

# Small Business Management

17e

LAUNCHING AND GROWING ENTREPRENEURIAL VENTURES

Longenecker  
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Hoy



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# Brief Contents



<b>Part 1</b>	<b>Entrepreneurship: A World of Opportunity</b>	
	1 The Entrepreneurial Life	1
	2 Integrity and Ethics: Foundations for Success in Small Business	32
<b>Part 2</b>	<b>Starting from Scratch or Joining an Existing Business</b>	
	3 Starting a Small Business	60
	4 Franchises and Buyouts	91
	5 The Family Business	117
<b>Part 3</b>	<b>Developing the New Venture Business Plan</b>	
	6 The Business Plan: Visualizing the Dream	141
	7 The Marketing Plan	170
	8 The Organizational Plan: Teams, Legal Structures, Alliances, and Directors	195
	9 The Location Plan	225
	10 Understanding a Firm's Financial Statements	254
	11 Forecasting Financial Requirements	290
	12 A Firm's Sources of Financing	314
	13 Planning for the Harvest	346
<b>Part 4</b>	<b>Focusing on the Customer: Marketing Growth Strategies</b>	
	14 Building Customer Relationships	366
	15 Product Development and Supply Chain Management	394
	16 Pricing and Credit Decisions	423
	17 Promotional Planning	447
	18 Global Opportunities for Small Businesses	473
<b>Part 5</b>	<b>Managing Growth in the Small Business</b>	
	19 Professional Management and the Small Business	501
	20 Managing Human Resources	530
	21 Managing Operations	562
	22 Managing the Firm's Assets	594
	23 Managing Risk in the Small Business	622
	<b>Cases</b>	<b>645</b>
	<b>Index</b>	<b>693</b>
	<b>Appendix A</b>	<b>Sample Business Plan</b>
	<b>Appendix B</b>	<b>Valuing a Business</b>

Appendices A and B are available online. The online appendices can be accessed by going to [www.CengageBrain.com](http://www.CengageBrain.com) and selecting the Longenecker text.



## Part 1

### Entrepreneurship: A World of Opportunity

#### Chapter 1 The Entrepreneurial Life

<i>In the Spotlight: Blue Avocado</i>	1
1-1 Small Size but Large Significance	3
1-2 Small Business and Entrepreneurial Opportunity: The Same or Different?	4
1-2a What Is a Small Business?	4
1-2b What Is an Entrepreneurial Opportunity, and Who Are the Entrepreneurs?	6
1-3 Entrepreneurial Qualities: No Big Ego Required	9
1-3a Founders versus Other Entrepreneurs	9
1-3b Franchisees	10
1-3c Entrepreneurial Teams	10
<i>Living the Dream</i> Bootstrapping Is at the Heart of Entrepreneurship	10
1-3d Social Entrepreneurs	11
1-3e Women Entrepreneurs	11
1-3f Be a Small Business Owner Who Thinks and Acts Like an Entrepreneur	12
<i>Living the Dream</i> My First Step	13
1-4 Your Motivations for Owning a Business	13
1-4a Types of Entrepreneurial Motivations	15
1-4b Understanding Your Paradigm	18
1-5 The Competitive Edge of Entrepreneurs	21
1-5a Customer Focus	21
1-5b Quality Performance	21
1-5c Integrity and Responsibility	22
1-5d Innovation	22
1-5e Niche Markets	23
1-6 Building an Entrepreneurial Legacy	24
1-7 Where to From Here?	25

#### Chapter 2 Integrity and Ethics: Foundations for Success in Small Business

<i>In the Spotlight: PortionPac® Chemical Corporation</i>	32
2-1 What Is Integrity?	33

2-2 Integrity and the Interests of Major Stakeholders	34
2-2a “Big Three” Stakeholders—Owners, Customers, and Employees	35
<i>Living the Dream</i> The Customer Isn’t Always (Doing) Right	38
2-2b Social Responsibility and Small Business	39
2-2c Governmental Laws and Regulations	40
2-3 The Challenges and Benefits of Acting with Integrity	41
2-3a Small Companies and the Legitimacy Lie	41
2-3b Integrity and the Internet	43
2-3c Integrity and Doing Business Abroad	44
2-3d Trust and the Integrity Edge	45
2-4 Building a Business with Integrity	46
2-4a The Foundations of Integrity	46
2-4b Leading with Integrity	46
2-4c An Ethical Organizational Culture	47
2-4d Better Business Bureaus	48
2-4e The Ethical Decision-Making Process	49
2-5 Small Business and the Natural Environment	50
2-5a Sustainability Matters	51
<i>Living the Dream</i> I Love the Taste of Plastic in the Morning	52
2-5b Green Opportunities for Small Business	52



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# Part 2

## Starting from Scratch or Joining an Existing Business

### Chapter 3 Starting a Small Business

*In the Spotlight: Peter Nguyen*

3-1	Developing Startup Ideas	62
3-1a	Types of Startup Ideas	62
3-1b	Common Sources of Startup Ideas	63
	<i>Living the Dream</i> When Serendipity Creates a Domino Effect	65
3-2	Using Innovative Thinking to Generate Business Ideas	66
3-3	Using Internal and External Analyses to Assess New Business Ideas	69
3-3a	Outside-In Analysis	69
3-3b	Inside-Out Analysis	72
3-3c	Integrating Internal and External Analyses	73
3-4	Selecting Strategies that Capture Opportunities	75
3-4a	Broad-Based Strategy Options	75
3-4b	Focus Strategies	76
	<i>Living the Dream</i> Niche Knockoffs: Sometimes There's Just No Stopping Them	78
3-5	Screening New Business Ideas	79
3-6	Is Your Startup Idea Feasible?	81
3-6a	Market Potential	82
3-6b	Industry Attractiveness	83
3-6c	New Venture Leadership	84

### Chapter 4 Franchises and Buyouts

*In the Spotlight: The Dwyer Group®: Seven Companies, One Code of Values*

4-1	What Is a Franchise?	92
4-1a	Franchising Terminology	92
	<i>Living the Dream</i> Greg Carafello—A Franchise Turnaround	94
4-1b	The Impact of Franchising	95
4-2	The Pros and Cons of Franchising	95
4-2a	The Pros	95
4-2b	The Cons	98
4-2c	The Costs of Being a Franchisee	100
4-3	Evaluating Franchise Opportunities	100
4-3a	Selecting a Franchise	100
4-3b	Investigating the Potential Franchise	101
4-3c	Becoming a Franchisor	103
4-3d	Legal Issues in Franchising	105
4-4	Buying an Existing Business	106
4-4a	Reasons for Buying an Existing Business	106
4-4b	Finding a Business to Buy	107



