Management* is to present current, relevant content in unique and interesting ways, drawing on an abundance of real-world examples to keep the reader completely engaged. Thus, the 18th edition of *Small Business Management* offers plenty of updates, including the following:

- A host of misconceptions about becoming a small business owner can cause you to give up your entrepreneurial dream. We have revised Chapter 1, “The Entrepreneurial Life,” to help you better understand your motivations for starting a business and to avoid distorted concepts about what is required for you to be an effective business owner. Getting off on the right foot is critical to your success.
- Social entrepreneurship has become a major topic in entrepreneurial circles, both in practice and on college campuses. Recognizing this trend, Chapter 2 introduces some of the important concepts and principles involved in the launch

of a socially oriented enterprise. We have also included examples of socially minded entrepreneurs, such as Alicia Polak at Khaya Cookie Company, Father Greg Boyle at Homeboy Industries, and Nick Frey at Boo Bicycles.

- Prioritizing a small business owner’s responsibilities to major stakeholders can be difficult. With that in mind, Chapter 2, “Integrity, Ethics, and Social Entrepreneurship,” presents a framework (adapted from the writings of ethics and morality scholar Archie Carroll) for managing stakeholder considerations as a unified whole, which will help owners to determine how to balance stakeholder interests.
- We are thrilled to continue offering *LivePlan* from Business Plan Pro, the unquestioned leader in business planning software. *LivePlan* has interactive features that guide you through the writing process in ways not previously available.
- Chapter 8 covers the organizational plan for a startup or small business, and it has been further developed to provide direction for alternative paths that small business owners may choose to take. For example, though an increasing number of startups are being launched by entrepreneurial teams, we expanded the section on operating as a solo entrepreneur for those who choose this option. We also provide a more complete description of legal forms of organization that can be adopted, including the B Corporation, so that the reader will be able to pick the organizational form most suitable for his or her needs and interests.
- The number of small businesses being launched on the Internet continues to grow. Chapter 9, “The Location Plan,” includes an expanded section on effective models of e-commerce and emerging options that can lead to new business opportunities for online entrepreneurs.
- In a previous edition, we improved the presentation of financial statements (Chapter 10, “Understanding a Firm’s Financial Statements”) and the preparation of financial forecasts for small businesses (Chapter 11, “Forecasting Financial Requirements”). Our goal was to make the material more logical for the reader to follow. We have continued to build on this approach in the 18th edition in order to make the material even easier to grasp.
- Updated information on raising capital to grow a business, including best practices for raising money on the Internet (crowdfunding), is provided in Chapter 12, “A Firm’s Sources of Financing.” But stay tuned: Regulations concerning such topics are constantly evolving, and entrepreneurs must be aware of the fast-changing landscape of publicly raised capital.
- Because of the importance of establishing and improving relationships with customers, and the development of new and more sophisticated tools to make this more manageable, we continue to expand and update the sections on creating and using customer data in Chapter 14, “Building Customer Relationships.” These sections now offer more practical instruction on CRM methods that make sense for small businesses, regardless of the level of sophistication, and provide insights on available software packages that may be most suitable for a small business. The section on call centers has also been significantly revised and expanded using information and cost figures from up-to-date research and analysis provided by the consulting firm McKinsey & Co.
- Challenges related to product development continue to be among the most difficult that confront small firms, and Chapter 15 has been revised to reflect

this. For this reason, the 18th edition includes, for example, more cutting-edge approaches in a significantly reworked section on the development of the physical product. We have also provided more information regarding the rules applying to brand name selection, specifically addressing the circumstances resulting from doing business online.

- Small business owners are discovering that social media can offer cost-effective ways of getting their message out. They are also learning that more and more customers rely on social media to make buying decisions. With this in mind, Chapter 17, “Promotional Planning,” has been rewritten to place greater emphasis on social media marketing strategies.
- Legal regulations of human resource management practices continue to become more complicated. For this reason, Chapter 20, “Managing Human Resources,” has been revised to provide helpful hiring information, including updated descriptions of relevant employment laws, further insights into interview questioning, and other issues related to compliance in hiring practices.
- The world of health care and insurance provided by small businesses is undergoing major changes. Chapter 23, “Managing Risk in the Small Business,” has been revised to help entrepreneurs adjust to these changes.
- Updated Living the Dream features in each chapter capture entrepreneurs in action as they face the challenges of small business and entrepreneurship. The authors’ personal conversations and correspondence with many of the entrepreneurs profiled add depth to these features and ensure accuracy.
- In addition to the cases appearing in the book, many others, old and new, are available on the instructor resource website (www.cengage.com).

