

GLOBAL  
EDITION



# Entrepreneurship

*Starting and Operating A Small Business*

FOURTH EDITION



Steve Mariotti • Caroline Glackin

ALWAYS LEARNING

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# **ENTREPRENEURSHIP:** STARTING & OPERATING A SMALL BUSINESS

Global Edition

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# **ENTREPRENEURSHIP:** **STARTING & OPERATING** **A SMALL BUSINESS**

Fourth Edition

Global Edition

Steve Mariotti • Caroline Glackin

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—*Steve Mariotti*

To my children, Elise and Spencer, whose support and love  
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To my parents, Howard and Maria Wiedenman,  
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of education. My love and gratitude.

—*Caroline Glackin*

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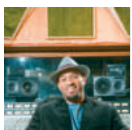
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## Preface

# Helping Students Own Their Future

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*Entrepreneurship: Starting and Operating a Small Business (ESOSB), Fourth Edition*, is the newest edition in a line of entrepreneurship textbooks written by Steve Mariotti, founder of the Network for Teaching Entrepreneurship (NFTE). Once again, it is written with professor and entrepreneur Caroline Glackin, and it promotes entrepreneurship as a career option for college students.

Business students, as well as those from other disciplines, can benefit from *ESOSB*. For business students, it recasts their prior learning from a typical corporate context and focuses it on small and entrepreneurial enterprises. For students in such fields as hospitality, the arts, engineering, and fashion merchandising, the text introduces key business concepts and provides examples from a broad range of careers. Cases from hospitality, technology, retail, manufacturing, distribution, real estate, finance, and not-for-profit organizations bring a wealth of learning opportunities. Most importantly, *ESOSB 4e* is a balanced mix of the academic and applied components of entrepreneurship education. Students are introduced to the theories, methods, and knowledge and skills required of entrepreneurs and are immediately given practical examples and discussion opportunities. Using the Application Exercises and Exploring Online features at the end of each chapter, they are encouraged to take this new knowledge and apply it in their own lives, so that the course materials are reinforced and internalized.

## Highlights of New Content and Changes

*Entrepreneurship: Starting and Operating a Small Business, Fourth Edition*, contains new content and some changes, including the following:

- Three new Chapter Openers include Mercedes, University Parent, and inDinero.
- Nine new short End-of-Chapter Case Studies: Urban Decay, Gat Creek Furniture, Gentle Rest Slumber, Dr. Farrah Gray, Happy Belly Curbside Kitchen, BNI, Gelato Fiasco, The Bun Company, and Anago Cleaning Systems.
- Seven new longer End-of-Chapter Case Studies: Foursquare, Empact, Amazon.com, Damon White Party Promotions, Airbnb, AYZH, and iContact.
- All new Unit Cases. These are more interesting and relatable for students and include: Spanx, Kitchen Arts & Letters, Inc., Lee's Ice Cream, ONLC Training Centers, and Honest Tea.
- Step into the Shoes, Entrepreneurial Wisdom, BizFacts, and Global Impact Features. These have been updated and expanded with 16 new featured items, including 12 Step into the Shoes and 4 Global Impact Features. Among the newly featured people and organizations are: Indeed.com, In-N-Out Burgers, Sweet dis(Solve), Twitter, ContextMedia, Mental Floss, Zhang Xin, P'Kolino, Jack Threads,

Rent the Runway, Tom's, Vostu, American Public University, and TechWorld These features connect chapter content to business facts and examples to reinforce learning.

- **Honest Tea Featured Business Plan.** From its early stage funding search, this example provides students with an interesting start-up plan for a company that is also featured in the Unit 5 case. This bookends the contents of the text.
- **Business Model Canvas.** The Osterwalder and Pigneur Business Model Canvas is introduced in Chapter 2 with the example of the University Parent Business Plan that is included in Appendix 1. Students are encouraged to develop a business model and to explore the Lean Startup process.
- **BizBuilder Business Plan Questions.** These have been modified to clarify the work and connect the content to student work using the business plan templates.
- **Chapter Learning Objectives.** The objectives have been revised to conform more fully to the categories of knowledge acquisition, comprehension, application, analysis, synthesis, and evaluation commonly assessed in higher education.

## Combining Street Smarts and Academic Smarts

*Entrepreneurship: Starting and Operating a Small Business, Fourth Edition*, is an extension of the academic programs developed by Steve Mariotti under the auspices of NFTE. Since 1987, NFTE has reached over 500,000 graduates and trained more than 5,000 teachers in 15 countries to impart its innovative entrepreneurship curriculum through its 17 U.S. sites and 8 international program partners. NFTE is widely viewed as a world leader in promoting entrepreneurial literacy and has a proven track record of helping young people start a great variety of successful ventures.