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	<i>Living the Dream</i> Buying Someone Else's Idea	108
4-4c	Investigating and Evaluating Available Businesses	108
4-4d	Quantitative Factors in Valuing the Business	110
4-4e	Nonquantitative Factors in Valuing a Business	110
4-4f	Negotiating and Closing the Deal	111

### Chapter 5 The Family Business

*In the Spotlight: Two Men and a Truck*

5-1	What Is a Family Business?	118
5-1a	Family and Business Overlap	119
5-1b	Advantages and Disadvantages of a Family Business	120
5-2	Dynamic Family Businesses	122
5-2a	The Imprint of Founders on the Family Business Culture	122
5-2b	The Commitment of Family Members	122
5-3	Family Roles and Relationships	124
5-3a	Co-preneurs	124
5-3b	Mom or Dad, the Founder	125
5-3c	Sons and Daughters	125
5-3d	Sibling Cooperation, Sibling Rivalry	126
	<i>Living the Dream</i> Nature or Nurture?	127
5-3e	In-Laws In and Out of The Business	128
5-3f	The Entrepreneur's Spouse	128
5-4	Good Governance in the Family Firm	129
5-4a	Nonfamily Employees in a Family Firm	129
5-4b	Family Retreats	130
5-4c	Family Councils	131
5-4d	Family Business Constitutions	131
5-5	The Process of Leadership Succession	132
5-5a	Available Family Talent	133
5-5b	Preparing for Succession	134
5-5c	Transfer of Ownership	135

# Part 3

## Developing the New Venture Business Plan

### Chapter 6 The Business Plan: Visualizing the Dream

<i>In the Spotlight: Maternova</i>	141
6-1 An Overview of the Business Plan	142
6-2 Will Writing a Plan Make a Difference?	143
6-2a The Balance Between Planning and Executing	144
6-2b What Form Will the Business Plan Take?	145
6-3 Preparing a Business Plan: The Content and Format	146
6-3a Cover Page	148
6-3b Table of Contents	149
6-3c Executive Summary (Overview)	149
6-3d Company Description	150
6-3e Industry, Target Customer, and Competitor Analysis	151
6-3f Product/Service Plan	152
6-3g Marketing Plan	152
6-3h Operations and Development Plan	152
6-3i Management Team	152
6-3j Critical Risks	153
6-3k Offering	153
6-3l Exit Strategy	154
6-3m Financial Plan	154
6-3n Appendix of Supporting Documents	154
<i>Living the Dream</i> Accelerated Ventures	155
6-4 Advice for Writing a Business Plan	156
6-4a Analyze the Market Thoroughly	156
6-4b Provide Solid Evidence for Any Claims	156
6-4c Think Like an Investor	157
6-4d Don't Hide Weaknesses—Identify Potential Fatal Flaws	157
6-4e Maintain Confidentiality	158
6-4f Pay Attention to Details	158
6-5 Understanding the Business Model	159
6-5a Revenue Model	159
6-5b Cost Structures	161
6-5c Maximum Investment	161
6-5d Managing Business Model Risk	162
<i>Living the Dream</i> Changing the Business Model	162
6-6 Resources for Business Plan Preparation	163
6-6a Computer-Aided Business Planning	163
6-6b Professional Assistance in Business Planning	163
6-7 Keeping the Right Perspective	164

### Chapter 7 The Marketing Plan 170

<i>In the Spotlight: Startup Professionals</i>	170
7-1 What Is Small Business Marketing?	171
7-1a Marketing Philosophies Make a Difference	172
7-1b A Consumer Orientation—The Right Choice	172
7-2 The Formal Marketing Plan	174
7-2a Market Analysis	174
7-2b The Competition	175
7-2c Marketing Strategy	175
<i>Living the Dream</i> What's Next?	177
7-3 Marketing Research for the Small Business	178
7-3a The Nature of Marketing Research	179
<i>Living the Dream</i> Research Keeps Going and Going and Going	179
7-3b Steps in the Marketing Research Process	180
7-4 Understanding Potential Target Markets	183
7-4a Market Segmentation and Its Variables	183
7-4b Marketing Strategies Based on Segmentation Considerations	184
7-5 Estimating Market Potential	186
7-5a The Sales Forecast	186
7-5b Limitations of Forecasting	187
7-5c The Forecasting Process	188

### Chapter 8 The Organizational Plan: Teams, Legal Structures, Alliances, and Directors 195

<i>In the Spotlight: Axiient, Sapience Knowledge Systems, and Velocent Systems</i>	195
8-1 Building a Management Team	197
8-1a Achieving Balance	198
<i>Living the Dream</i> It Can Be Lonely at the Top	198
8-1b Expanding Social Networks	199
8-2 Common Forms of Legal Organization	200
8-2a The Sole Proprietorship Option	201
8-2b The Partnership Option	202
8-2c The C Corporation Option	205
8-3 Considerations in Choosing an Organizational Form	207
8-4 Specialized Forms of Organization	209
8-4a The Limited Partnership	209
8-4b The S Corporation	210
8-4c The Limited Liability Company	210
8-4d The Professional Corporation	211
8-4e The Nonprofit Corporation	211
<i>Living the Dream</i> Doing Good and Doing Well, with Organizational Forms to Match	212