Achieving Your Best

Small Business Management is organized to help students and future entrepreneurs achieve success in whatever field they choose. The wide spectrum of content, applications, cases, graphics, stories, and other details offered in *Small Business Management* has assisted many small business entrepreneurs in making their dreams come true. With a focus on learning, our features emphasize activities that capture student interest and guarantee practical knowledge, including the following:

- **In the Spotlight.** The chapter-opening “In the Spotlight” feature profiles an amazing collection of entrepreneurs, whose unique insights into how to start, run, and grow a business will help readers identify and explore the full range of issues facing today’s business owners.
- **Unique Support for Building a Business Plan.** The material in Part 3, “Developing the New Venture Business Plan,” is integral to learning how to develop workable plans. Closely aligned with the approaches to planning that we present in the textbook, additional business plan templates can be found on the instructor resource website.
- **Integrated Learning System.** Our integrated learning system uses each chapter’s learning objectives to give structure and coherence to the text content, study aids, and instructor’s ancillaries, all of which are keyed to these objectives. The numbered objectives are introduced in the “Looking Ahead” section, and each is concisely addressed in the “Looking Back” section at the end of each chapter. The integrated learning system also simplifies lecture

and test preparation. The lecture notes in the *Instructor's Manual* are grouped by learning objective and identify the PowerPoint® slides that relate to each objective. Questions in the *Test Bank* are grouped by objective as well. A correlation table at the beginning of each *Test Bank* chapter permits selection of questions that cover all objectives or that emphasize objectives considered most important by individual instructors.

- **You Make the Call.** “You Make the Call” sections at the end of each chapter are very popular with both students and instructors because they present realistic business situations that require the examination of key operating decisions. By having students take on the role of a small business owner, these exercises give them a leg up in addressing issues facing small businesses.
- **Living the Dream.** Practical examples from the world of small business and entrepreneurship carry both instructional and inspirational value. “Living the Dream” boxes appear at critical junctures throughout the chapters, refueling and refreshing chapter concepts with documented experiences of practicing entrepreneurs.
- **STARTUPS.** The “STARTUP” feature highlights useful entrepreneurial tools, actions, and resources for new businesses, as well as ways to transform the ventures. These boxes are interspersed throughout the chapters in appropriate settings.

Updated and Enhanced Supplements

All resources and ancillaries that accompany *Small Business Management*, 18th edition, have been created to support a variety of teaching methods, learning styles, and classroom situations.

- **Instructor's Manual.** Lecture notes in the *Instructor's Manual* are grouped by learning objective and tied to PowerPoint® slides that relate to each objective. The manual also contains sources of audio/video and other instructional materials, answers to the “Discussion Questions,” comments on “You Make the Call” situations, and teaching notes for the cases.
- **Test Bank.** Questions in the *Test Bank* are grouped by learning objectives and include true/false, multiple-choice, and discussion questions. Metadata tags are attached to each question.
- **Cognero® Testing Software.** Cengage Learning Testing Powered by Cognero® is a flexible, online system that allows you to import, edit, and manipulate content from the text's *Test Bank* or elsewhere, including your own favorite test questions; create multiple test versions in an instant; and deliver tests from your LMS, your classroom, or wherever you want.
- **PowerPoint® for Instructors.** A complete PowerPoint® package is available to aid in lecture presentation. The PowerPoint® slides are available on the password-protected instructor resource website.
- **“Startup Stories” Videos.** Available through MindTap, videos created for this text let you in on some very big ideas at work in a variety of innovative small businesses. Some of the small businesses covered include TWO MEN AND A TRUCK, River Pools & Spas, and Graeter's Ice Cream, among many others. Use these videos to bring the real world into your classroom, and let your students learn from the experts.

- **LivePlan®.** Students learn how to use the award-winning, best-selling professional software *LivePlan* to create a business plan. This online resource provides all the essentials to create winning business plans, including step-by-step instructions for preparing each section of a plan. Ready-to-customize samples, advice, a detailed marketing analysis with links to demographic and marketing tools, and helpful financial tools make it easy to create a solid plan. Video and written tutorials from Palo Alto Software founder Tim Berry ensure that students fully understand how to maximize *LivePlan*'s dynamic tools.