This textbook unites Steve Mariotti's experience with relevant academic theory and practice, supported by a rich variety of examples and stories. Caroline Glackin brings years of experience in the university classroom, as a lender to small and microbusinesses, and as an entrepreneur and small business owner. Together, these two authors have produced a text that is practical, useful, and academically strong.

## Organization

*Entrepreneurship: Starting and Operating a Small Business, Fourth Edition*, is organized to follow the life cycle of an entrepreneurial venture from concept through implementation into harvesting or replication. It is a comprehensive text written in light of the reality that college students often take only one course in entrepreneurship and the topic is covered in a multitude of ways. For instructors who will teach the course as a "business plan," *ESOSB 4e* offers step-by-step content to build a plan over a semester or a quarter. For those who focus on the management of small and entrepreneurial ventures, there is an abundance of high-quality material on the critical topics of management, human resources, marketing, and operations for such ventures. For those charged with teaching a comprehensive introductory course, all of the components are provided.

# Chapter Learning System

## Chapter Openers Set the Stage

Each chapter starts with an inspirational quote, an introduction, and Learning Objectives that provide a “road map” so readers know where they are headed. Readers connect with a story of a real business in the opening vignette that sets the stage for upcoming material.

# 1

## Entrepreneurs Recognize Opportunities

**Learning Objectives**

1. Summarize what entrepreneurs do.
2. Examine how free-enterprise economies work and how entrepreneurs fit into them.
3. Identify and evaluate opportunities to start your own business.
4. Explain how profit works as a signal to the entrepreneur.



Tom Skaly, TerraCycle

**“Everyone lives by selling something.”**  
—Robert Louis Stevenson, Scottish author

**Entrepreneurship**  
Have you ever eaten a Subway sandwich? Used an Apple device? Listened to music with Skullcandy headphones? The entrepreneurs that founded these companies brought these products into your world. Entrepreneurship is all around us.

**What is an Entrepreneur?**  
Most Americans earn money by working in business. They are somehow engaged in the buying and selling of products or services in order to earn money.

- A product is something that exists in nature or is made by human beings. It is tangible, meaning that it can be physically touched.
- A service is labor or expertise exchanged for money. It is intangible. It cannot physically be touched.

Someone who earns a living by working directly for someone else's business is an **employee** of that business. There are many roles for employees. At Ford Motor Company, for instance, some employees build the cars, some sell the cars, and some manage the company. But most employees have one thing in common—they do not own the business; they work for others who do. They know how much money they can earn, and that amount is limited to salary or wages, plus bonuses and any stock options they may receive.

People who have their own businesses work for themselves and are called **small business owners**, or **entrepreneurs**. Entrepreneurs are often both owners and employees. For an entrepreneur, the sky is the limit as far as earnings are concerned. Unlike an employee, an entrepreneur owns

product something tangible that exists in nature or is made by people.

service intangible work that provides time, skills, or expertise in exchange for money.

entrepreneur a person who recognizes an opportunity and organizes and manages a business, assuming the risk for the sake of potential return.

## “Step into the Shoes” of the Experts

Step into the Shoes features appear in each chapter and offer insight into the business practices of entrepreneurs and an opportunity to discuss the brief example. It brings the content to life with real-world application.


### Step into the Shoes . . .

#### Russell Simmons Makes Rap Happen

In the late 1980s, Russell Simmons was promoting rap concerts at the City University of New York. At the time, rap was considered a passing fad, but Simmons was passionate about it. Even though most record executives thought rap would be over in a year or two, Simmons believed it was a business opportunity. He formed Def Jam Records with fellow student Rick Rubin for \$5,000. Within a year, they produced hit records by Run DMC and LL Cool J, and Simmons went on to become a multimedia mogul.

Simmons took a chance on this opportunity because he felt that, if you personally know 10 people who are eager to buy your product or service, 10 million would be willing to buy it if they knew about it. He was right about rap's popular potential, perceived opportunities: You may be passionate about something, but there may not be enough consumer interest to sustain an actual business venture.

Simmons loved rap and hoped other people would, too. That was the internal factor—he had the passion to sustain himself as he worked relentlessly to make his dream come true. As it turned out, music fans at that time were looking for a fresh sound. Rap filled the bill. This was an external opportunity that coincided with Simmons's



## BizFacts

BizFacts impart useful information regarding entrepreneurship statistics, company practices, or business applications.

