ENTRE PRE NEUR SHIP

5TH ASIA-PACIFIC EDITION

CENGAGE

Entrepreneurship: Theory/Process/Practice
5th Edition
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First edition published in 2006
Second edition published in 2010
Third edition published in 2013
Fourth edition published in 2016

Acknowledgements
Graphic used beside certain box heads throughout: Getty Images Plus/iStock/Yevhenii Dubinko

Adapted from Kuratko, Entrepreneurship 10e, © 2017, Cengage Learning.

National Library of Australia Cataloguing-in-Publication Data
Creator: Howard Frederick, author
Title: Entrepreneurship: Theory/Process/Practice/Howard Frederick/Allan O'Connor/Donald F. Kuratko (author).
Edition: 5th Asia-Pacific edition
ISBN: 9780170411752 (paperback)
Notes: Includes index.
Other Creators/Contributors:
Allan O'Connor/Donald F. Kuratko (author).

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Printed in China by China Translation & Printing Services.
1 2 3 4 5 6 7 22 21 20 19 18

ENTRE PRE NEUR SHIP

THEORY / PROCESS / PRACTICE

5TH ASIA-PACIFIC EDITION

FREDERICK / O'CONNOR / KURATKO

BRIEF CONTENTS

CONTENTS

Guide to the text

As you read this text you will find a number of features in every chapter to enhance your study of Entrepreneurship and help you understand how the theory is applied in the real world.

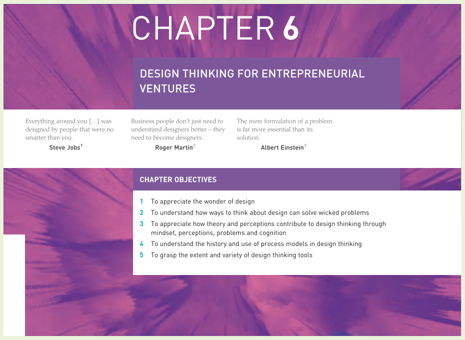
PART OPENING FEATURES

Chapter list outlines the chapters contained in each part for easy reference.

CHAPTER OPENING FEATURES

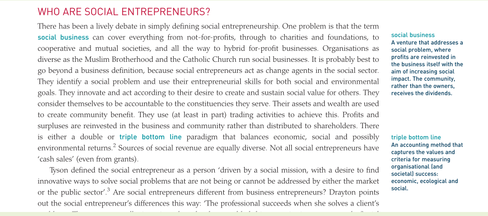
Gain an insight into the thoughts and ideas of famous entrepreneurs and public figures through the **Chapter opening quotes**.

Identify the key concepts that the chapter will cover with the **Chapter objectives** at the start of each chapter.



FEATURES WITHIN CHAPTERS

When you see **Key terms** marked in bold, study the **Margin definition** to learn important vocabulary for your profession. See the **Glossary** at the back of the book for a full list of key terms and definitions.


WHO ARE SOCIAL ENTREPRENEURS?

There has been a lively debate in simply defining social entrepreneurship. One problem is that the term **social business** can cover everything from not-for-profits, through to charities and foundations, to cooperative and mutual societies, and all the way to hybrid for-profit businesses. Organisations as diverse as the Muslim Brotherhood and the Catholic Church run social businesses. It is probably best to go beyond a business definition, because social entrepreneurs act as change agents in the social sector. They identify a social problem and use their entrepreneurial skills for both social and environmental goals. They innovate and act according to their desire to create and sustain social value for others. They consider themselves to be accountable to the constituencies they serve. Their assets and wealth are used to create community benefit. They use (at least in part) trading activities to achieve this. Profits and surpluses are reinvested in the business and community rather than distributed to shareholders. There is either a double or **triple bottom line** paradigm that balances economic, social and possibly environmental returns.[2] Sources of social revenue are equally diverse. Not all social entrepreneurs have 'cash sales' (even from grants).