8-5	Forming Strategic Alliances	213	10-3	Viewing the Income Statement and Balance Sheet Together	270
8-5a	Strategic Alliances with Large Companies	213	10-4	The Cash Flow Statement	271
8-5b	Strategic Alliances with Small Companies	214		<i>Living the Dream</i> Surviving Tough Times Means Effectively Managing Your Finances	272
8-5c	Setting Up and Maintaining Successful Strategic Alliances	215	10-4a	Profits versus Cash Flows	273
8-6	Making the Most of a Board of Directors	216	10-4b	Measuring a Firm's Cash Flows	273
8-6a	Selection of Directors	216	10-5	Evaluating a Firm's Financial Performance	278
8-6b	Contributions of Directors	217	10-5a	Liquidity (Ability to Pay Its Debt)	279
8-6c	Compensation of Directors	217	10-5b	Profitability on Assets	280
8-6d	An Alternative: An Advisory Board	218	10-5c	Use of Debt Financing	281
			10-5d	Return on Owners' Equity	281
<b>Chapter 9 The Location Plan</b>		<b>225</b>	<b>Chapter 11 Forecasting Financial Requirements</b>		
	<i>In the Spotlight: VaVaVroom and Clayton Fear Farm</i>	225	<i>In the Spotlight: The Need to Manage Growth</i>		
9-1	Locating the Brick-and-Mortar Startup	227	11-1	The Purpose of Financial Forecasting	291
9-1a	The Importance of the Location Decision	227	11-2	Forecasting Profitability	292
9-1b	Key Factors in Selecting a Good Location	227	11-3	Forecasting Asset and Financing Requirements	296
	<i>Living the Dream</i> Some Entrepreneurs Want to Keep on Truckin'	229	11-3a	Determining Asset Requirements	298
	<i>Living the Dream</i> Doing Business Without the Big Corner Office—or Any Office at All!	234		<i>Living the Dream</i> Forecasting in an Uncertain Economy	299
9-2	Designing and Equipping the Physical Facilities	235	11-3b	Determining Financing Requirements	300
9-2a	Challenges in Designing the Physical Facilities	235	11-4	Forecasting Cash Flows	304
9-2b	Challenges in Equipping the Physical Facilities	235	11-4a	Pro Forma Statement of Cash Flows	305
9-2c	Business Image	237	11-4b	The Cash Budget	306
9-3	Locating the Startup in the Entrepreneur's Home	237	11-5	Use Good Judgment When Forecasting	308
9-3a	The Attraction of Home-Based Businesses	238	<b>Chapter 12 A Firm's Sources of Financing</b>		
9-3b	The Challenges of Home-Based Businesses	239	<i>In the Spotlight: 4moms</i>		
9-4	E-Commerce: Locating a Startup on the Internet	240	12-1	Firm Characteristics and Sources of Financing	315
9-4a	Benefits of E-Commerce to Startups	240	12-1a	Firm's Economic Potential	316
9-4b	E-Commerce Business Models	241	12-1b	Company Size and Maturity	316
9-4c	Internet-Based Businesses and the Part-Time Startup Advantage	247	12-1c	Nature of Firm's Assets	317
			12-1d	Owner Preferences for Debt or Equity	317
<b>Chapter 10 Understanding a Firm's Financial Statements</b>		<b>254</b>	12-2	Debt or Equity Financing?	317
	<i>In the Spotlight: J&amp;S Construction Company</i>	254	12-2a	Potential Profitability	317
	The Lemonade Kids	256	12-2b	Financial Risk	320
	Setting Up the Business	256	12-2c	Voting Control	321
	Opening Day	257	12-3	Sources of Early Financing	321
	Collecting Accounts Receivable	258	12-3a	Personal Savings	322
	Strategic Planning for the Following Saturday	258	12-3b	Friends and Family	323
	The Second Saturday of Business	258	12-3c	Credit Cards	323
10-1	The Income Statement	259	12-4	Bank Financing	324
	<i>Living the Dream</i> The Little Things Are the Big Things When It Comes to Managing Finances	263	12-4a	Types of Loans	325
10-2	The Balance Sheet	264	12-4b	Understanding a Banker's Perspective	326
10-2a	Assets	265	12-4c	Selecting a Banker	327
10-2b	Debt and Equity	266	12-4d	Negotiating the Loan	328
10-2c	Owners' Equity	267			



12-5 Business Suppliers and Asset-Based Lenders	330	<b>Chapter 13 Planning for the Harvest</b>	<b>346</b>
12-5a Accounts Payable (Trade Credit)	330	<i>In the Spotlight: Tapestry Medical</i>	<b>346</b>
12-5b Equipment Loans and Leases	331	13-1 The Importance of the Harvest	348
12-5c Asset-Based Lending	331	13-2 Methods of Harvesting a Business	348
12-6 Private Equity Investors	332	13-2a Selling the Firm	348
12-6a Business Angels	332	13-2b Distributing the Firm's Cash Flows	352
12-6b Venture Capital Firms	333	<i>Living the Dream</i> Two Friends Build and Successfully Exit Their Business	353
<i>Living the Dream</i> "Shark Tank": Changing the Game of Angel Investing	334	13-2c Initial Public Offering (IPO)	354
12-7 Government Loan Programs	335	13-2d Private Equity Recapitalization	355
12-7a The Small Business Administration	335	13-3 Firm Valuation and Payment Methods	357
12-7b State and Local Government Assistance	336	13-3a The Harvest Value	357
12-7c Community-Based Financial Institutions	337	13-3b The Method of Payment	357
12-8 Where Else to Look	337	13-4 Developing an Effective Harvest Plan	358
12-8a Large Corporations	337	13-4a Anticipate the Harvest	358
12-8b Stock Sales	337	13-4b Expect Conflict—Emotional and Cultural	359
12-9 Crowdfunding	338	13-4c Get Good Advice	359
<i>Living the Dream</i> Parke New York: A Success at Crowdfunding	340	13-4d Understand What Motivates You	360
		<i>Living the Dream</i> Why My Exit Strategy Failed	361
		13-4e What's Next?	361

## Part 4

### Focusing on the Customer: Marketing Growth Strategies

<b>Chapter 14 Building Customer Relationships</b>	<b>366</b>	14-5c Motivations	385
<i>In the Spotlight: Zane's Cycles</i>	<b>366</b>	14-5d Attitudes	385
14-1 What Is Customer Relationship Management?	367	14-6 Understanding Sociological Influences on Customers	386
14-1a Benefits of CRM to a Small Firm	368	14-6a Cultures	386
14-1b Essential Materials for a CRM Program	369	14-6b Social Classes	386
14-2 Outstanding Customer Relationships through Extraordinary Service	369	14-6c Reference Groups	387
14-2a Managing Customer Satisfaction	370	14-6d Opinion Leaders	387
<i>Living the Dream</i> Imitation Can Be the Sincerest Form of Flattery—and Just Plain Good Business	372	<b>Chapter 15 Product Development and Supply Chain Management</b>	<b>394</b>
14-2b Evaluating a Firm's Customer Service Health	374	<i>In the Spotlight: Tools that Are Powering Small Business Product Development</i>	<b>394</b>
14-3 Using Technology to Support Customer Relationship Management	376	15-1 To Grow or Not to Grow	396
14-3a Creating a CRM Database	378	15-2 Innovation: A Path to Growth	397
14-3b Using a CRM Database	379	15-2a Gaining a Competitive Advantage	397
14-3c Data Use and Privacy Concerns	380	15-2b Achieving Sustainability	398
14-4 Customers as Decision Makers	381	15-3 The Product Life Cycle and New Product Development	400
14-4a Need Recognition	381	15-3a The Product Life Cycle	400
14-4b Information Search and Evaluation	382	15-3b The New Product Development Process	401
14-4c Purchase Decision	383	<i>Living the Dream</i> Lighting the Way to Product Development	403
14-4d Post-Purchase Evaluation	383	15-4 Building the Total Product	404
14-5 Understanding Psychological Influences on Customers	384	15-4a Branding	405
14-5a Needs	384	15-4b Packaging	407
14-5b Perceptions	384		