Special Thanks and Acknowledgments

There are numerous individuals to whom we owe a debt of gratitude for their assistance in making this project a reality. In particular, we thank our friends—and we mean *good friends*—at Cengage Learning. We are especially indebted to Jason Fremder, John Sarantakis, Emily Horowitz, and word master Jeanne Yost. Without them, this book would exist only in our heads! They are amazing when it comes to coordination and motivation, keeping us on track and moving forward. Besides all that, they let us have a little fun along the way. They are just wonderful people, and they take seriously their roles in making certain that *Small Business Management* continues its tradition of excellence.

We also want to offer words of appreciation and acknowledgment to Wes Bailey, who was a contributing author of Chapter 23, “Managing Risk in the Small Business.” Mr. Bailey is president of Bailey Insurance and Risk Management, Inc., in Waco, Texas, and is well recognized as a leader in the industry. His assistance with the authorship of this chapter should assure readers that they are receiving timely and relevant information about risk management. And we thank Bradley Norris, a colleague and senior lecturer at Baylor University, for his suggestions regarding Chapter 21, “Managing Operations.” Finally, we thank Brian Lovin at Baylor University for assisting us with our research and for his contribution to the writing of some of the cases.

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State Fair Community College
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Fort Lewis College
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Catawba College
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Weber State University
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Jefferson Community College
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Southeast Community College

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To the Instructor

As a final word of appreciation, we express our sincere thanks to the many instructors who use our text in both academic and professional settings. Based on years of teaching and listening to other teachers and students, *Small Business Management* has been designed to meet the needs of its readers. And we continue to listen and make changes in the text. Please write or call us to offer suggestions to help us make the book even better for future readers. Our contact information is Bill Petty (254-710-2260, bill_petty@baylor.edu), Les Palich (254-710-6194, les_palich@baylor.edu), and Frank Hoy (508-831-4998, fhoy@wpi.edu). We would love to hear from you.

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Justin G. Longenecker's authorship of *Small Business Management* began with the first edition of this book. He authored a number of books and numerous articles in such journals as *Journal of Small Business Management*, *Academy of Management Review*, *Business Horizons*, and *Journal of Business Ethics*. He was active in several professional organizations and served as president of the International Council for Small Business. Dr. Longenecker grew up in a family business. After attending Central Christian College of Kansas for two years, he went on to earn his B.A. in political science from Seattle Pacific University, his M.B.A. from Ohio State University, and his Ph.D. from the University of Washington. He taught at Baylor University, where he was Emeritus Chavanne Professor of Christian Ethics in Business until his death in 2005.

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ENTREPRENEURSHIP

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CHAPTER 1

The Entrepreneurial Life

The story of Table Occasions is one of classic entrepreneurship. Chia Stewart and Claudia Narvaez have engaged in a decade-long process of making their dream happen, by first creating a strategy, a company, and a brand, and then adapting and growing as opportunities present themselves and life's curve balls come their way.

Stewart and Narvaez launched their table-decorating business in 2006 and helped it blossom into a center for



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In the **SPOTLIGHT**
Table Occasions, Inc.
www.tableoccasions.com

event-planning activity for their community. What started with rentals of higher-end party tables, chairs, and linens has transformed into a one-stop shop for all event needs—from rentals, to planning and coordination, to execution. The result of this new “industry” that has set a high standard for party-throwing in El Paso, Texas, has been that other new, related businesses—such as creative bakeries and custom stationary shops—have cropped up or expanded all around town to take part in the new economic activity.

The friendship that started in middle school transformed into something much

After studying this chapter, you should be able to . . .

- 1-1. Explain the importance of small business and entrepreneurship in our society.
- 1-2. Distinguish between the terms *small business* and *entrepreneurial opportunity*.
- 1-3. Explain the basic characteristics of entrepreneurs, and describe different kinds of entrepreneurship.
- 1-4. Discuss the importance of understanding your motivations and perceptions related to owning a small business.
- 1-5. Describe five potential competitive advantages of small entrepreneurial companies over large firms.
- 1-6. Explain the concept of an entrepreneurial legacy and its challenges.

**OPEN
LOOKING
AHEAD**

different in the business partnership that Stewart and Narvaez formed. Together, they saw an opportunity for a business where each partner could bring to the table something different and exciting, creating one complete and new concept.

When Table Occasions started its operations, events were not a big deal in the community—at least not from an artistic perspective. But Stewart and Narvaez saw an unexploited niche that they could develop. They made event decorating a “must” in social and professional circles, to the point that skimping on decorations is now seen as showing a lack of dedication to the cause. This has solidified their customer base and redefined decorating expenses as “essential,” which is why the recent recession did not weaken their sales and revenues.