Tyson defined the social entrepreneur as a person 'driven by a social mission, with a desire to find innovative ways to solve social problems that are not being or cannot be addressed by either the market or the public sector'.[3] Are social entrepreneurs different from business entrepreneurs? Drayton points out the social entrepreneur's differences this way: 'The professional succeeds when she solves a client's

social business
A venture that addresses a social problem, where profits are reinvested in the business itself with the aim of increasing social impact. The community, rather than the owners, receives the dividends.

triple bottom line
An accounting method that captures the values and criteria for measuring organisational (and societal) success: economic, ecological and social.

In every chapter, **Entrepreneurship in practice** boxes share tips, insights and interesting facts about entrepreneurship.

ENTREPRENEURSHIP IN PRACTICE

ARE YOU CUT OUT TO BE AN ENTREPRENEUR?

Not everyone is cut out to be an entrepreneur, and with more than 30 per cent of small businesses failing in their start-up, it's worth checking out the traits that characterise some success stories before you start a business.

One of Australia's best-known entrepreneurs is Naomi Simson, founder of online gift retailer RedBalloon (www.redballoon.com.au). She is often asked what character traits are needed to succeed in business.

'I usually defer to businessman and entrepreneur Jack Cowin, who puts it better than I ever could,' Simson says. 'I saw Jack present at the EY Entrepreneurs workshop, where he opened with the quote "an entrepreneur needs to be a cross between a microbiologist and an astronomer." He believes that true entrepreneurs are special in that they can be both detailed and visionary.'

Simson says great entrepreneurs are curious, persistent, in search of better ways to do things, endlessly positive and focused, and have exemplary people skills. While entrepreneurs can be born with these traits, she says some can also be learned.

'Curiosity and positivity are hard things to teach – you either have them or you don't,' she says. 'But characteristics like focus and persistence can be learned, and need to be – without them you're unlikely to make it as an entrepreneur or business owner.'

Simson attributes the success of her own business to tenacity and hard work. 'It was almost three months before RedBalloon made its first sale,' she says. 'People used to ask me "when [are] you going to give up?" but the thought never crossed my mind. I never, ever thought that it would not work and I never contemplated throwing in the towel.'

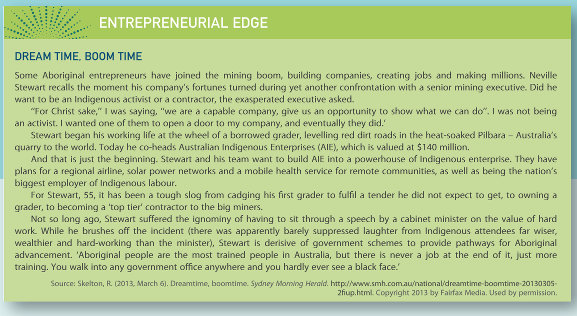
Australia's tall poppy syndrome can be a factor in potentially successful entrepreneurs falling by the wayside. Simson says entrepreneurs can be derided if they get 'above their post', take a risk and fail.

'This is not very productive in a country that needs strong, decisive leaders more than ever,' she says. 'As entrepreneurs – anywhere in the world – we often have trouble imagining failure in the first place. But that doesn't mean failing is a bad thing. Failure is very much a reality of being an entrepreneur – we take risks and sometimes those risks don't pay off.'

Source: Bryant, G. (2013, 5 August). Are you cut out to be an entrepreneur? *The Age, My Small Business*. Copyright 2013 by Fairfax Media. Used by permission.

ENTREPRENEURSHIP IN PRACTICE

Entrepreneurial edge boxes appear throughout, featuring the stories of real-life entrepreneurs and companies to illustrate the conceptual material covered in each chapter.


ENTREPRENEURIAL EDGE

DREAM TIME, BOOM TIME

Some Aboriginal entrepreneurs have joined the mining boom, building companies, creating jobs and making millions. Neville Stewart recalls the moment his company's fortunes turned during yet another confrontation with a senior mining executive. Did he want to be an Indigenous activist or a contractor, the exasperated executive asked.