### BizFacts

- There are 27.3 million businesses in the United States; approximately 99.9 percent of them are small companies with fewer than 500 employees.
- Small businesses in America employed 49.2 percent of the country's private (nongovernment) workforce, hired 43 percent of high-tech workers, and created 64 percent of net new jobs annually over the last decade.
- Home-based businesses make up 52 percent and franchises 2 percent of all small firms.
- Small businesses represent 99.7 percent of all companies with employees.
- Small firms constituted 98 percent of all identified exporters and produced 33 percent of the country's known export value in fiscal year 2010.

Source: U.S. Small Business Administration, accessed March 9, 2014, <http://www.sba.gov>.

## Entrepreneurial Wisdom

Entrepreneurial Wisdom contains insights or advice that will help students in the preparation of a business plan or management of an enterprise.

### Entrepreneurial Wisdom . . .

A useful way to evaluate a business idea is to look at its strengths, weaknesses, opportunities, and threats (SWOT). This is called SWOT analysis.

- **Strengths**—All the capabilities and positive points the company has, from experience to contacts. These are internal to the organization.
- **Weaknesses**—All the negatives the company faces, such as lack of capital or training or failure to set up a

workable accounting system. These are internal to the organization.

- **Opportunities**—Any positive external events or circumstances that can help the entrepreneur get ahead of the competition.
- **Threats**—Any external factors, events, or circumstances that can harm the business, such as competitors, legal issues, or declining economies.

## Global Impact

Global Impact, featured in each chapter, provides examples of entrepreneurial ventures around the world or information that can be applied in global trade.

### Global Impact . . .

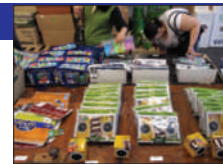
#### Upcycling Waste Internationally—TerraCycle, Inc.

In 2003, John Szaky's TerraCycle won a business plan contest from Carrot Capital for \$1 million in seed funding. But the venture capital firm wanted TerraCycle to drop its environmental focus, and Szaky turned down the offer. It was a critical decision that later helped the business achieve its competitive advantage.

TerraCycle converts unrecyclable packaging waste to upcycled products. An early inspiration was implemented when TerraCycle ran out of money to buy bottles in which to sell fertilizer derived from worm waste. It was decided to

a few examples of the more than one hundred TerraCycle products sold in large retail chains, including Home Depot, Whole Foods, Wal-Mart, and Target. The concept has spread to the United Kingdom, Brazil, Mexico, Israel, and Canada, among others.

By working with concerned groups in each country, TerraCycle has the potential of becoming an iconic representative of up-



Wu Kaixiang/Corbis Images

## Honest Tea Business Plan

This is the plan developed by founders Seth Goldman and Barry Nalebuff during Honest Tea's first year of operations. It appears following Chapter 2 and includes a comprehensive market analysis and detailed historical financials. The business raised over \$1 million at a time when sales were less than \$250,000 and the company had operating losses. The Honest Tea plan is an excellent example for students and one that many of them will understand, to some extent, as customers of bottled tea.



Business Plan for 1999  
December 1998  
4905 Del Ray Avenue, Suite 304  
Bethesda, Maryland 20814  
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Fax: 301-652-3557

E-mail: seth@honesttea.com

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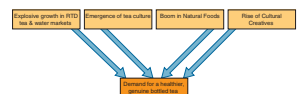
Our tea leaves are provided by internationally known companies that specialize in tea buying, blending and importation. Our primary source is Hilsen & Lyon of Germany, the largest specialty tea company in the world. Another, Assam Tea Traders, has direct tea to tea estates in the Assam District of Northern India. The other ingredients are commodities which are in plentiful supply.

As the Company grows in size, we anticipate dealing more directly with the tea growers. We intend to visit the tea estates so that we can verify that the labor conditions of the tea workers meet international standards and International Labor Organization conventions. We also expect to ensure that the tea is grown organically.

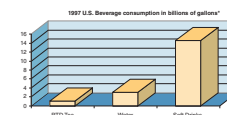
#### Market Opportunity

##### Beyond Snapple—The Emerging Market for Quality Bottled Tea

We have identified four market trends that are fueling demand for Honest Tea within the \$72 billion non-alcoholic liquid refreshment beverage market:



1. **Explosive growth in Ready-to-Drink (RTD) tea and bottled water markets**—Although carbonated soft drinks still dominate the beverage market, in the past two years Ready-to-Drink teas and bottled water have emerged as alternatives. Since 1992 the US tea market has enjoyed 40% annual growth, reaching sales of \$2 billion in 1996. The bottled water market has grown to \$2.4 billion, with most of the growth fueled by sales of single-serving bottles.



