

# Small Business Management <sup>19e</sup>

LAUNCHING AND GROWING ENTREPRENEURIAL VENTURES

Longenecker • Petty • Palich • Hoy





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*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 requires 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*.

We welcome you to the 19th edition of *Small Business Management: Launching and Growing Entrepreneurial Ventures*. At its core, *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.

In 1964, Halsey Broom and Justin Longenecker wrote the first edition of *Small Business Management: Launching and Growing Entrepreneurial Ventures*. As colleagues at Baylor University, they discovered that they shared a passion for teaching students about the importance and the opportunities provided from owning their own businesses.

At that time, courses in entrepreneurship and small business management were almost nonexistent. In those days, business curriculums at practically all colleges and universities taught students only how to work for someone else. But Broom and Longenecker believed

there was another alternative, and a good one, for students to achieve their professional goals through owning a business of their own. They contended that owning a business was a way to make life better for others, while building wealth for themselves, and at the same time providing a way to give back to their communities.

From that small beginning in 1964, *Small Business Management* is now in its 19th edition. Few textbooks survive even three editions, much less 19! By 2018, we estimate that some 3 million readers who aspire to become entrepreneurs have benefitted from the book. From our knowledge, no other small business management textbook has even come close to this number of readers. Also, we are aware that many students have chosen to keep *Small Business Management*, rather than sell it at the end of a semester, making the book 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.” Looking back, we can see that these two college professors were ahead of their time.

Why has *Small Business Management* continued for 54 years to be a leader in preparing students to own their own small businesses? We believe there are a number of reasons, a few being:

- Most importantly, the *Small Business Management* author team over the years have never become complacent. We have continued to live the dream started by Broom and Longenecker. As they did, we believe that what we are doing matters in the lives of our readers. It is about more than just presenting facts and figures—so much more. It is about life itself.
- 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.
- *Small Business Management* provides instruction and guidance that will greatly improve your odds for success as you take your own entrepreneurial journey. We continue to present the best information available today about launching and growing small businesses.
- Examples throughout the textbook demonstrate that there is not a single path to success. The goal is to help you find one that will work best for you.
- We emphasize the importance of building relationships along the way. Even if you are the company’s only employee, you still have relationships with and depend on others, including your family, a banker, suppliers, and customers. To succeed you must be effective in your relationships with other people. The bottom line: You cannot accomplish anything of any significance by yourself!
- Many readers of *Small Business Management* have limited training and experience in understanding the valuable information provided by financial statements. There are just some things that cannot be understood about the business except through the numbers. Our textbook gives the reader a more thorough, but intuitive, presentation on financial statements than do most other textbooks focused on small business management.
- Readers have described how the chapters on managing the business have kept them from making the kinds of mistakes that Andrew Mason and others have made.

We could continue discussing the textbook’s primary features, but hopefully the list above is sufficient to gain a sense of the book. But while *Small Business Management* offers a great foundation for an entrepreneurial career, we also encourage you to continue learning 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.”

## Follow Your Dreams

As you will see, *Small Business Management* focuses on essential concepts and building skills that you will need to grow and manage a business successfully. But at the core, we also consider a much broader concern—the pursuit of entrepreneurial dreams.

Entrepreneurs should be about fulfilling dreams—for themselves, their families, their employees, and their communities. The journey should always be about more

than just the money. As a small business owner, what you do matters, not just to yourself, but to others as well.

As you look to your future career path, there are definite advantages to initially working for someone else. It can 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.

So, we challenge you to give serious thought to joining them—and if you do, you may need to begin small, but *dream big if you want*. 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!*

## Changing the Learning Model

When it comes to how we learn, the author team has become increasingly convinced over the years that what worked in the past no longer does for many individuals. More than ever, a learner’s cooperation is required. That is, a student must take part in the process.

Learning can at times be hard work and requires a willingness to be engaged. However, it can be fun both for the teacher and student alike when the student is actively participating. Simply put, we believe that without engagement, there can be little meaningful learning.

For this reason, the authors have joined with Cengage to make the learning process more engaging. With this latest edition of *Small Business Management*, we will be taking greater advantage of the technology now available to enhance the reader’s participation.

To achieve this goal of greater student engagement comes by syncing the *Small Business Management* digital textbook with Cengage’s MindTap, an online, highly personalized learning experience built upon all-new content by the authors for this 19th edition.

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. Beginning with the 18th edition of *Small Business Management*



and now even more so with this current 19th edition, 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 like 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.