''For Christ sake,'' I was saying, ''we are a capable company, give us an opportunity to show what we can do''. I was not being an activist. I wanted one of them to open a door to my company, and eventually they did.'

Stewart began his working life at the wheel of a borrowed grader, levelling red dirt roads in the heat-soaked Pilbara – Australia's quarry to the world. Today he co-heads Australian Indigenous Enterprises (AIE), which is valued at $140 million.

And that is just the beginning. Stewart and his team want to build AIE into a powerhouse of Indigenous enterprise. They have plans for a regional airline, solar power networks and a mobile health service for remote communities, as well as being the nation's biggest employer of Indigenous labour.

For Stewart, 55, it has been a tough slog from cadging his first grader to fulfil a tender he did not expect to get, to owning a grader, to becoming a 'top tier' contractor to the big miners.

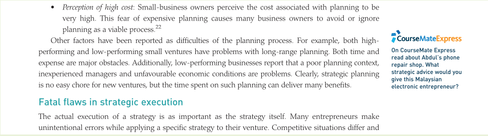
Not so long ago, Stewart suffered the ignominy of having to sit through a speech by a cabinet minister on the value of hard work. While he brushes off the incident (there was apparently barely suppressed laughter from Indigenous attendees far wiser, wealthier and hard-working than the minister), Stewart is derisive of government schemes to provide pathways for Aboriginal advancement. 'Aboriginal people are the most trained people in Australia, but there is never a job at the end of it, just more training. You walk into any government office anywhere and you hardly ever see a black face.'

Source: Skelton, R. (2013, March 6). Dreamtime, boomtime. *Sydney Morning Herald*. http://www.smh.com.au/national/dreamtime-boomtime-20130305-2fiup.html. Copyright 2013 by Fairfax Media. Used by permission.

ENTREPRENEURIAL EDGE

ICONS

Explore the online resources by following the **CourseMate Express** margin icons throughout the text. Find additional activities, quizzes and more!


• *Perception of high cost*: Small-business owners perceive the cost associated with planning to be very high. This fear of expensive planning causes many business owners to avoid or ignore planning as a viable process.[22]

Other factors have been reported as difficulties of the planning process. For example, both high-performing and low-performing small ventures have problems with long-range planning. Both time and expense are major obstacles. Additionally, low-performing businesses report that a poor planning context, inexperienced managers and unfavourable economic conditions are problems. Clearly, strategic planning is no easy chore for new ventures, but the time spent on such planning can deliver many benefits.

CourseMateExpress

On CourseMate Express read about Abdul's phone repair shop. What strategic advice would you give this Malaysian electronic entrepreneur?

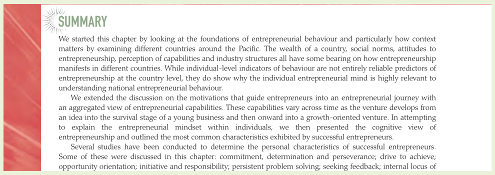
Fatal flaws in strategic execution

The actual execution of a strategy is as important as the strategy itself. Many entrepreneurs make unintentional errors while applying a specific strategy to their venture. Competitive situations differ and

END-OF-CHAPTER FEATURES

At the end of each chapter you will find several tools to help you to review, practise and extend your knowledge of the key learning objectives.

Review your understanding of the key chapter topics with the **Summary** and **Key terms & concepts**.


SUMMARY

We started this chapter by looking at the foundations of entrepreneurial behaviour and particularly how context matters by examining different countries around the Pacific. The wealth of a country, social norms, attitudes to entrepreneurship, perception of capabilities and industry structures all have some bearing on how entrepreneurship manifests in different countries. While individual-level indicators of behaviour are not entirely reliable predictors of entrepreneurship at the country level, they do show why the individual entrepreneurial mind is highly relevant to understanding national entrepreneurial behaviour.