The services and products that Table Occasions offers are truly transformative, reflecting the party thrower’s personality, with unique tablecloths, flowers, cakes, catering, entertainment, lighting, and more. As Stewart says, “We use products that, when coordinated with a wide range of event concepts, help the planners pull off the perfect memorable and successful event—without overwhelming themselves in the process. Almost every event in town is now a virtual wonderland of visual treats for event-goers to enjoy and remember. It has truly made events magical.”

Their well-recognized success has inspired others to start competitive businesses in town. But Table Occasions continues to lead the pack due to its commitment to quality, community service, creativity, professionalism, and personal attention to every event. As a matter of fact, Stewart and Narvaez still engage in hard labor when it is needed to get a job done right. They know that the buck stops with them, and they always make sure that every host is proud of every event.

And now the duo is starting to make plans for the next stage of their entrepreneurial venture: franchising Table Occasions. New locations, new partnerships, and new strategies are being explored in order to make calculated risks and investments in franchises that can take advantage of the economies of scale that Table Occasions can now offer through the infrastructure developed in El Paso. The risks may be large, but the partners’ passion and willingness to invest their time and money in building an effective team, leading the industry in creativity and trendsetting, providing high-quality services and products, and being the first to grasp new opportunities will lead them to success.

Much like a marriage, Stewart and Narvaez have struggled personally and professionally through changes, in good times and bad times. But together, they manage complex situations, support each other, and reap the rewards of a successful company. The hardest part of their work does not come from the physical labor but from having to juggle their work and personal lives. Both are working mothers (with one divorce thrown into the mix), and weekends away, early mornings, late nights, last-minute changes, and weather emergencies pull them away from their families. Its hard work . . . so hard it hurts! However, Stewart and Narvaez have learned to rely on the different strengths that each brings to the company, to support each other’s visions, and to always act with the utmost integrity toward one another. “Without trust in each other, we would not have been able to come this far” claims Stewart. “Business is all about people, and we have to surround ourselves with people we can depend on, and who depend on us.”

Source: Interview with Chia Stewart, founder and CEO, Table Occasions, Inc., December 28, 2014.

Having worked for over four decades with both entrepreneurs and students who aspire to own companies, we have designed this book to prepare you for owning your own small business—one that may even grow over time to become a large firm. In addition, we will be drawing on the extensive experience of entrepreneurs who offer their advice and counsel on important issues. Understand that this book is not just about learning facts; rather, we want to prepare you to act on your dreams. We want your study of small business management to change your life!

We believe that owning a business is one of the most noble of all professions—*especially if done well*. No other life’s work does more to help you learn and develop as a person, contribute to the success of a team, create value for customers, and make a significant difference in the community. While owning a business is generally about producing a product or service and selling it for a profit, you will find that the deepest rewards from owning your own business come from helping your employees grow, both professionally and personally, and offering goods or services that improve the lives of your customers. After all, what happens at work carries over into your personal life.¹ But you should understand that the road can be rough, with some big potholes along

the way. We believe that the words of Theodore Roosevelt over a century ago, when he described “the man in the arena,” apply perfectly to these entrepreneurs:

It is not the critic who counts; not the man who points out how the strong man stumbles, or where the doer of deeds could have done them better. The credit belongs to the man who is actually in the arena, whose face is marred by dust and sweat and blood; who strives valiantly; who errs, who comes short again and again, because there is not effort without error and shortcoming; but who does actually strive to do the deeds; who knows great enthusiasms, the great devotions, who spends himself in a worthy cause; who at the best knows in the end the triumph of high achievement, and who at the worst, if he fails, at least fails while daring greatly, so that his place shall never be with those cold and timid souls who neither know victory nor defeat.²

The primary purpose of this chapter is to offer words of encouragement for anyone wanting to be a small business owner. We will begin the chapter by providing an overview of small business and entrepreneurship, along with stories of entrepreneurs who started and grew businesses. Then we will quickly get you started thinking about your motivations and perceptions related to owning a small business. Next, we will explain the ways small firms can be competitive, even against industry giants. Finally, we want you to think about building an entrepreneurial legacy that you can leave to those who follow in your footsteps.

So, if you, like many others who come from many different walks of life, want to have your own business, then read on. You are about to embark on a course of study that will prove invaluable in reaching your goal. Entrepreneurship can provide an exciting life and offer substantial personal rewards. We passionately contend that there is no finer calling.