\*Based on Soft Drink Appearance from Beverage Marketing Inc. The RTD Tea figure is based on 1997 sales volume of \$2.4 billion, which equates to roughly one billion gallons.

2. **Beyond the tea bag—The emergence of tea culture**—Snapple and similar brands helped make tea accessible to a broader population. But now in the same way that gourmet coffees have become popular, consumers are beginning to develop an appreciation for fine tea. Over the last six years U.S. loose leaf tea sales have more than doubled, from \$1.8 billion

# End-of-Chapter Learning Portfolio

End-of-chapter materials help students demonstrate a working understanding of key concepts and develop critical-thinking skills.

All chapters include the following:

- **Key Terms** list.
- **Critical Thinking Exercises** that require students to consider important issues and support thoughtful responses.
- **Key Concept Questions** that review core topics.
- **Application Exercises** that give students a structured opportunity to reinforce chapter topics through experience.
- **Exploring Your Community** and **Exploring Online** assignments that invite students to go into their business communities or search online for information.
- **BizBuilder Business Plan Questions**, which guide students through the development of business plan components as they learn new information throughout the book.
- **Cases for Analysis**, including one short case and one longer case with analytical questions. Cases cover a variety of issues and draw on real business scenarios. Examples of businesses that may be familiar to students include Foursquare, Urban Decay, and Amazon .com. Other organizations that may be less familiar include Happy Belly Curbside Kitchen, Gelato Fiasco, Anago Cleaning Systems, and AYZH. These cases reflect a diverse set of entrepreneurs, industries, and geographic locations.

## Entrepreneurship Portfolio

### Critical Thinking Exercises

- 2-1. Shawn is creating a business that provides advertising on public restroom stall doors. He is funding the project from his personal savings of \$5,000 and does not expect to use any outside financing. Should he create a business plan? Why or why not?
- 2-2. Charly and Devon are planning to license technology from NASA that would make it impossible to accidentally lock a child in a car. The technology is complex, and the market analysis and financial assumptions take up a lot of pages. The two women have written a 68-page business plan. Explain your concerns about the plan in light of the chapter text.
- 2-3. What factors make the difference between a good business plan and an excellent one?
- 2-4. Visit an Internet shopping site, such as the Home Shopping Network (<http://www.HSN.com>) or QVC (<http://www.QVC.com>). Select five products for sale that you find interesting or unusual. Make a list of the products and your explanation of the market opportunities they reflect.
- 2-5. Explain how this statement applies to business plans: Errors of omission can sometimes be greater than errors of commission.

### Key Concept Questions

- 2-6. Explain why a prospective business founder might want to create a feasibility study or Business Model Canvas before developing a complete business plan.
- 2-7. How can spending time researching and writing a business plan save an entrepreneur time and money in the short and long term?
- 2-8. What are the parts of a Business Model Canvas? How can the entire canvas assist an entrepreneur?
- 2-9. Explain why the executive summary is the most important section of any business plan.
- 2-10. One mistake entrepreneurs make in their business plans is that of only including an income statement. What other financial statements should be incorporated and why?
- 2-11. Print an assignment, or any body of text, with 1-inch margins, double spaced, using 12-point Times New Roman. Then, print the same document with 0.8-inch margins, single spaced, using a 10-point Arial typeface. Which is easier to read? Why? How would this relate to a business plan?
- 2-12. Name three categories of investors/lenders that might have an interest in your business plan.
- 2-13. Why is it important to identify a business's culture from the beginning?

## Entrepreneurship Portfolio

### Critical Thinking Exercises

- 3-1. Use the following charts to define a business you would like to start, and analyze your competitive advantage.

Business Definition Question	Response
<b>The Offer:</b> What products and services will be sold by the business?	
<b>Target Market:</b> Which customer segments will the business focus on?	
<b>Production Capability:</b> How will that offer be produced and delivered to those customers?	
<b>Problem Solving:</b> What problem does the business solve for its customers?	
Competitive Advantage Questions	Competitive Difference (USP)
<b>The Offer:</b> What will be better and different about the products and services that will be sold?	
<b>Target Market:</b> Which segments of consumers should be the focus of the business to make it as successful as possible?	
<b>Production and Delivery Capability:</b> What will be better or different about the way the offer is produced and delivered to those customers?	