We extended the discussion on the motivations that guide entrepreneurs into an entrepreneurial journey with an aggregated view of entrepreneurial capabilities. These capabilities vary across time as the venture develops from an idea into the survival stage of a young business and then onward into a growth-oriented venture. In attempting to explain the entrepreneurial mindset within individuals, we then presented the cognitive view of entrepreneurship and outlined the most common characteristics exhibited by successful entrepreneurs.

Several studies have been conducted to determine the personal characteristics of successful entrepreneurs. Some of these were discussed in this chapter: commitment, determination and perseverance; drive to achieve; opportunity orientation; initiative and responsibility; persistent problem solving; seeking feedback; internal locus of


KEY TERMS & CONCEPTS

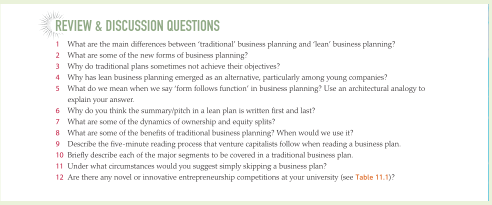
CourseMateExpress

Review key terms with interactive flashcards.

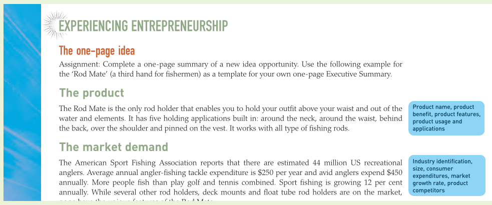
bankruptcy
calculated risk taking
career risk
cognition
corporate entrepreneurship
corporate venturing
dark side of entrepreneurship
drive to achieve
entrepreneurial behaviour
entrepreneurial capabilities
entrepreneurial career
entrepreneurial characteristics
entrepreneurial cognition
entrepreneurial leadership
entrepreneurial motivation
entrepreneurial persistence
entrepreneurial stress
entrepreneurial team
external optimism
family and social risk
financial risk
goal orientation
internal locus of control
intracapital
intrapreneurship
intraprise
need to achieve
need to control
new-venture development
opportunity-driven
opportunity orientation
opportunity propensity
psychic risk
risk propensity
self-efficacy
social cognition theory
strategic renewal
succession plan
tolerance for ambiguity

Review and discussion questions enable you to test your comprehension of the key concepts in the chapter and encourage group discussion.

Experiencing entrepreneurship activities emphasise learning by doing, giving you the opportunity to put your new skills into practice.


REVIEW & DISCUSSION QUESTIONS

1 What are the main differences between 'traditional' business planning and 'lean' business planning?
2 What are some of the new forms of business planning?
3 Why do traditional plans sometimes not achieve their objectives?
4 Why has lean business planning emerged as an alternative, particularly among young companies?
5 What do we mean when we say 'form follows function' in business planning? Use an architectural analogy to explain your answer.
6 Why do you think the summary/pitch in a lean plan is written first and last?
7 What are some of the dynamics of ownership and equity splits?
8 What are some of the benefits of traditional business planning? When would we use it?
9 Describe the five-minute reading process that venture capitalists follow when reading a business plan.
10 Briefly describe each of the major segments to be covered in a traditional business plan.
11 Under what circumstances would you suggest simply skipping a business plan?
12 Are there any novel or innovative entrepreneurship competitions at your university (see Table 11.1)?


EXPERIENCING ENTREPRENEURSHIP

The one-page idea

Assignment: Complete a one-page summary of a new idea opportunity. Use the following example for the 'Rod Mate' (a third hand for fishermen) as a template for your own one-page Executive Summary.

The product

The Rod Mate is the only rod holder that enables you to hold your outfit above your waist and out of the water and elements. It has five holding applications built in: around the neck, around the waist, behind the back, over the shoulder and pinned on the vest. It works with all type of fishing rods.