15-4c Labeling	408
15-4d Warranties	408
<b>15-5 Product Strategy</b>	<b>409</b>
15-5a Product Marketing versus Service Marketing	409
15-5b Product Strategy Options	410
<b>15-6 The Legal Environment</b>	<b>411</b>
15-6a Consumer Protection	411
15-6b Protection of Marketing Assets	411
<b>15-7 Supply Chain Management</b>	<b>414</b>
15-7a Intermediaries	414
15-7b Channels of Distribution	414
15-7c The Scope of Physical Distribution	416

## **Chapter 16 Pricing and Credit Decisions 423**

### *In the Spotlight: Dyn* 423

<b>16-1 Setting a Price</b>	<b>424</b>
16-1a Cost Determination for Pricing	425
16-1b How Customer Demand Affects Pricing	427
<i>Living the Dream</i> Asking Customers to Pay—What a Shock!	428
<b>16-2 Applying a Pricing System</b>	<b>428</b>
16-2a Break-Even Analysis	429
16-2b Markup Pricing	431
<b>16-3 Selecting a Pricing Strategy</b>	<b>432</b>
16-3a Penetration Pricing	432
16-3b Skimming Pricing	432
16-3c Follow-the-Leader Pricing	432
16-3d Variable Pricing	432
16-3e Price Lining	433
<i>Living the Dream</i> Commodity or Specialty?	433
16-3f Pricing at What the Market Will Bear	434
<b>16-4 Offering Credit</b>	<b>434</b>
16-4a Benefits of Credit	435
16-4b Factors that Affect Selling on Credit	435
16-4c Types of Credit	436
<b>16-5 Managing the Credit Process</b>	<b>438</b>
16-5a Evaluation of Credit Applicants	438
16-5b Sources of Credit Information	439
16-5c Aging of Accounts Receivable	440
16-5d Billing and Collection Procedures	441
16-5e Credit Regulation	442

## **Chapter 17 Promotional Planning 447**

### *In the Spotlight: HubSpot, Inc.* 447

<b>17-1 Promotion Is Communication</b>	<b>448</b>
<b>17-2 Determining the Promotional Budget</b>	<b>450</b>
17-2a Budgeting a Fixed Percentage of Sales	450
17-2b Deciding How Much Is Left Over After Other Expenses Are Covered	450
17-2c Spending at the Same Level as Competitors	451



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17-2d Determining How Much Is Needed to Achieve Objectives	451
<b>17-3 Promotion Using the Internet and Social Media</b>	<b>451</b>
17-3a The Small Business Website	451
17-3b Social Media	453
<b>17-4 Personal Selling in the Small Firm</b>	<b>457</b>
17-4a The Importance of Product Knowledge	457
17-4b The Sales Presentation	457
17-4c Cost Control in Personal Selling	459
<i>Living the Dream</i> Know Your Audience	460
17-4d The Compensation Program for Salespeople	461
<b>17-5 Advertising Practices</b>	<b>462</b>
17-5a Advertising Objectives	462
17-5b Types of Advertising	462
17-5c Advertising Specialists	463
17-5d Frequency of Advertising	463
17-5e Where to Advertise	463
<b>17-6 Sales Promotion</b>	<b>465</b>
17-6a Specialties	465
17-6b Trade Show Exhibits	465
17-6c Coupons	466
17-6d Publicity	467
<i>Living the Dream</i> On a Mission	467
17-6e When to Use Sales Promotion	468

## **Chapter 18 Global Opportunities for Small Businesses 473**

### *In the Spotlight: Nomiku.com* 473

<b>18-1 Small Businesses as Global Enterprises</b>	<b>474</b>
<i>Living the Dream</i> Going Global Has Its Downsides	477
<b>18-2 The Forces Driving Global Businesses</b>	<b>477</b>
18-2a Expanding Markets	478
18-2b Gaining Access to Resources	480
18-2c Cutting Costs	481
18-2d Capitalizing on Special Features of Location	482

18-3 Strategy Options for Global Firms	483	18-4 Challenges to Global Businesses	488
18-3a Exporting	483	18-4a Political Risk	489
<i>Living the Dream</i> Spreading Gilt around the World	484	18-4b Economic Risk	489
18-3b Importing	485	18-4c The Ease of Doing Business Index	490
18-3c Foreign Licensing	486	18-5 Assistance for Global Enterprises	491
18-3d International Franchising	487	18-5a Analyzing Markets and Planning Strategy	491
18-3e International Strategic Alliances	487	18-5b Connecting with International Customers	491
18-3f Locating Facilities Abroad	488	18-5c Financing	493

## Part 5

### Managing Growth in the Small Business

#### Chapter 19 Professional Management and the Small Business 501

*In the Spotlight: Stella & Chewy's* 501

19-1 Small Business Leadership	502
19-1a What Is Leadership?	503
19-1b Leadership Qualities of Founders	503
19-1c What Makes a Leader Effective?	503
19-1d Leadership Styles	504
19-1e Leaders Shape the Culture of the Organization	505
19-2 The Small Firm Management Process	506
19-2a From Founder to Professional Manager	507
19-2b Firm Growth and Managerial Practices	509
19-3 Managerial Responsibilities of Entrepreneurs	510
19-3a Planning Activities	510
19-3b Creating an Organizational Structure	511
19-3c Delegating Authority	513
<i>Living the Dream</i> Warning! Those Who Delegate May Experience Separation Anxiety	514
19-3d Controlling Operations	515
19-3e Communicating	516
19-3f Negotiating	517
19-4 Personal Time Management	518
19-4a The Problem of Time Pressure	518
19-4b Time Savers for Busy Managers	519
<i>Living the Dream</i> Managing to Be Productive	520
19-5 Outside Management Assistance	521
19-5a The Need for Outside Assistance	521
19-5b Sources of Management Assistance	522

#### Chapter 20 Managing Human Resources 530

*In the Spotlight: Outsmart Yourself When Hiring* 530

20-1 Recruiting Personnel	531
20-1a The Need for Quality Employees	531
<i>Living the Dream</i> Two's Company, Three May Be a Crowd	532
20-1b The Lure of Entrepreneurial Firms	533