Attributes Important to Customers	Your Company		Competitor Number 1	Competitor Number 2	Competitor Number 3
	Weight (1-5)	Rating (1-7)	Weighted Rating (1-27)	Weighted Rating (1-27)	Weighted Rating (1-27)
Quality					
Price					
Location					
Selection					
Service					
Speed					
Turnaround					
Specialization					
Personalization					
Total	100				

# Additional Resources

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## Instructor Resources

At the Instructor Resource Center, [www.pearsonglobaleditions.com/Mariotti](http://www.pearsonglobaleditions.com/Mariotti), instructors can easily register to gain access to a variety of instructor resources available with this text in downloadable format. If assistance is needed, our dedicated technical support team is ready to help with the media supplements that accompany this text. Visit <http://247.pearsoned.com> for answers to frequently asked questions and toll-free user support phone numbers.

The following supplements are available with this text:

- Instructor's Resource Manual
- Test Bank
- TestGen® Computerized Test Bank
- PowerPoint Presentations

## Student Resources

### BizBuilder Business Plan Worksheets and Templates Online

Go to [www.pearsonglobaleditions.com/Mariotti](http://www.pearsonglobaleditions.com/Mariotti) to download business plan and presentation templates that will help students write a plan and present it.

- **BizBuilder Business Plan Worksheets** provide step-by-step instructions on building a business plan. The MS Word document contains a comprehensive set of questions and tables organized by business plan section. The Excel document includes Start-Up Costs, Sales Projections, Income Statement, Balance Sheet, Cash Flow, and Ratio Analysis worksheets.
- **BizBuilder Business Plan Template** provides a professional-looking format for a business plan that ties in with assignments in the text.
- **BizBuilder Business Plan Presentation Template** guides the student through the process of creating a PowerPoint presentation for a business plan.

Students can build their business plans using the BizBuilder worksheets. Appendix 2 provides students with instructions on how to use the worksheets that mirror the planning process in the book and contains more questions in some areas than are found in commercially available planning software. Once they have created a plan using the worksheets, students can generate a professional-looking document using the BizBuilder Business Plan Template.

## LivePlan

Through a partnership with Palo Alto Software, we're able to provide 6-month access to LivePlan at a reduced rate with the purchase of a textbook. LivePlan simplifies business planning, budgeting, forecasting, and performance tracking for small businesses and startups. Set business goals, compare performance to industry benchmarks, and see all your key numbers in an easy-to-use dashboard so you know exactly what's going on in your business. To order LivePlan with the textbook, use package ISBN 0134072073.



# About the Authors

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**STEVE MARIOTTI**, founder of the Network for Teaching Entrepreneurship (NFTE), is considered one of today's leading experts in education for at-risk youth. In 1982, he changed career paths when he decided to leave the corporate sector and become a special education teacher in the New York City public school system.

Mariotti's first assignment was in the East New York section of Brooklyn, and his last was in the Fort Apache section of the South Bronx. During his six-and-a-half years teaching, Mariotti discovered he could successfully motivate even his most challenging students by teaching them how to run a business. This experience inspired him to create a new kind of program—the first to bring entrepreneurial education to low-income youth.

In 1987, Mariotti founded The Network for Teaching Entrepreneurship (NFTE). Today, NFTE's mission is to provide entrepreneurship education programs to young people from low-income communities around the world. NFTE's programs have a proven track record of success, and the network is widely viewed as the thought leader in the field. NFTE is an active member of the Council on Foreign Relations. In 2013, Mariotti traveled to Southeast Asia as a guest of the U.S. State Department on a mission to spread entrepreneurial education to youth from emerging economies in the region.

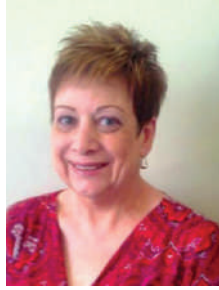
Mariotti was recently nominated for a Pulitzer Prize for his work chronicling the lives of entrepreneurs worldwide for *The Huffington Post* and for a Nobel Peace Prize for his pioneering work in entrepreneurial education. A life-long advocate for low-income students, Mariotti is the recipient of numerous awards including:

- Ernst & Young Entrepreneur of the Year Award
- Bernard A. Goldhirsh Social Entrepreneur of the Year Award
- National Director's Entrepreneurship Award from the Minority Business Development Agency of the U.S. Department of Commerce
- Association of Education Publishers' Golden Lamp Award
- ACE/Currie Foundation Humanitarian Venture Award
- America's Top High School Business Teacher

In addition, Mariotti has been the subject of many national media profiles on such programs as *ABC Evening News* and *20/20*.