1-1 SMALL SIZE, GREAT SIGNIFICANCE

If you have a serious interest in starting and operating your own business—now or in the future—you are not alone. You may be part of what Paul Reynolds, a leading researcher in the entrepreneurship field, calls a major social phenomenon.³ Isabell M. Welpe, a business professor at Technische Universität München, captures the significance of entrepreneurship for an individual and society at large in these words:

Entrepreneurship is a necessity in our society. It is a philosophy based on individual initiative and on the insight that entrepreneurship is more than just getting a job. Entrepreneurship achieves self-fulfillment, gains respect and enables real innovation by looking at the next necessary steps toward a better world.⁴

The significance of small business can also be observed in its contribution to the economy. Within the United States, it is estimated that 12 million people are involved in some form of entrepreneurial venture, and that as many as half of all adults will be engaged in self-employment at some point during their working careers.⁵ The following facts provide an understanding of the important role of small businesses in the United States:⁶

- There are 27.8 million small businesses in the United States with fewer than 500 employees, a common definition of a small business.
- Small companies account for 99.7 of all businesses—and 90 percent have fewer than 20 employees!



Explain the importance of small business and entrepreneurship in our society.

- Fifty-five million people work in small businesses, representing 49 percent of all employees and 42 percent of all salaries paid to employees.
- Small enterprises hire 43 percent of all high-tech employees (scientists, engineers, computer programmers, and others).
- Many small companies have been going global, representing 97 percent of all exporters.
- Business owners are well educated, with 50 percent having a college degree, an increase of 32 percent from 2000 to 2010.
- About one-fourth of the 23.5 million military veterans in the United States are interested in starting or buying their own business.

Given this information, it's clear that individuals who start and lead small businesses make a significant contribution to the economy and the quality of our lives. On the other hand, we know that a lot of people talk about owning a business but never make it happen. Also, the number of young persons who own private businesses in the United States is at a 24-year low. According to *The Wall Street Journal*, only 3.6 percent of households headed by young adults (less than 30 years of age) owned private businesses in 2013—compared to 10.6 percent in 1989. This trend potentially has negative implications for future economic growth.

It is difficult to pinpoint the reasons for the decline in young people choosing to own a small business. Possible reasons include the difficulty in raising capital during the Great Recession and, possibly, a lower tolerance for risk by young people. Ruth Simon and Caelainn Barr write:

*The decline also reflects a generation struggling to find a spot in the workforce. Younger workers have had trouble gaining the skills and experience that can be helpful in starting a business. Some doubt their ability.*⁷

On the other hand, the Kauffman Foundation estimates that 70 percent of young people still dream of owning their own business sometime in the future.⁸ Thus, it seems fair to say that while young people today are generally less inclined to start a business, they have in no way given up hope of eventually owning their own business. So, it makes us, as the authors of this text, all the more committed to help young people be better prepared to start a small business. Our hope is that your study of *Small Business Management* will give you the confidence and skills that you need to be successful in owning your own business. And that is not only important for you, but for those you could serve as well.

1-2 SMALL BUSINESS AND ENTREPRENEURIAL OPPORTUNITY: IS THERE A DIFFERENCE?

Let's take a more detailed look at the terms *small business* and *entrepreneurial opportunity* to gain a better understanding of what they represent. Both are at the heart of all that you will study in this book.

1-2a What Is a Small Business?

What does it mean when we talk about “small business?” A neighborhood restaurant or bakery is clearly a small business, and Toyota is obviously not. But among small businesses, there is great degree of diversity in size, in growth potential, in organizational structure, and often in culture.



Distinguish between the terms *small business* and *entrepreneurial opportunity*.

Many efforts have been made to define the term *small business*, using such criteria as number of employees, sales volume, and value of assets. But there is no generally accepted or universally agreed-on definition. Size standards are basically arbitrary, adopted to serve a particular purpose. For example, the U.S. Small Business Administration defines a small business as having fewer than 500 employees.⁹ But in specific cases, the government may define a small business differently—such as one with fewer than 10 employees—in order to exempt a very small business from certain regulations, if compliance would prove to be too costly, given its small size.

In addition to size, small businesses differ drastically in their growth potential. Those few businesses with phenomenal prospects for growth are called **high-potential ventures**, or **gazelles**. Even within this group, there is variation in styles of operation and approaches to growth. Very few begin as high-tech startups—the kind that made Silicon Valley famous. In contrast to such high-potential ventures, **attractive small firms** offer substantial financial rewards for their owners. Income from these entrepreneurial ventures may grow into the millions or even tens of millions of dollars. They represent a major segment of small businesses—solid, healthy firms that can provide rewarding careers and create financial wealth for the owners.