20-1c Sources of Employees	534
20-1d Diversity in the Workforce	537
20-1e Job Descriptions	538
20-2 Evaluating Prospects and Selecting Employees	539
20-2a Step 1: Use Application Forms	539
20-2b Step 2: Interview the Applicant	539
20-2c Step 3: Check References and Other Background Information	540
<i>Living the Dream</i> With Friends Like that, Who Needs References?	542
20-2d Step 4: Test the Applicant	543
20-2e Step 5: Require Physical Examinations	544
20-3 Training and Developing Employees	544
20-3a Basic Components of Training and Development	545



20-3b Orientation for New Personnel	545	21-6 Lean Production and Synchronous Management	586
20-3c Employee Training	546	21-6a Lean Production	586
20-3d From Training to Implementation	548	21-6b Synchronous Management	587
20-3e Development of Managerial and Professional Employees	549		
<b>20-4 Compensation and Incentives for Employees</b>	<b>550</b>	<b>Chapter 22 Managing the Firm's Assets</b>	<b>594</b>
20-4a Wage and Salary Levels	550	<i>In the Spotlight: The Cutting Edge Elite</i>	594
20-4b Financial Incentives	550	22-1 The Working Capital Cycle	595
20-4c Stock Incentives	551	22-1a The Timing and Size of Working Capital Investments	597
20-4d Employee Benefits	551	22-1b Examples of Working Capital Management	598
<b>20-5 Special Issues in Human Resource Management</b>	<b>552</b>	22-2 Managing Cash Flows	602
20-5a Co-Employment Agreements	552	22-3 Managing Accounts Receivable	604
20-5b Legal Protection of Employees	553	22-3a How Accounts Receivable Affect Cash	604
20-5c Labor Unions	554	22-3b The Life Cycle of Accounts Receivable	604
20-5d Formalizing Employer–Employee Relationships	554	22-3c Accounts Receivable Financing	607
20-5e The Need for a Human Resource Manager	555	22-4 Managing Inventory	607
		22-4a Reducing Inventory to Free Cash	607
		22-4b Monitoring Inventory	608
		22-4c Controlling Stockpiles	609
		<i>Living the Dream</i> Taking Stock of Inventory Management	609
		22-5 Managing Accounts Payable	610
		22-6 Cash Conversion Period Revisited	611
		22-7 Capital Budgeting Techniques	612
		22-7a Accounting Return on Investment	613
		22-7b Payback Period	614
		22-7c Discounted Cash Flows	614
		22-8 Capital Budgeting Practices in Small Firms	615
<b>Chapter 21 Managing Operations</b>	<b>562</b>	<b>Chapter 23 Managing Risk in the Small Business</b>	<b>622</b>
<i>In the Spotlight: Local Motors</i>	562	<i>In the Spotlight: Homestead Interior Doors</i>	622
21-1 Competing with Operations	564	23-1 What Is Business Risk?	623
21-2 The Operations Process	565	23-2 Basic Types of Pure Risk	624
21-2a Managing Operations in a Service Business	565	23-2a Property Risks	624
21-2b Types of Manufacturing Operations	567	<i>Living the Dream</i> An Emergency Plan May Make the Difference Between Survival and Failure	625
21-2c Capacity Considerations	567	23-2b Liability Risks	626
21-2d Planning and Scheduling	568	23-2c Personnel Risks	629
21-3 Inventory Management and Operations	569	23-3 Risk Management	630
21-3a Objectives of Inventory Management	569	23-3a The Process of Risk Management	631
21-3b Inventory Cost Control	570	23-3b Risk Management in the Small Business	632
21-3c Inventory Recordkeeping Systems	572	<i>Living the Dream</i> Employee Dishonesty Insurance May Be Needed When You Least Expect It	633
21-4 Operations Management and Quality	572	23-4 Basic Principles of a Sound Insurance Program	634
21-4a Quality as a Competitive Tool	573	23-5 Common Types of Business Insurance	635
21-4b The Customer Focus of Quality Management	573	23-5a Property and Casualty Insurance	635
<i>Living the Dream</i> Drumming Up Business by Giving Customers Exactly What They Want	574	23-5b Life and Health Insurance	638
21-4c “The Basic Seven” Quality Tools	576		
21-4d Quality Inspection versus Poka-Yoke	577		
21-4e Statistical Methods of Quality Control	578		
21-4f International Certification for Quality Management	579		
21-4g Quality Management in Service Businesses	579		
21-5 Purchasing Policies and Practices	580		
21-5a The Importance of Purchasing	580		
21-5b Measuring Supplier Performance	582		
21-5c Building Good Relationships with Suppliers	583		
21-5d Forming Strategic Alliances	584		
21-5e Forecasting Supply Needs	584		
21-5f Using Information Systems	584		
<i>Living the Dream</i> High-Tech Tools Offer Operations Solutions	585		

## Cases

1	DashLocker	645	15	Graeter's Ice Cream	676
2	PortionPac Chemicals	646	16	Dynamic Network Services, Inc.	678
3	The Kollection: From Music Hobby to Startup and Beyond	648	17	HubSpot, Inc.	680
4	Two Men and a Truck®/International, Inc.	651	18	Auntie Anne's Pretzels in China	681
5	The Avedis Zildjian Company, Inc.	653	19	Andrew Mason and the Rise and Fall of Groupon	684
6	HyperWear, Inc.	655	20	Jason Fried and Hiring Practices at 37signals	687
7	ReadyMade Magazine	656	21	River Pools & Spas	688
8	Couchsurfing International	657	22	Pearson Air Conditioning & Service	689
9	Cookies-N-Cream	660	23	Jack's Restaurant	692
10	Harper & Reiman, LLC	661			
11	Ashley Palmer Clothing, Inc.	664			
12	Moonworks	667			
13	Network Collie	669			
14	Numi Tea	674			

## Index

693

Appendices A and B are available online. The online appendices can be accessed by going to [www.CengageBrain.com](http://www.CengageBrain.com) and selecting the Longenecker text.

## Appendix A Sample Business Plan

## Appendix B Valuing a Business

# Preface



Welcome to the 17th 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 its authors, we believe that the reason for its success is our decision to take on 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 know 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 back to a bookstore at the end of a semester. In the case of *Small Business Management*, a large number of students have made it a part of their 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 dream 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. Finally, many describe how the chapters on managing the business have kept them from making the kinds of mistakes that Andrew Mason (see sidebar above) and others have made.

*Small Business Management* lays out, in a step-by-step fashion 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 every day, building on the foundation provided by this text. This advice

*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 3. 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—a concept, along with many others, that you will understand more fully after reading *Small Business Management: Launching & Growing Entrepreneurial Ventures*.