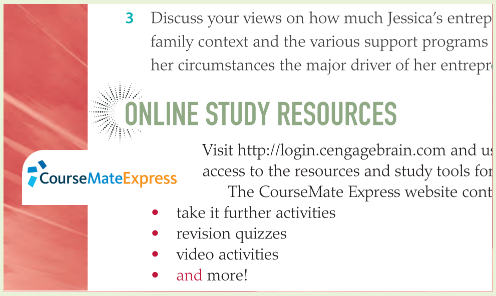
Product name, product benefit, product features, product usage and applications

The market demand

The American Sport Fishing Association reports that there are estimated 44 million US recreational anglers. Average annual angler-fishing tackle expenditure is $250 per year and avid anglers expend $450 annually. More people fish than play golf and tennis combined. Sport fishing is growing 12 per cent annually. While several other rod holders, deck mounts and float tube rod holders are on the market,

Industry identification, size, consumer expenditures, market growth rate, product competitors

Online study resources help extend your understanding of the key points through wider research using CourseMate Express.


3 Discuss your views on how much Jessica's entrep family context and the various support programs her circumstances the major driver of her entrepr

ONLINE STUDY RESOURCES

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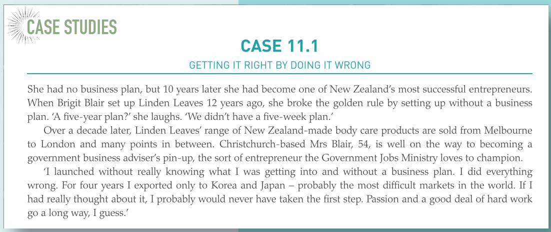
Visit http://login.cengagebrain.com and us access to the resources and study tools for

The CourseMate Express website cont

• take it further activities
• revision quizzes
• video activities
• and more!

CASE STUDIES

End of Chapter Case studies present issues in context, encouraging you to integrate and apply the concepts discussed in the chapter to the workplace, then analyse each case in-depth with related **questions.**



CASE STUDIES

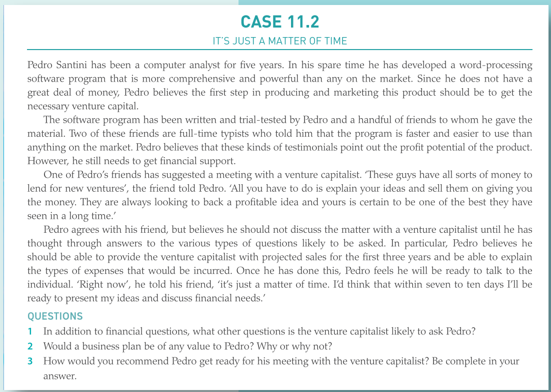
CASE 11.1

GETTING IT RIGHT BY DOING IT WRONG

She had no business plan, but 10 years later she had become one of New Zealand's most successful entrepreneurs. When Brigit Blair set up Linden Leaves 12 years ago, she broke the golden rule by setting up without a business plan. 'A five-year plan?' she laughs. 'We didn't have a five-week plan.'

Over a decade later, Linden Leaves' range of New Zealand-made body care products are sold from Melbourne to London and many points in between. Christchurch-based Mrs Blair, 54, is well on the way to becoming a government business adviser's pin-up, the sort of entrepreneur the Government Jobs Ministry loves to champion.

'I launched without really knowing what I was getting into and without a business plan. I did everything wrong. For four years I exported only to Korea and Japan – probably the most difficult markets in the world. If I had really thought about it, I probably would never have taken the first step. Passion and a good deal of hard work go a long way, I guess.'



CASE 11.2

IT'S JUST A MATTER OF TIME

Pedro Santini has been a computer analyst for five years. In his spare time he has developed a word-processing software program that is more comprehensive and powerful than any on the market. Since he does not have a great deal of money, Pedro believes the first step in producing and marketing this product should be to get the necessary venture capital.

The software program has been written and trial-tested by Pedro and a handful of friends to whom he gave the material. Two of these friends are full-time typists who told him that the program is faster and easier to use than anything on the market. Pedro believes that these kinds of testimonials point out the profit potential of the product. However, he still needs to get financial support.