The least profitable types of small businesses—including many small service companies, such as pool-cleaning businesses, dry cleaners, beauty shops, and appliance repair shops—provide modest returns to their owners. These are called **microbusinesses**, and their distinguishing feature is their limited ability to generate significant profits. Entrepreneurs who devote personal effort to such ventures receive a profit that essentially compensates them for their time. Many companies of this type are also called **lifestyle businesses** because they permit an owner to follow a desired lifestyle, even though they provide only modest financial returns. Employing fewer than 10 employees, lifestyle businesses make up the largest sector of the U.S. economy. Such enterprises usually do not attract investors and are financed with owner savings or money provided by friends and family.

Lifestyle businesses are not only important to the U.S. economy, but they have also become vital for many individuals in developing countries in Asia, South America, and Africa. In these countries, starting and running a small business can easily double or triple a family's income and make a significant difference in the quality of family members' lives. To help these individuals, some organizations are providing **microloans**, sometimes for only a few dollars, to allow them to buy inventory or do whatever else needs to be done to get started in business.

So, understanding a small business is dependent on our definition of *small* and the firm's growth potential. For our studies, we will mostly be directing our attention to **small businesses** that meet the following criteria, at least in spirit:

1. Compared to the largest firms in the industry, the business is small; in most instances, the business has fewer than 100 employees.
2. Except for its marketing function, the business's operations are geographically localized.
3. No more than a few individuals provide the equity financing for the business. Equity financing (discussed in Chapter 12) is the money invested in the business by the owners and possibly by a few other individuals.
4. The business may begin with a single individual, but it has the potential to become more than a “one-person show” and may eventually grow to be a mid-sized company or even a large firm.
5. The business must have growth potential, whether or not the owner chooses to capture that growth.

high-potential venture (gazelle)

A small firm that has great prospects for growth.

attractive small firm

A small firm that provides substantial profits to its owner.

microbusiness

A small firm that provides minimal profits to its owner.

lifestyle business

A microbusiness that permits the owner to follow a desired pattern of living.

microloans

Very small loans, often provided to entrepreneurs in developing countries.

small business

A business with growth potential that is small compared to large companies in an industry, has geographically localized operations, is financed by only a few individuals, and has a small management team.

Obviously, some small businesses will fail to meet all of these standards, but they are still of great interest to us. For example, a small executive search firm—a firm that helps corporate clients recruit high-level managers—may operate in many sections of the country and thereby fail to meet the second criterion. Nevertheless, the discussion of management concepts in this book is aimed primarily at the type of firm that fits the general pattern outlined by these criteria.

1-2b What Is an Entrepreneurial Opportunity?

At its core, the entrepreneurial process begins with identifying an attractive opportunity, which is more than merely having a good idea. Such opportunities make the enterprise economically attractive for the owners while offering customers a product or service that is so appealing that they are willing to let go of their hard-earned money to buy it. In other words, an entrepreneur must find a way to create value for customers. An **entrepreneurial opportunity**, then, is an *economically attractive and timely opportunity* that creates value both for prospective customers and for the firm's owners. (In Chapter 3, you'll learn how to identify good opportunities.)

So an **entrepreneur** is a person who relentlessly pursues an opportunity, in either a new or an existing enterprise, to create value while assuming both the risk and the reward for her or his efforts. Entrepreneurs generally think differently about resources than do employee-managers. While managers in large corporations so often think like administrators or bureaucrats—wanting larger budgets or more employees—entrepreneurs work to do more with less. They may try to use other people's resources, which is called **bootstrapping**. For example, an entrepreneur might resort to bartering or, in the early days of a business, work to create income from other sources to fund the business. Let's look at three ventures started by some present-day entrepreneurs who have successfully created value for customers and themselves alike.

KELLY'S DELIGHT (HEWITT, TX)¹⁰

After graduating from college, Patrick Linstrom knew he needed to do something to help pay off his student loans. He had an idea for a product that he wanted to sell that was not quite available yet: all-natural liquid cane sugar. With just a concept in mind, Linstrom set off on his journey to enter this untapped market. "It is vital to learn as much as you can about the overall business, before investing your time and money into such a venture," Linstrom says. After researching the liquid sugar market for over eight months, he was ready to make a product. By maxing out all of his credit cards and taking out a personal loan, Linstrom was able to pay for the initial production of his product. With an actual product in hand, he began selling his liquid sugar to local businesses.