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 will be the key to making the basket, reaching the goal line, crossing home plate, jumping the net (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, a former professor, and/or a key customer or supplier. You must be effective in your relationships with other people, including those you don’t control. The bottom line: You cannot accomplish anything of any real significance by yourself!

## Follow Your Dreams

As you will see, *Small Business Management* is focused on teaching you the essential concepts and building skills that you will need to grow and manage a business successfully. It also focuses on 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, what they do matters.

Many students enroll in colleges and universities to gain qualifications that 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 working initially 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 pre-med 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 company, 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!*

## 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 totally engaged. Thus, the 17th edition of *Small Business Management* offers plenty that's new, 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 1 introduces some of the important issues when considering the launch of a socially oriented enterprise. We have also included examples of socially minded entrepreneurs, such as Amy George at BlueAvocado and Robert Hennessy at DashLocker.
- Prioritizing a small business owner's responsibilities to major stakeholders can be difficult. With that in mind, Chapter 2, “Integrity and Ethics: Foundations for Success in Small Business,” now 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 announce an optional course add-on from Business Plan Pro, the unquestioned leader in business planning software. Its new *LivePlan* has interactive features that guide you through the writing process in ways not previously available.
- We provide a new example of a complete business plan on the Longenecker website ([www.cengagebrain.com](http://www.cengagebrain.com)) that was used successfully in raising capital from investors.
- Locating small businesses 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 and the preparation of financial forecasts for small businesses (in Chapter 10, “Understanding a Firm's Financial Statements,” and 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 17th edition in order to make the material even easier to grasp. Bill Petty, the co-author who wrote these chapters, invites any instructor using the text to contact him for suggestions or assistance in teaching these chapters. Just call him directly (254-710-2260) or e-mail him ([bill\\_petty@baylor.edu](mailto:bill_petty@baylor.edu)).
- Updated information on raising capital to grow a business, including best practices for raising money on the Internet (or what is called *crowdfunding*), is provided in Chapter 12, “A Firm's Sources of Financing.” But stay tuned: New regulations are being prepared by the Securities and Exchange Commission that may significantly change how entrepreneurs can raise capital from the public.



- 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, the sections on creating and using customer data in Chapter 14, “Building Customer Relationships,” have been greatly expanded. These sections now offer more practical instruction on CRM methods that make sense for small businesses, regardless of the level of sophistication. Privacy issues related to the use of customers’ personal data are also addressed in more detail.
- 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 far 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 information for entrepreneurs who wish to hire employees, including updated descriptions of relevant employment laws, an outline of limitations that apply to 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 show you how to 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.
- New cases have been added to the case section at the end of the text, including DashLocker, The Kollektion, the Avedis Zildjian Company (the oldest family business in the United States), Hyper Wear, and Auntie Anne’s Pretzels in China. These and other relevant cases provide opportunities for students to apply chapter concepts to entrepreneurial situations in a realistic and timely way. Because reaction to the video cases added in the 16th edition was so positive, we decided to retain them in this edition.
- In addition to the cases appearing in the book, many others, old and new, are available on the Longenecker website ([www.cengagebrain.com](http://www.cengagebrain.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. More than half of the spotlights are video enriched, because nothing helps students master the lessons of

small business and entrepreneurship as much as seeing those lessons put into practice.

- **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 in *Small Business Management Online* ([www.cengagebrain.com](http://www.cengagebrain.com)).
- **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.
- **Video Cases.** Actual interviews with small business owners and entrepreneurs bring together high-interest video segments and in-text case material. Case instruction augmented by video filmed on location in diverse businesses such as TWO MEN AND A TRUCK, PortionPac Chemicals, Cookies-N-Cream, *ReadyMade* Magazine, and other entrepreneurial success stories makes studying effective small business management all the more interesting.
- **Small Business & Entrepreneurship Resource Center (SBERC) Exercises.** Each chapter includes an exercise that directs the student to a current article in the Gale database about topics covered in the chapter.

## Updated and Enhanced Supplements

All resources and ancillaries that accompany *Small Business Management*, 17th 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. This edition's *Instructor's Manual* has been revised by Patricia Worsham of Cal Poly Pomona. It is available on the text website ([www.cengagebrain.com](http://www.cengagebrain.com)) and on the *Instructor's Resource CD* (IRCD).
- **Test Bank.** The *Test Bank* has been revised by Carol Heeter of Ivy Technical Community College. 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. The *Test Bank* in Word is available on the *Instructor's Resource CD* (IRCD).
- **ExamView® Testing Software.** ExamView contains all of the questions in the printed *Test Bank*. This easy-to-use test-creation software program is compatible with Microsoft Windows®. Instructors can add or edit questions, instructions, and answers. Questions may be chosen by previewing them on screen, selecting them randomly, or selecting them by number. Instructors can also create quizzes online, either on the Internet, a local area network (LAN), or a wide area network (WAN).
- **PowerPoint® for Instructors.** A complete PowerPoint package is available to aid in lecture presentation. The PowerPoint slides, revised by Charlie Cook of the University of West Alabama, are available on both the IRCD and the password-protected instructor's website.
- **Instructor's Resource CD.** Instructors can get quick access to all of these ancillaries from the easy-to-use *Instructor's Resource CD* (IRCD) that lets the user electronically review, edit, and copy what's needed. The IRCD contains the *Instructor's Manual*, *Test Bank* in Microsoft Word and in ExamView, PowerPoint slides, and business plan templates.
- **"Startup Stories" Videos.** Available online through CourseMate, CengageNow, and MindTap sites, 17 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 *ReadyMade* Magazine, 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.
- **Small Business & Entrepreneurship Resource Center.** The Small Business & Entrepreneurship Resource Center (SBERC) from Gale, a part of Cengage Learning and a leader in e-research for libraries and schools, can be accessed through CourseMate and directs students to 900,000 published full-text articles directly related to small business management. These articles are easily searchable by business topic, business type, and commonly asked how-to questions. This powerful resource also includes access to hundreds of sample business plans and the legal forms necessary to start a new venture in every state. Powered by InfoTrac, the how-to section provides direct access to the most popular topics and questions students have about starting and running a small business.
- **CengageNow.** This robust, online course management system gives you more control in less time and delivers better student outcomes. CengageNOW includes teaching and learning resources organized around lecturing,

creating assignments, grading, quizzing, and tracking student progress and performance. Automatic grading and a gradebook option provide more control while saving you valuable time. A “Personalized Study” diagnostic tool empowers students to master concepts, prepare for exams, and become more involved in class.