He has authored and coauthored 34 books and workbooks on entrepreneurship, selling over 10 million worldwide and distributing many more copies for free to at-risk communities, including prisons. His popular book *The Young Entrepreneur's Guide to Starting and Running a Small Business* has recently been published in a new edition by Random House and is used to teach entrepreneurship from the United States to China, India, and the Middle East. Mariotti is a regular attendee and speaker at The World Economic Forum.

Raised in Flint, Michigan, Mariotti received his B.B.A. in business economics and his M.B.A. from the University of Michigan, Ann Arbor. He has also studied at Harvard University, Stanford University, and Brooklyn College. He started his professional career as a treasury analyst for Ford Motor Company before founding his own company, Mason Import/Export Services.



**CAROLINE GLACKIN, Ph.D.**, is a “pracademic” who has successfully worked as a microenterprise and small business owner and manager, as an executive director of a community development financial institution, and as an academic in areas of community development finance, entrepreneurship, and management. She is the Edward L. Snyder Endowed Chair for Business at Shepherd University in West Virginia. She has been assisting entrepreneurs in achieving their dreams for over 30 years.

Glackin earned a doctorate from the University of Delaware, where her research emphasis was on microfinance. She received an M.B.A. from The Wharton School at the University of Pennsylvania and a B.A. from Bryn Mawr College. Her professional career began with the DuPont Company, American Bell, Bell Atlantic, and American Management Systems. She has consulted for businesses and not-for-profit agencies in turn-around and high-growth situations. After exiting a family business, she became the executive director of a community development financial institution serving businesses and not-for-profits.

Dr. Glackin has succeeded in leading change in the practical fields of her research and has received numerous honors and awards. These include the first Gloeckner Business Plan Award at The Wharton School, the Minority Business Advocate of the Year for Delaware from the U.S. Small Business Administration, and the She Knows Where She’s Going Award from Girls Inc. Dr. Glackin cochaired the Delaware Governor’s Task Force for Financial Independence. She has participated in the Cornell University Emerging Markets Think Tank Series and has presented her research and pedagogy at numerous professional conferences.

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*Steve Mariotti*

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*Caroline Glackin*

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# Entrepreneurs Recognize Opportunities

## Learning Objectives

1. Summarize what entrepreneurs do.
2. Examine how free-enterprise economies work and how entrepreneurs fit into them.
3. Identify and evaluate opportunities to start your own business.
4. Explain how profit works as a signal to the entrepreneur.



Tom Szaky, Terracycle.  
(Paul Zimmerman/  
Getty Images)



**“Everyone lives by selling something.”**

—Robert Louis Stevenson, Scottish author

**T**om Szaky was a 20-year-old college student in need of inspiration for a business plan competition, when he happened to visit friends who were using red worms to compost waste that they then used as plant fertilizer. The idea captured his imagination, and he created a business plan for an environmentally friendly company that would convert trash into fertilizer. Although he finished in fifth place in the competition, Szaky moved ahead to make the company a viable venture.<sup>1</sup>

TerraCycle Inc. has expanded its product lines to encompass a wide range of recycling and upcycling, including branded products for Target and Kraft Foods. The company is the producer of the world’s first product made from and packed in recycled waste: fertilizer generated from waste. Szaky sells to some of the world’s largest retailers, including Wal-Mart, Target, and Home Depot, and oversees programs that involve entire communities in recycling projects. Sales exceed \$20 million per year, and the company has collected literally billions of discarded items. TerraCycle plant food was twice named the most eco-friendly product in Home Depot. Tom Szaky and TerraCycle have turned waste into treasure.

## Entrepreneurship

Have you ever eaten a Subway sandwich? Used an Apple device? Listened to music with Skullcandy headphones? The entrepreneurs that founded these companies brought these products into your world. Entrepreneurship is all around us.

### What Is an Entrepreneur?

Most Americans earn money by working in *business*. They are somehow engaged in the buying and selling of products or services in order to earn money.

**product** something tangible that exists in nature or is made by people.

**service** intangible work that provides time, skills, or expertise in exchange for money.

**entrepreneur** a person who recognizes an opportunity and organizes and manages a business, assuming the risk for the sake of potential return.

- A **product** is something that exists in nature or is made by human beings. It is *tangible*, meaning that it can be physically touched.
- A **service** is labor or expertise exchanged for money. It is *intangible*. It cannot physically be touched.

Someone who earns a living by working directly for someone else’s business is an *employee* of that business. There are many roles for employees. At Ford Motor Company, for instance, some employees build the cars, some sell the cars, and some manage the company. But most employees have one thing in common—they do not *own* the business; they work for others who do. They know how much money they can earn, and that amount is limited to salary or wages, plus bonuses and any stock options they may receive.