Despite positive feedback from local customers, lack of a good distribution strategy hurt the startup. Linstrom knew he needed to expand if he wanted his company to experience significant profits. He decided to update his strategy to reach more customers by changing the small packet design for his product into a 16-ounce bottle. With a better-designed product, Linstrom was set on getting his liquid cane sugar on the shelves of H-E-B, a major grocery chain in Texas. "I probably called H-E-B 100 times before I was able to meet someone. I think I finally got to the right buyer who thought this was a good product," says Linstrom. His first meeting proved successful, and H-E-B decided to test Kelly's Delight in 125 stores. "We owe our business to H-E-B," Linstrom says. "They were the first retailer that took a chance on us, and it has made a world of difference."



In the meantime, Linstrom knew he needed to continue expanding his retail store footprint. Through a mutual friend, Linstrom was able to meet with Tom McClintock, a vice president of Coca-Cola. McClintock loved the product idea and quit his job at Coca-Cola to join Linstrom's team at Kelly's Delight. After teaming up with McClintock, Linstrom never looked back.

As of 2014, Kelly's Delight was selling in over 7,000 retailers across the country, including such stores as Walmart, Target, H-E-B, and many other locations. Competitors have entered the market, but Linstrom continues to maintain competitive prices by keeping his manufacturing costs minimal and his management team lean. He believes that he is still far from reaching his goals and plans to enter the Asian market soon.

Liquid sugar may seem like a simple concept, but executing a final product at a price consumers are willing to pay is the hard part. Linstrom says, "Sometimes you have to fake it before you make it. You have to believe you can accomplish what you set out to do, and take the risk that is necessary to accomplish your goals. From my experience, I would say that a successful business takes inspiration, preparation, and opportunity. Many people have inspiration but have not taken the time to prepare. So when the opportunity is presented to them, they are not able to capitalize on their risk. [They] should always be preparing and know that opportunity will strike if they just stay persistent."

BLANK LABEL (BOSTON, MA)⁴¹

When Fan Bi was working his first professional job in London in 2006, he was introduced to the business world's dress code. Bi loved custom tailoring but understood that this luxury came at a price. He discovered the vast difference in experience between shopping by size for pre-made clothes and shopping by style of fabric for customizable clothes.

"I used to buy dress shirts off the rack," Bi says. "But this idea of going to a fabric market, being measured, being able to choose different fabrics . . . I thought, 'Wow, you know, this is a really different experience.'" Then, during a vacation to Shanghai in the summer of 2008, where custom tailoring was provided at a far more competitive price, he asked the question "Can custom be affordable?"

Bi came up with the idea for affordable custom shirts during his study abroad program at Babson College. The faculty at Babson helped Bi hone his idea and recruit campus sales reps. One of these sales reps was Danny Wong, a student at nearby Bentley University. Unfortunately, the idea was met with a lack of interest from the college students. Also, the business was not scalable and lacked a clear supply chain. So Bi partnered with Wong to bring the business online, where overhead expenses were lower and the potential market was large. At the beginning of 2010, they launched the Blank Label website.

"We wanted to be the destination where people can come and design their own apparel," Bi says. Online visitors were able to design a custom shirt by selecting fabric, color combination, and style of cuff, collar, placket, pocket, button, monogram, and even custom label—all for less than \$100.

Since going online in 2010, the pair has seen their customer demographic shift toward business professionals who purchase six to ten dress shirts per year. They went from generating \$345,000 in sales during their first year of business to over \$1.1 million in 2011. By June 2012, Blank Label had sold 30,000 dress shirts.

The web-savvy founders managed almost the entire process remotely. "Thanks to the Internet," Bi says, "you can work with the best people in the world, not just the

best people in your neighborhood.” But Bi and Wong weren’t content just being shirt makers. Wong wanted Blank Label to emerge as a hub for everything “co-created.”

In 2013, Blank Label opened its first pattern room in downtown Boston. The reason behind this decision was consumers’ preference to touch and feel products before making a purchase. This was especially true when it came to buying ties, chinos, jackets, and suits. “We thought that maybe we should experiment, and that has paid off in spades,” Bi observes.

The store quickly began generating revenues of about \$100,000 a month, increasing 10 to 15 percent month over month. Its physical store sales were expected to account for 70 percent of its total by the end of the year. Also, the number of employees went from 4 to 22, with Bi raising \$500,000 from investors to fund the company’s growth. With the initial success, Bi and Wong decided to open a second store in Boston’s Downtown Crossing area, with plans to open six more stores along the East Coast.

HUGHES GROUP LLC (TACOMA, WASH.)¹²

Even if it were true that the entrepreneurial spirit is born and not made, it would still remain that this characteristic comes with no birthright of success. It’s a hard truth that Patrick L. Hughes, Sr., founder and CEO of Hughes Group LLC, stumbled many times before his company was named the National Minority Small Business of the Year.