**In the Spotlight.** Now found in the MindTap Learning Path, the “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.

**Living the Dream.** Practical examples from the world of small business and entrepreneurship carry both instructional and inspirational value. You’ll now find these activities in the MindTap Learning Path.

**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.

**You Make the Call.** For the 19th edition, “You Make the Call” appears in MindTap. These features 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.

## New Updates in Content

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 more interested. Thus, the 19th 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 responsibility 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 19th edition 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 19th 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’s MindTap Learning Path 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.

## Updated and Enhanced Supplements

All resources and ancillaries that accompany *Small Business Management*, 19th 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 contains sources of audio/video and other instructional materials, answers to the “Discussion Questions,” comments on “You Make the Call” situations, and additional teaching notes.
- **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.

- **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.

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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, we seriously would!

# About the Authors



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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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# The Entrepreneurial Life

The primary purpose of this chapter is to provide you an overall view of owning a small business and thinking like an entrepreneur. By studying this chapter, you should be able to . . .

- 1-1** Explain the importance of small businesses and entrepreneurship in our society.
- 1-2** Describe what it means to be a small entrepreneurial firm.
- 1-3** Identify how small businesses can compete against the giants.
- 1-4** Understand what might motivate you to be a small business owner with all its risks and uncertainties.
- 1-5** Discuss ways to build a successful business as a part of your life legacy.



**A**s the co-authors of *Small Business Management: Launching and Growing Entrepreneurial Ventures*, we have spent several decades interacting with entrepreneurs—as friends, as consultants, and even as investors. It has been a blast! These experiences have largely framed what we teach in class, our areas of research, and ultimately what we present in this book.

And now we want you to know what we have learned over the years, so that you will be prepared to own a small business—one that hopefully will make a difference in your life, as well in the lives of many others. We want your study to be more than just learning facts for an exam. *Far more importantly, we want to equip you with the necessary tools for a journey that could be life changing.*

To begin, we want you to understand that:

1. Owning a business is a noble profession—*especially if it's done well*. No other life's work does more to further your personal development and allow you to make significant contributions to society.

2. The richest rewards of owning a small business come from:
  - a. Offering goods or services that improve the lives of your customers and makes a difference in the community.
  - b. Developing an organizational culture that allows your employees to grow professionally and personally.

So, let's get started by looking at some big-picture issues for anyone wanting to think like an entrepreneur and be a small business owner.

## 1-1 SMALL SIZE, GREAT SIGNIFICANCE

Paul Reynolds, a leading researcher in the entrepreneurship field, calls entrepreneurship a major social phenomenon.<sup>1</sup> In addition to changing people's lives, its significance can be observed in the contributions small businesses make to the economy and society. Consider the following:<sup>2</sup>

- There are 27.8 million businesses in the United States with fewer than 500 employees, accounting for 99.7 percent of all businesses—and 90 percent have fewer than 20 employees!
- 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 gone global, representing 97 percent of all exporters.

Another revealing fact is the interest young people have in eventually owning their own business, as indicated by the number of college students enrolling in small business and entrepreneurship classes.

Clearly, small business owners are important contributors to our economy.

## 1-2 SMALL BUSINESS AND ENTREPRENEURSHIP GO TOGETHER

Let's look at the terms *small business* and *entrepreneurship*.

### 1-2a What Is a Small Business?

What does it mean to be a “small business?” A neighborhood restaurant or bakery is clearly a small business, and Toyota is obviously not. To distinguish between small and large businesses, we naturally consider their relative size, but it is also helpful to think about a small firm's potential to grow. Consider, too, that small firms with different growth potential require different management.

- **Size.** Here, we must say that size is “in the eye of the beholder.” When we think about a firm's size, we typically use such criteria as the number of employees, sales volume, amount of profit, and the size of the company's assets. However, size standards are arbitrary and frequently adopted to serve a purpose. For example, the U.S. Small Business Administration generally defines a small business as having fewer than 500 employees. However, in



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



Describe what it means to be a small entrepreneurial firm.

specific cases, the government may define a small business differently—such as one with fewer than 10 employees—to exempt it from certain regulations if compliance would be too costly, given its small size. Therefore, using numerical criteria can be subjective at best.