One of Pedro's friends has suggested a meeting with a venture capitalist. 'These guys have all sorts of money to lend for new ventures', the friend told Pedro. 'All you have to do is explain your ideas and sell them on giving you the money. They are always looking to back a profitable idea and yours is certain to be one of the best they have seen in a long time.'

Pedro agrees with his friend, but believes he should not discuss the matter with a venture capitalist until he has thought through answers to the various types of questions likely to be asked. In particular, Pedro believes he should be able to provide the venture capitalist with projected sales for the first three years and be able to explain the types of expenses that would be incurred. Once he has done this, Pedro feels he will be ready to talk to the individual. 'Right now', he told his friend, 'it's just a matter of time. I'd think that within seven to ten days I'll be ready to present my ideas and discuss financial needs.'

QUESTIONS

1. In addition to financial questions, what other questions is the venture capitalist likely to ask Pedro?
2. Would a business plan be of any value to Pedro? Why or why not?
3. How would you recommend Pedro get ready for his meeting with the venture capitalist? Be complete in your answer.

Guide to the online resources

FOR THE INSTRUCTOR

Cengage is pleased to provide you with a selection of resources that will help you prepare your lectures and assessments. These teaching tools are accessible via **cengage.com.au/instructors** for Australia or **cengage.co.nz/instructors** for New Zealand.

COURSEMATE EXPRESS

CourseMate Express is your one-stop shop for learning tools and activities that help students succeed. As they read and study the chapters, students can access revision quizzes, Take it further activities, a case archive, online video activities and much more! **CourseMate Express** also features the Engagement Tracker, a first-of-its-kind tool that monitors student engagement in the content. Ask your Learning Consultant for more details.

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INSTRUCTOR'S MANUAL

The **Instructor's manual** includes:

- chapter objectives
- key chapter headings
- chapter summary
- lecture notes
- answers to the review and discussion questions
- additional key terms and concepts
- teaching notes for the end-of-chapter activities and exercises.

WORD-BASED TEST BANK

This bank of questions has been developed in conjunction with the text for creating quizzes, tests and exams for your students. Deliver these through your LMS and in your classroom.

POWERPOINT™ PRESENTATIONS

Use the chapter-by-chapter **PowerPoint slides** to enhance your lecture presentations and handouts by reinforcing the key principles of your subject.

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Encourage your students to critically analyse a real-life **business plan for Cocoa Samoa**. The business plan can be viewed online and comes with accompanying questions.

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FOR THE STUDENT

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COURSEMATE EXPRESS FOR ENTREPRENEURSHIP

Access your **CourseMate Express** website, which includes a suite of interactive resources designed to support your learning, revision and further research.

Includes:

- Revision quizzes
- Take it further activities
- Business plan, with accompanying questions
- Case archive
- Online video activities
- Weblinks
- And more!

ENTREPRENEURSHIP: FOREWORD

Recently, I met a PhD student studying astrophysics. Ten years ago, he would have been overqualified for a job in Australia and would have been on a plane to NASA or Boeing in the US.

But this is a new world for students today. Abundant with opportunity, and crazy new. Today's students have a side-hustle. In his spare time, he is starting a new business to prospect asteroids for mining companies. How exciting! He can see a future that the rest of us have missed, and he has unique knowledge to make it a reality. If he is successful, there will be a great new company, new jobs and a new way to support planet Earth.

This student has the opportunity, the tools and the support he needs to make that company. This new way of working has become increasingly sophisticated, surprisingly predictable and well supported by a global community. We call this new way of working 'entrepreneurship' and this book is a brilliant map to navigate through this new terrain.

Ten years ago, when I co-founded the first start-up incubator in Australia, Pollenizer, the world was quite different. The support for entrepreneurs wasn't there. This book couldn't have been written as it has been today. People were just starting to learn the new ways of working and telling each other about them. This is a characteristic of entrepreneurs – they are determined to learn faster than everyone else, and to do so out loud so that 'the rising tide lifts all boats'. This book is your 'hack' to skip the first 10 years and learn what we learned from its pages.