“My mother said I was a true entrepreneur from the time I was a child. When the other kids wanted to play cowboys and Indians, I always wanted to run the general store or saloon. I loved capitalism without even knowing what capitalism was,” said Hughes, who got his first taste of the full-time business world after retiring from the Army in 2003. “But when I finally went into business for myself, I sure made a lot of mistakes early on.”

His Tacoma, Washington–based logistics company provides products and services to federal and commercial markets. “We are a minority-owned and service disabled veteran–owned company,” said Hughes, noting that the company has 213 employees in 11 locations across the nation, and saw just over \$8 million in revenue in 2011 and was expecting \$8.5 million to \$9 million in 2012 revenue.

Like many business success stories, the tale of Hughes Group is one that started small—as a carpet-cleaning business in Hughes’s garage while he was a logistics officer in the Army—and grew over time. But Hughes says the difference between where his company is today and the hundreds of other startups specializing in logistics is that he never considered for an instant that his small business should stay small.

“If there’s anything I see small businesses doing wrong, it’s thinking they’ve got to stay in a niche,” said Hughes. “Diversity is the lifeblood of a small business; become an expert in your area, and then branch out from there. In other words learn how to do other different, but related, skills.”

Today, Hughes Group has expanded to a full-bore logistics company that offers a facility maintenance and supply division, as well as a division with management, assessment, development, and support services. Hughes Group has clients in both the government and the commercial arena.

Though Hughes Group wasn’t officially founded until 2004, Hughes spent his last years in the military planning what life would look like post-service. He had accumulated nearly 30 years of logistics experience but lacked the know-how to run a business. Luckily, his first big job was close to home: Hughes landed a contract with the military, which parlayed into a series of other logistics contracts.

First, he needed funding. “When I was first reading about the 8(a) Business Development Program offered by the Small Business Administration (SBA), I took my application into the local SBA office. They scratched it up and circled it in red where

I did it wrong,” said Hughes, laughing. He eventually qualified for an initial \$300,000 line of credit—enough to get Hughes Group off the ground. He had the loan; now he needed business smarts.

“What you don’t realize at the start is when you make a dollar, you do not have a dollar to spend,” Hughes said. “I think this is where many 8(a) businesses fail; you may get 15 cents off that \$1 you made because you already spent it before you got it. There’s always overhead, taxes, and so on.” Over the next few years, Hughes’s increasing business skill allowed him to take out another loan backed by the SBA and the Grow America Fund along with the city to buy a 15,000-square-foot building.

Now, in addition to running his company from the headquarters, Hughes uses some of the office space to help foster other startups operating in the government market space, especially those run by disadvantaged owners such as veterans, minorities, and women. “One of the greatest things you can have in business is a network,” Hughes says. “We’re essentially offering a network for these disadvantaged businesses to accelerate into the government contracting arena.” Though the fee for the space rental is nominal, Hughes sees its value as being greater to the local business community. “I learned from the mistakes I made early on, and I am sure I will make some more over the years. But I want to pass the knowledge on to others,” Hughes said.

1-3 ENTREPRENEURIAL QUALITIES: BIG EGO NOT REQUIRED

People often ask, “Are entrepreneurs born or made?” That question has long been debated with little agreement. However, Stephen Spinelli and Robert Adams have nicely summarized research on entrepreneurial characteristics. The entrepreneurs they describe as having and exhibiting “desirable and acquirable attitudes and behaviors” fall under the following six descriptors:¹³

1. *Commitment and determination*—Tenacious, decisive, and persistent in problem solving.
2. *Leadership abilities*—Self-starters and team builders who focus on honesty in their business relationships.
3. *Opportunity obsession*—Aware of market and customer needs.
4. *Tolerance of risk, ambiguity, and uncertainty*—Risk takers, risk minimizers, and uncertainty tolerators.
5. *Creativity, self-reliance, and adaptability*—Open-minded, flexible, uncomfortable with the status quo, and quick to learn.
6. *Motivation to excel*—Goal-oriented and aware of personal strengths and weaknesses.

On the other side of the coin, some attitudes and behaviors should be avoided at all costs. An almost certain way to fail as an entrepreneur, as many have learned by experience, is to do the following:

1. Overestimate what you can do.
2. Lack an understanding of the market.
3. Hire mediocre people.
4. Fail to be a team player, which is usually the result of taking oneself too seriously.



Explain the basic characteristics of entrepreneurs, and describe different kinds of entrepreneurship.