- **LivePlan®.** Students can now 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
- **Write Experience.** Cengage Learning's Write Experience helps students write effectively without adding to instructor workload! Write Experience utilizes artificial intelligence to score student writing instantly and accurately. It also provides students with detailed revision goals and feedback on their writing to help them improve written communication and critical thinking skills. Write Experience is the first product designed and created specifically for the higher education market through an exclusive agreement with McCann Associates, a Vantage Learning Affiliated operating company, and also powered by e-Write IntelliMetric Within™.
- **MindTap.** MindTap is a fully online, highly personalized learning experience built upon Cengage Learning content. MindTap combines student learning tools—readings, multimedia, activities and assessments—into a singular Learning Path that guides students through their course. Instructors personalize the experience by customizing authoritative Cengage Learning content and learning tools, including the ability to add their own content in the Learning Path via apps that integrate into the MindTap framework seamlessly with Learning Management Systems.

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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 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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Karen Cranford  
*Catawba College*  
George W. Crawford  
*Clayton College & State  
University*  
Bruce Davis  
*Weber State University*  
Helen Davis  
*Jefferson Community College*  
Terri Davis  
*Howard College*  
Bill Demory  
*Central Arizona College*  
Michael Deneen  
*Baker College*  
Sharon Dexler  
*Southeast Community College*  
Warren Dorau  
*Nicolet College*  
Max E. Douglas  
*Indiana State University*  
Bonnie Ann Dowd  
*Palomar College*  
Michael Drafke  
*College of Dupage*

Franklin J. Elliot  
*Dine College*  
Franceen Fallett  
*Ventura College*  
R. Brian Fink  
*Danville Area Community College*  
Dennette Foy  
*Edison College*  
David W. Frantz  
*Purdue University*  
Janice S. Gates  
*Western Illinois University*  
Armand Gilinsky, Jr.  
*Sonoma State University*  
Darryl Goodman  
*Trident Technical College*  
William Grace  
*Missouri Valley College*  
William W. Graff  
*Maharishi University  
of Management*  
Jack Griggs  
*Texas Heritage Bank*  
Mark Hagenbuch  
*University of North Carolina,  
Greensboro*  
Carol Harvey  
*Assumption College*  
James R. Hindman  
*Northeastern University*  
Betty Hoge  
*Limestone College*  
Eddie Hufft  
*Alcorn State University*  
Sherrie Human  
*Xavier University*  
Ralph Jagodka  
*Mt. San Antonio College*  
Larry K. Johansen  
*Park University*  
Michael Judge  
*Hudson Valley Community College*  
Mary Beth Klinger  
*College of Southern Maryland*  
Charles W. Kulmann  
*Columbia College of Missouri*  
Rosemary Lafragola  
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William Laing  
*Anderson College*  
Ann Langlois  
*Palm Beach Atlantic University*

Rob K. Larson  
*Mayville State University*  
David E. Laurel  
*South Texas Community College*  
Alecia N. Lawrence  
*Williamsburg Technical College*  
Les Ledger  
*Central Texas College*  
Michael G. Levas  
*Carroll University*  
Richard M. Lewis  
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Rosa L. Okpara  
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Timothy O'Leary  
*Mount Wachusett Community  
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Pamela Onedechk  
*University of Pittsburgh at  
Greensburg*  
Dick Petite  
*SUNY Brockport & Monroe  
Community College*  
Claire Phillips  
*North Harris College*  
Dean Pielstick  
*Northern Arizona University*  
Mark S. Poulos  
*St. Edward's University*  
Julia Truitt Poynter  
*Transylvania University*  
Fred Pragasam  
*University of North Florida*  
Thomas Pressly  
*Penn State-Shenango*  
Mary Ellen Rosetti  
*Hudson Valley Community  
College*  
June N. Roux  
*Delaware Technical and  
Community College*  
Jaclyn Rundle  
*Central College*  
John K. Sands  
*Western Washington University*  
Craig Sarine  
*Lee University*  
Duane Schecter  
*Muskegon Community College*  
Joseph A. Schubert  
*Delaware Technical and  
Community College*  
Matthew Semadeni  
*Texas A&M University*  
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Sherry L. Shuler  
*American River College*  
Cindy Simerly  
*Lakeland 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](mailto:bill_petty@baylor.edu)), Les Palich (254-710-6194, [les\\_palich@baylor.edu](mailto:les_palich@baylor.edu)), and Frank Hoy (508-831-4998, [fhoy@wpi.edu](mailto:fhoy@wpi.edu)). We would love to hear from you.

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# CHAPTER 1

## The Entrepreneurial Life

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For three women in Austin, Texas, starting a business was more than personal ambition; it was about inviting millions to take simple steps to reduce their impact on the planet by making it easy to “do good and get it done.” In 2008, those words became the mission statement of founders Melissa Nathan, Paige Davis, and Amy George, and BlueAvocado was born. Since its inception, the company has helped to upcycle 875, 000 plastic bottles into beautiful products that are keeping 70 million disposables out of landfills and oceans.

In 2008, San Francisco became the first city in the country to ban plastic bags, highlighting the environmental consequences of a disposable lifestyle. Retailers IKEA and Whole Foods led the retailer pack, banning plastic bags and offering rebates to customers. Sisters Nathan and Davis keyed in on this lifestyle transformation, developing the country’s first reusable, multifunctional shopping kit to meet the needs of the American shopper.

**In the SPOTLIGHT**  
BlueAvocado  
[www.blueavocado.com](http://www.blueavocado.com)

After a failed prototype, the company honed its shoppingkit product offering, and by the end of 2008, it had secured its first orders from Whole Foods Southwest Region and HEB Grocers for a pilot program. These beginning efforts led to 8 regions and 180 Whole Foods stores adopting BlueAvocado’s products. In March 2009, the company landed key placements at specialty grocery and flagship retailers like Nieman Marcus, Home Shopping Network, Amazon.com, and Drugstore.com.

By 2011, BlueAvocado had expanded its product portfolio to include lunch kits, washable Ziploc replacement bags, recycling bins, and eco-travel and eco-beauty items. In 2012, the company launched its green rewards iPhone app with Whole

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.



Foods and the Whole Planet Foundation, rewarding shoppers who actively buy green with coupons that can be used or donated to the foundation. In Amy George's words,

*Since day one, we have put an impact label on every single product that shows you the difference you make by reducing your ecological footprint. We also created a sustainability report in line with international standards, which may make us the earliest-stage, privately held company (possibly in the world) to do this. Our business is about impact, measuring*

*what matters, and inspiring others by sharing the potential we have to create a better world if we look at our products and actions differently.*

BlueAvocado represents a new kind of company whose long-term value will be measured not only by the return to its shareholders, but by its contribution to the lives of the people on its journey and the ability to preserve precious natural resources.