People who have their own businesses work for themselves and are called small business owners, or **entrepreneurs**. Entrepreneurs are often both owners and employees. For an entrepreneur, the sky is the limit as far as earnings are concerned. Unlike an employee, an entrepreneur owns

<sup>1</sup>TerraCycle Inc., accessed March 9, 2014, <http://www.terracycle.net>.

**Learning Objective 1**

Summarize what entrepreneurs do.



the profit that his or her business earns, and may choose to reinvest it in the business or take it as payment.

An entrepreneur is someone who recognizes an opportunity to start a business that other people may not have noticed and acts on it. As economist Jeffrey A. Timmons wrote in the preface of *New Venture Creation: Entrepreneurship for the 21st Century*, “A skillful entrepreneur can shape and create an opportunity where others see little or nothing—or see it too early or too late.”<sup>2</sup>

The French word *entrepreneur* began to take on its present-day meaning in the seventeenth century. It was used to describe someone who undertook any project that entailed risk—military, legal, or political, as well as economic. Eventually, it came to mean someone who started a new business venture—often of a new kind or a new (or improved) way of doing business. French economist Jean-Baptiste Say wrote at the turn of the nineteenth century:

An entrepreneur is an economic agent who unites all means of production—the land of one, the labor of another and the capital of yet another, and thus produces a product. By selling the product in the market he pays rent on land, wages to labor, interest on capital and what remains is his profit. He shifts economic resources out of an area of lower and into an area of higher productivity and greater yield.<sup>3</sup>

Say argued that entrepreneurs “added value to scarce resources.” Coal is a resource because it is used as fuel. Wood is a resource because it can be used to build a house or a table, to make paper, or to burn as fuel. Economists consider *scarce* all resources that are worth money, regardless of their relative availability.

Debbi Fields, founder of Mrs. Fields Cookies, took resources—eggs, butter, flour, sugar, chocolate chips—and turned them into cookies. People liked what she did with those resources so much that they were willing to pay her more for the cookies than it cost her to buy the resources to make them. She *added value* to the resources she purchased by what she did with them and created a multimillion-dollar business in the process.

Entrepreneurs may have different reasons to start and continue their businesses, but they share the common focus of capturing sustained value. Entrepreneurs seek opportunities that they envision as generators of incremental income, or *wealth*. Whether the business is intended to meet short-term household cash needs or to grow into a publicly traded company, viability is critical. Each activity of the firm should be driven by this need.

**free-enterprise**

**system** economic system in which businesses are privately owned and operate relatively free of government interference.

**capitalism** the free-market system, characterized by individuals and companies competing for economic gains, ownership of private property and wealth, and price determination through free-market forces.

**Learning Objective 2**

Examine how free-enterprise economies work and how entrepreneurs fit into them.



## The Free-Enterprise System

An economy is the wealth and resources of a country or region, including its financial structure. The economy of the United States is a **free-enterprise system** because it is characterized by private (rather than governmental) ownership of capital assets and goods; anyone is free to start a business. Americans do not have to get permission from the government to go into business, although they are expected to obey laws and regulations.

The free-market system, which is also called **capitalism**, typifies the following attributes:

- Individuals and companies may compete for their own economic gains.

<sup>2</sup>Jeffrey A. Timmons, *New Venture Creation: Entrepreneurship for the 21st Century*. McGraw-Hill

<sup>3</sup>Jean-Baptiste Say, *A treatise on political economy; or the production distribution and consumption of wealth (Traité d'économie politique ou simple exposition de la manière dont se forment, se distribuent et se composent les richesses)*, C. R. Prinsep, trans. [slightly modified] and Clement C. Biddle., ed. (Philadelphia: Lippincott, Grambo & Co., 1855). Library of Economics and Liberty, accessed June 26, 2013, <http://www.econlib.org/library/Say/sayT.html>.

- Private wealth and property ownership are permissible.
- Free-market forces primarily determine prices.

Cash or goods invested to generate income and wealth is called **capital**; in a free-enterprise system anyone who possesses or can raise the necessary capital may start a business.

**capital** money or property owned or used in business.

## Voluntary Exchange

The free-enterprise system is also sometimes referred to as a private enterprise free-trade system because it is based on **voluntary exchange**. Voluntary exchange is a transaction between two parties who agree to trade money for a product or service. Each wishes to take advantage of what the trade offers. The parties agree to the exchange because each will benefit.