- **Growth Potential.** Small businesses also differ dramatically when it comes to their potential to grow and how they must be managed. They have commonly been differentiated as follows:
  1. **Microbusinesses** make up the largest sector of the U.S. economy in terms of the number of businesses. This sector includes many small service companies, such as pool-cleaning businesses, dry cleaners, and appliance repair shops. These companies are also called **lifestyle businesses** because they often permit an owner to follow a desired lifestyle. Their distinguishing feature is their limited ability to generate significant profits.
  2. **Attractive small firms** offer substantial financial rewards for their owners, where profits may grow into the millions or even tens of millions of dollars. They also can provide rewarding careers for employees.
  3. **High-potential ventures** (also called **gazelles**) are businesses with phenomenal prospects for growth. These firms are usually high tech, with the potential to change how people live.

So, how we think of a **small business** depends on how we define *small* and on the nature of the business in terms of its growth potential. For our purposes, we will primarily be interested in businesses with the following characteristics:

1. Compared to the largest firms in the industry, the business is small; in most instances, it 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 equity financing for the business. Equity financing (discussed in Chapter 12) is 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 must have the potential to become at least a mid-sized company, whether or not the owner chooses to capture that growth.

Obviously, some small businesses will fail to have these characteristics, but they may still be of interest to us.

## 1-2b What Is Entrepreneurship?

There is no single definition of *entrepreneurship*. Some focus on the willingness of a person (the **entrepreneur**) to create value while assuming both significant risks and the rewards for his or her efforts in a new or existing business venture. Others target innovations created by entrepreneurs, while still others focus on the personality traits of entrepreneurs.

We prefer a working definition of *entrepreneurship* that focuses on the process:

**Entrepreneurship** is the relentless pursuit of an opportunity without regard to owning all the resources needed to capture the opportunity. It involves a process that begins with identifying an opportunity and ends with exiting the business, or what is often called “harvesting the value of the company.”

### microbusinesses

A small firm that provides minimal profits to its owner.

### lifestyle businesses

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

### attractive small firms

A small firm that provides substantial profits to its owner.

### high-potential ventures (gazelles)

A small firm that has great prospects for growth.

### 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.

### entrepreneur

A person willing to create value, in either a new or an existing business, while assuming both the risks and the reward for his or her efforts.

### entrepreneurship

A four-stage process that involves the relentless pursuit of an opportunity without regard to owning all the resources needed to capture the opportunity.

From beginning to end, entrepreneurship involves four stages, which are reflected in Exhibit 1.1:

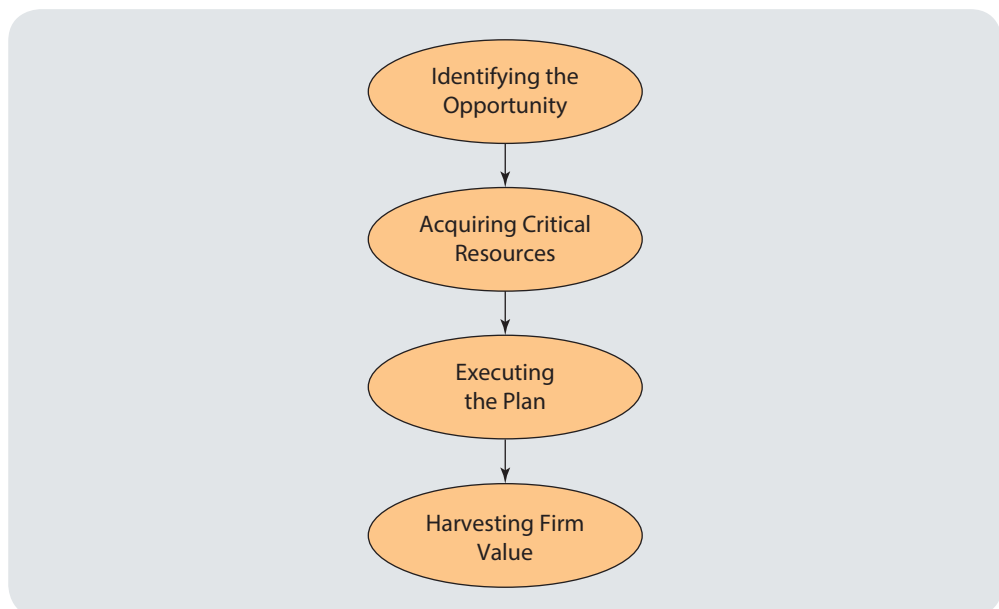
1. **Identifying an attractive opportunity.** Understand that an opportunity is more than merely having a good idea. Real opportunities should be market driven, offering customers a product or service that is so appealing that they are willing to let go of their hard-earned money to buy it. (In Chapter 3, you'll learn how to identify good opportunities.)
2. **Acquiring the critical resources needed for growing the business.** In a small business, there is no more important issue than efficiently managing resources. Thus, learning how to think about resources may mean the difference between success and failure.  
When entrepreneurs think about resources, they should not just think about money. It is important to also understand the following:
  - Entrepreneurs find ways to do more with less when it comes to resources.
  - Critical resources include much more than money, such as the right management team, the right partners, and access to the right assets, such as inventory and equipment.
  - Entrepreneurs sometimes must **bootstrap**, such as resorting to bartering, generating income from other sources, or using a personal credit card.
3. **Executing the plan.** The entrepreneur must now scale the business to make it economically attractive. Among other things, you will need to know how the firm will make money, support growth, and create barriers of entry to keep the competition away.
4. **Harvesting the business.** At some point, an entrepreneur must think about exiting the business to capture the value that he or she has created over the years. This can happen by passing the business on to the next generation in the family, by selling the company to other investors, or in a few rare instances, by issuing the company's stock to the public. (These options will be explained in detail in Chapter 13.)