Source: Written by Amy George, CEO, BlueAvocado, October 15, 2012.

**H**aving worked for 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.

Let us say at the very beginning that 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 of entrepreneurship 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.<sup>1</sup>

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.

The entrepreneurs and owners of small businesses are some of our greatest heroes. We believe that the words of Theodore Roosevelt, when he described “the man in the arena,” apply perfectly to these individuals:

*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 shortcomings; 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.<sup>2</sup>*

So, if you, like so 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 BUT LARGE SIGNIFICANCE

If you have a serious interest in starting and operating your own business—now or in the future—you are not alone. Paul Reynolds, a leading researcher in the field, says that entrepreneurship is “on the scale of a lot of other major social phenomena.”<sup>3</sup>

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.<sup>4</sup> As shown graphically in Exhibit 1.1, the industries in which small businesses are more prevalent include services, construction, retail trade, health care, and hospitality (accommodations and food). To get a sense of the breadth and depth of the impact of small businesses on the economy overall, consider the following facts, as reported by the U.S. Small Business Administration:<sup>5</sup>

- As of 2009, there were almost 6 million businesses in the United States with employees. Of these businesses, 90 percent had fewer than 20 employees, and companies with fewer than 500 employees accounted for almost all the firms—99.7 percent.
- The companies with fewer than 500 employees hired almost 50 percent of all employees, accounted for 43 percent of all the salaries paid to employees, and in 2007, generated 38 percent of all business revenues.
- Small enterprises hire 43 percent of all high-tech employees (scientists, engineers, computer programmers, and others)
- From 1992 to 2010 when there were job increases in the economy, small businesses with fewer than 500 workers outperformed large firms in net job creation in about three out of four quarters.
- Many small companies have been going global, representing 97.3 percent of all exporters.
- For the 10 years ending in 2010, one of the most dramatic trends has been the increase in minority business owners, which is up 86 percent for both Hispanics and Asian Americans and 13 percent for blacks, as compared to only 5 percent for whites.
- The growth in self-employed individuals with college degrees, both baccalaureate and master’s degrees, increased 32 percent from 2000 to 2010.

It’s also interesting to note that about one-fourth of the 23.5 million military veterans in the United States are interested in starting or buying their own business.<sup>6</sup>

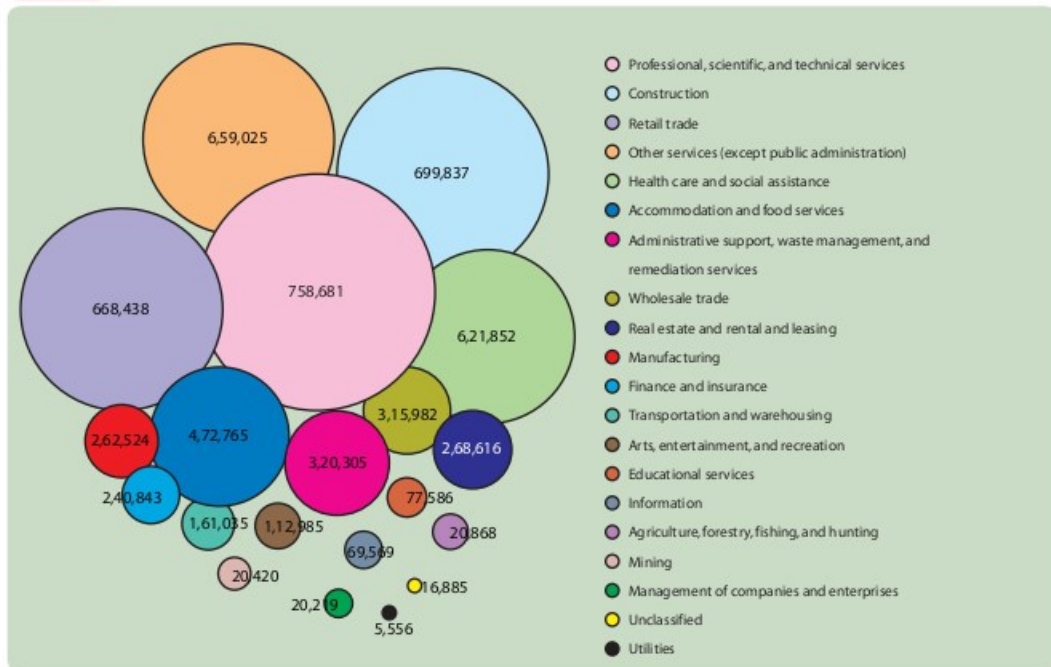
In a study sponsored by the Kauffman Foundation Research Series, Tim Kane talks about the role of startups in job creation:

*The oft-quoted American sports slogan “Winning isn’t everything. It’s the only thing” could well be attributed to the economic importance of firm formation in creating jobs. . . . A relatively new data set from the U.S. government called Business Dynamics Statistics validates that U.S. startups classified as “less than one year old” create an average of 3 million new jobs annually. All other ages of firms, including . . . firms established two centuries ago, are net job destroyers, losing 1 million jobs net per year.<sup>7</sup>*



LO  
1-1  
Explain the importance of small business and entrepreneurship in our society.

**EXHIBIT** **1.1** Number of Firms with Fewer than 500 Employees by Industry (2009)



Source: "The Small Business Economy 2011," United States Government Printing Office, [www.sba.gov/sites/default/files/SBE\\_2011\\_2.pdf](http://www.sba.gov/sites/default/files/SBE_2011_2.pdf).

Still, the most recent recession was a particularly difficult time for small businesses. The number of startups declined from 670,058 in 2006 to 597,074 in 2008, with bankruptcies increasing from 19,605 in 2006 to 60,837 in 2009.

In whatever way you choose to measure it, those individuals who start and lead small businesses are making a significant difference in the economy and in the quality of our lives. As we have already said, they are some of the heroes among us.

## 1-2 SMALL BUSINESS AND ENTREPRENEURIAL OPPORTUNITY: THE SAME OR DIFFERENT?

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 to 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 organizational structure, and often in culture.

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



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

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.<sup>8</sup> 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 really 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. The few businesses that have 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 in California 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 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. They employ fewer than 10 employees and 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. In this book, 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. Financing for the business is provided by no more than a few 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.

Obviously, some small firms 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



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**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.