For example, José has a construction business, and his neighbors hire him to renovate their kitchen. He wants to earn money and is willing to use his skills and time to do so. The neighbors are willing to give him money to get the renovation done. They each have something the other wants, so they are willing to trade. A satisfactory exchange only takes place when both parties believe they will benefit.

**voluntary exchange** a transaction between two parties who agree to trade money for a product or service.

## Benefits and Challenges of Free Enterprise

The public benefits from living in a free-enterprise system because it discourages entrepreneurs who waste resources by driving them out of business. It encourages entrepreneurs to use resources to satisfy consumer needs efficiently by rewarding them with profit and wealth.

Where entrepreneurs are free to trade voluntarily to as large a market as possible, their ability to find customers to buy their goods or services increases, as well as their overall ability to meet customer needs. Meanwhile, the Internet has made it much easier for businesses to sell to clients all over the world. Shipping, too, has become much faster and less expensive.

Society in general benefits because free enterprise encourages competition between entrepreneurs. Someone who can make cookies that taste as good as Mrs. Fields Original Cookies and sell them at a lower price would eventually attract the company's customers. This would force Mrs. Fields to lower prices to stay competitive, or the company would go out of business. Consumers would benefit because they would get to buy the same-quality cookie at a lower price.

## Global Impact . . .

### Free Trade

For much of recorded history, international trade was difficult and hazardous. To sell products in another country often required long and dangerous journeys overland or by ship. Many countries were closed to outside trade. Governments also used their power to give their own businesspeople competitive advantages over those from other countries by establishing trade barriers, such as imposing taxes (tariffs) on foreign goods that made them very expensive. Governments could also enforce restrictions on how many imports or exports could cross their borders.

Today, trade barriers have fallen in many parts of the world. The North American Free Trade Agreement (NAFTA) of 1994 eliminated trade barriers between the United States, Mexico, and Canada. This turned the entire continent into a free-trade zone. The General Agreement on Tariffs and Trade (GATT) cut or eliminated tariffs between 117 countries. This evolved into the World Trade Organization, which has 159 members.

On the flip side, free enterprise has some disadvantages. If a company fails, its employees are out of work. Owners who have invested their financial resources in the business lose money. Other companies or individuals that depended on the products and services of the failed business themselves lose customers or suppliers.

## What Is a Small Business?

Many people think of business only in terms of “big” businesses—companies such as Apple, Wal-Mart, Microsoft, General Motors, and Berkshire Hathaway. However, the vast majority of businesses are small businesses. A small business is defined by the U.S. Small Business Administration’s Office of Advocacy as having fewer than 500 employees and selling less than \$5 million worth of products or services annually. A neighborhood restaurant, a mattress manufacturer, a technology research company, and a clothing boutique can all be examples of a small business; even a leading local employer may be classified as “small” under this definition.

The core principles involved in running a large company—like Microsoft—and a corner deli are the same. However, the operations of a small business are not the same as those of a large one. Most multimillion-dollar businesses started out as small, entrepreneurial ventures. This is why entrepreneurship is often called the engine of an economy. It drives economic creativity, giving rise to wealth and jobs and improving the standard of living.

## Definitions of Success—Monetary and Other

The Millennial Generation (born between 1977 and 1995) has redefined success. It is more individualized than the traditional concept and based on factors beyond those of income and wealth. Business owners may start an enterprise to create a more environmentally friendly approach to a product or process, to provide jobs for a disadvantaged population, or to improve the mental or physical health of themselves or others. For these entrepreneurs, success might be measured by the ability to have an impact on the population they serve. Or, success may mean working to provide a lifestyle that permits a shortened work week or telecommuting. Recognition from peers and others could also be a goal. Financial success may be just one of many measures of achievement for an entrepreneur.

Starting a business is an opportunity, and like any opportunity, it should be evaluated by taking a careful look at all aspects of it. One thing

### BizFacts

- There are 27.3 million businesses in the United States; approximately 99.9 percent of them are small companies with fewer than 500 employees.
- Small businesses in America employed 49.2 percent of the country’s private (nongovernment) workforce, hired 43 percent of high-tech workers, and created 64 percent of net new jobs annually over the last decade.
- Home-based businesses make up 52 percent and franchises 2 percent of all small firms.
- Small businesses represent 99.7 percent of all companies with employees.
- Small firms constituted 98 percent of all identified exporters and produced 33 percent of the country’s known export value in fiscal year 2010.

Source: U.S. Small Business Administration, accessed March 9, 2014, <http://www.sba.gov>.