### bootstrap

Doing more with less in terms of resources invested in a business, and, where possible, controlling the resources without owning them.

## EXHIBIT

### 1.1 The Entrepreneurial Process



## 1-2c Entrepreneurs: Born or Made?

People often ask, “Are entrepreneurs born or made?” That question has long been debated with little agreement. However, Stephen Spinelli and Robert Adams have summarized research on entrepreneurial characteristics, including “desirable and acquirable attitudes and behaviors”:<sup>3</sup>

1. *Leadership abilities*—The ability to self-motivate and team-build with a focus on honesty in business relationships.
2. *Opportunity obsession*—A keen awareness of the market and customer needs.
3. *Commitment and determination*—Tenacity, decisiveness, and persistence in problem solving.
4. *Motivation to excel*—Goal orientation and awareness of personal strengths and weaknesses.
5. *Courage*—Strong moral convictions and a willingness to experiment.
6. *Tolerance of risk, ambiguity, and uncertainty*—The ability to take risks and to minimize them, as well as to tolerate uncertainty.
7. *Creativity, self-reliance, and adaptability*—Open-mindedness, resilience, and a quickness to learn.

On the other hand, some personal characteristics are deadly for an entrepreneur. 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 (usually the result of taking oneself too seriously).
5. Be a domineering manager.
6. Fail to share ownership in the business in an equitable way.

Three Harvard Business School professors came to similar conclusions based on a survey that asked company founders what they got wrong when starting their companies.<sup>4</sup> Overall, they acknowledged not being good listeners in two areas:

- They did not listen to prospective customers as they were designing their product or service. Instead, they “built” what they thought customers would want without ever asking.
- Their passion and egos caused them to react negatively to criticism and to discount ideas from others for improving their products or services. We frequently hear that an entrepreneur must have passion, which is true, but *unchecked passion can be destructive*.

To some extent, these traits describe a leader who lacks humility, a quality that we believe serves business leaders well.

Clearly, successful—and unsuccessful—entrepreneurs share certain characteristics. However, entrepreneurs are not cut out of a single mold. You only have to listen to their stories to hear the apparent differences in their priorities, perceptions, personalities, and behavior. Their success generally arises from having a clear mission, a desire to lead, and the recognition that business success requires hard work and long hours.

## 1-2d Types of Entrepreneurs

Entrepreneurs are not only founders of new businesses. Many individuals approach entrepreneurship a bit differently—but are entrepreneurial just the same. Let's now consider second-stage entrepreneurs, franchisees, social entrepreneurs, intrapreneurs, and entrepreneurial teams.

### SECOND-STAGE ENTREPRENEURS

At some point after a new firm is established, it may be purchased or taken over by a second-generation family member or another individual who may have been managing the company. These “second-stage” entrepreneurs do not necessarily differ greatly from founding entrepreneurs in the way they manage their businesses. Nevertheless, it is helpful to distinguish between entrepreneurs who start or substantially change companies and those who direct the continuing operations of established businesses.

### FRANCHISEES

According to the International Franchise Association, 44 percent of businesses in the United States are franchises.<sup>5</sup> **Franchisees** differ from other business owners in the degree of their independence. Because of the guidance and standardized systems provided by contractual arrangements with franchising organizations, franchisees function within the boundaries set by franchisors.

The franchisee is authorized to market the company's products or services and expects the franchisor to provide support in operating the business. Such support will usually include operating systems, training, financing, advertising, and other services. In addition to paying an annual franchising fee, the franchisee will usually pay a portion of the company's profits to the franchisor. (Chapter 4 presents more information about franchisees.)

### SOCIAL ENTREPRENEURS

**Social entrepreneurship** involves focusing on a social purpose so that it becomes an integral part of the company. Typically, the primary objectives of a person who dreams of owning a business are to gain financial rewards by providing a product or service that makes life better for customers and to create jobs for employees. But, in recent years, more and more small businesses are being launched with the explicit purpose of addressing a social challenge or human need. Also, an increasing number of universities are offering courses and even full degree programs in social entrepreneurship. (The topic of social entrepreneurship will be examined in greater depth in Chapter 2.)

### INTRAPRENEURS

The term **intrapreneurship** describes a person who has characteristics similar to those of an entrepreneur, but who works within an existing, usually larger, corporation as an employee. This individual assumes responsibility for taking a new idea and converting it into a profitable product, service, or even process that enhances the company's profitability or efficiency. Thus, an intrapreneur mostly creates value for the company, rather than starting his or her own new business. The corporate employer, however, should create an incentive schedule that rewards the intrapreneur for initiating a new idea and assuming the associated risk if it fails.

A primary benefit for an intrapreneur is having access to corporate resources, combined with the economies of scale enjoyed by a large corporation. A drawback is that employees who exhibit an entrepreneurial spirit can become frustrated by the bureaucracy within large corporations, especially in an environment where other employees may sabotage the intrapreneur's plans. An intrapreneur may need to be given greater

#### franchisees

An entrepreneur whose power is limited by a contractual relationship with a franchising organization.

#### social entrepreneurship

Entrepreneurial activity whose goal is to find innovative solutions to social needs, problems, and opportunities.

#### intrapreneurship

A process within an existing corporation involving an employee who assumes the responsibility for taking a new idea and converting it into a profitable product, service, or a process.

freedom, even to the point of allowing the intrapreneur to function outside of the existing bureaucracy. For example, Guy Kawasaki tells about working for Steve Jobs in creating the Macintosh within Apple, Inc. Jobs placed the team building the Macintosh in a separate facility, apart from the rest of the company. The employees not involved with the Macintosh were not even allowed to enter the building where the work was being done.

## ENTREPRENEURIAL TEAMS

Our discussion thus far has focused on entrepreneurs who function as individuals, and this is frequently the case. However, **entrepreneurial teams** can be extremely beneficial, particularly in ventures of any substantial size or complexity. An entrepreneurial team consists of two or more individuals who combine their efforts to function in the capacity of entrepreneurs. In short, you cannot grow a business to any significant size without a team of managers with complementary skills. (The role of entrepreneurial teams is discussed in Chapter 8.)

### entrepreneurial teams

Two or more people who work together as entrepreneurs on one endeavor.

## 1-3 CAN A SMALL COMPANY REALLY COMPETE WITH BIG COMPANIES?

How is it that small entrepreneurial firms can hold their own and often gain an edge over successful, more powerful businesses? The answer lies in the ability of new and smaller firms to exploit opportunities. In general, if a business can make its product or service cheaper, faster, and better, then it can be competitive. Small companies—if well managed—are just as able as larger firms to develop strategies that offer a competitive advantage.

Let's look at some ways in which small firms can gain a competitive advantage. (In Chapter 3, we'll elaborate on strategies for exploiting these potential advantages.)



Identify how small businesses can compete against the giants.

### 1-3a Integrity and Responsibility

The starting point of any competitive advantage is having a commitment to integrity. Consistently operating with integrity can set a small business apart, with a reputation of being trustworthy. Above all else, the core values of the entrepreneur, as reflected in what she or he says and does, determine the culture within a business. Others will conduct business with a company only when they feel that they can trust its representatives. Trust is the foundation of all relationships, including those in business. Chapter 2 discusses the critical importance of integrity and its role in entrepreneurship.

### 1-3b Customer Focus

Small companies are particularly adept at competing when they commit to a strong customer focus. Good customer service can be provided by a business of any size. However, small businesses have a greater potential to achieve this goal than larger firms do. They have the advantage of being able to serve customers directly and effectively, avoiding the layers of bureaucracy and corporate policies that tend to stifle employee initiative. In many cases, customers are personally acquainted with the entrepreneur and other key people in a small business. (We will provide further discussion of this subject in Chapter 14.)

### 1-3c Quality Performance

A small business does not need to take a back seat to larger firms when it comes to achieving quality in operations. We frequently observe owners of small businesses whose operations not only equal the quality performance of larger firms, but also often surpass

it. As one example, Lance and Cecilia Levine, owners of MFI International Manufacturing in El Paso, Texas, have a passion for quality. As small business owners, they are able to insist on high levels of quality without experiencing the frustration of a large-company CEO who may have to push a quality philosophy through layers of bureaucracy. In Cecilia's words, "A small business owner should have no fears about being able to compete when it comes to quality. It just needs to be part of the business culture."<sup>6</sup>

### 1-3d Innovation

Innovation, both in products or services and in competitive strategies, is within the reach of the small business in ways that were not thought possible a few years ago. For one thing, access to technology has helped smaller firms compete. In many cases, it has clearly leveled the playing field with larger companies.

Research departments of big businesses tend to focus on improving existing products. Creative ideas may be sidetracked because they are not related to existing product lines or because they are unusual. In his book, *The Innovator's Dilemma*, Clayton Christensen, a professor at the Harvard Business School, documents how large, established companies have missed major transformations in many industries—computers (mainframes to PCs), telephones (landline to mobile), photography (film to digital), stock markets (floor trading to online trading), and many others.<sup>7</sup> For this reason, many large companies acquire or at least engage in a joint venture with small technological businesses.

### 1-3e Niche Markets

Almost all small businesses try to shield themselves from competition by targeting a specific group of customers who have an identifiable but very narrow range of product or service interests and comprise what is called a **niche market**. The niche might consist of a uniquely specialized product or service, or it might focus on serving a geographical area. Numerous small businesses are uniquely positioned to capture these markets.

It is interesting to note that most successful entrepreneurs are not overly concerned about their ability to compete with their larger counterparts. With few exceptions, large corporations are bureaucracies, with bureaucrats as managers. Consequently, large companies have difficulty creating effective incentives for employees so that they will think entrepreneurially. There is considerable evidence that most workers in today's huge corporations are simply not engaged in their work. The bottom line is that small companies with an entrepreneurial culture can compete and compete well.

#### niche market

A specific group of customers with an identifiable but narrow range of product or service interests.

## 1-4 MOTIVATIONS FOR OWNING A BUSINESS

Being an entrepreneur is extremely challenging. At times, you will be discouraged, maybe even terrified. Some days, you will wish you had opted for the security (or at least the perception of security) of a regular job in an established company.

So, before you decide to start a business, think carefully about the person you are and who you want to be, and how owning a business will help you become that person. Jeff Sandefer and Robert Sirico put it this way:<sup>8</sup>

*When you embark upon a heroic journey—a life filled with meaning and purpose—the first step is to heed the admonition inscribed over the entrance to the Oracle of Delphi in ancient Greece: "Know Thyself." Search out who you are, and then you will be equipped to discover your heroic calling."*

In short, it's vitally important that you understand your personal motivations before you get into the small business world—or any calling, for that matter.



Understand what might motivate you to be a small business owner with all its risks and uncertainties.



## 1-4a Types of Entrepreneurial Motivations

A Harris poll inquiring into the reasons entrepreneurs give for owning a company found the following:<sup>9</sup>

1. To improve financial well-being (73%).
2. To be the boss (41%).
3. To follow a passion (22%).

We would expand the list to four fundamental reasons for owning a company, which incorporate those listed in the Harris poll:

1. Personal fulfillment
2. Personal satisfaction
3. Independence
4. Financial rewards

These motivations, along with specific examples of each, are shown in Exhibit 1.2 and discussed in the following sections.

### PERSONAL FULFILLMENT

Owning a business should provide significant personal fulfillment. All other motivations will not be enough in the tough times—and those times are sure to come. Apple co-founder Steve Jobs said it well:<sup>10</sup>

*The only way to do great work is to love what you do. If you haven't found it yet, keep looking. Don't settle. As with all matters of the heart, you'll know when you find it.*

At the core, the primary reason for owning your own business should be to create a product or service that improves life for others. Only when your company is about

EXHIBIT

## 1.2 Entrepreneurial Motivations