We've learned that '[a] startup is not a small version of a big company' (Steve Blank), and making one requires a different set of skills, tools and mindsets to a traditional MBA. Start-ups are not companies with less money, less access to resources and fewer employees. Start-ups are different in purpose, because they are generally building something that no one has seen before and customers don't care about – yet. Everything they do is intended to discover and prove the highest value solution to a clear problem and a known customer segment.

Start-ups are also different in kind, because they are riskier. Literally everything about this fragile entity could be wrong at the start. What if there is not an actual problem to solve here? What if the solution does not work? What if the founders hate each other and quit? What if the start-up can't get funding or get to revenue before it runs out of resources?

But this beginning is also a precious time because the company can take more risks with less to lose than a big company. That's how start-up practice can unlock powerful and disruptive new models.

So, read this book. Gobble up its contents and then do what entrepreneurs do. Start something. Go and find a problem to solve and solve it with a company. After all, the best way to learn entrepreneurship is to be an entrepreneur.

Phil Morle, May 2018
Main Sequence Ventures
The CSIRO's Innovation Fund

PREFACE

LEARNING-THROUGH-CREATING-VALUE-FOR-OTHERS

We do not have a word for it in English yet, but *Learning-through-creating-value-for-others* is the educational philosophy that drives this book.[1] We support personal enterprise; wherever it exists, whenever it exists, and whatever it is – social, environmental, business; the list is endless. It is about the 'enterprising spirit' that everyone has at birth. It is the spirit of true creativity and inventiveness, of curiosity and daring, of calculated risk against gain. Sadly, this burning spirit can be extinguished by parents, by oppressive society, by conformism of the school system, by crime or civil war, or by cultural proscriptions. However, it is always there in every person, even later in life, and they can choose to follow a path less travelled if the right conditions emerge that ignite a passion.

Starting a venture of any type – be it social, business, community, or environmental – requires a new mind-set, lots of passion, and deep knowledge. Entrepreneurs reach into their hearts and minds to find that special idea or innovation that excites them. When they find it, nothing can stop this 'force of nature'. 'I can do this', they say to themselves. 'I can design a solution to their pain or problem.'

From artists to zoologists, the enterprising spirit arises everywhere. Everyone can benefit from a basic course in entrepreneurship. Think of how many self-employed professions there are – artists, real-estate brokers, photographers, musicians, designers, writers, financial advisors, analysts and interior designers. Beyond this, think of the creative and innovative people in arts, civil society, not-for-profits, community trusts and social enterprises. All are on their personal entrepreneurship pathway.

Ours is a knowledge- and tools-based approach to entrepreneurship where you create value for others through testing and inquiry. You create a 'pretotype' (pretend-prototype) so that you can share and learn from your customer/client/stakeholder to design a solution to a problem that they will be thankful for. This approach triggers deep engagement and even deeper learning. Entrepreneurs learn by applying their existing and future competencies to create something novel of value of use to society.

Your teachers act as mentors and promote a student-centred approach based on project work, problem-based learning, and social team-based learning. You are fortunate that your university offers *just for you* a progressive method that teaches motivation, awareness, habits of thought, and skills needed to enable and achieve entrepreneurial success.

CAN YOU ACTUALLY TEACH ENTREPRENEURS?

People typically ask two questions of entrepreneurship educators such as your authors:

- *Does an entrepreneur really need teaching?* The answer is actually mixed. True, there are many entrepreneurs (maybe as high as 10-15 per cent) who dropped out of school. They never had patience to learn (nor did their teachers have much patience with them!). Other research shows that there is a higher rate of ADHD (they simply found it difficult to focus and complete their schoolwork). Even illiterate and dyslexic entrepreneurs can succeed without education (by learning visually and relying on others). Then there is teenage non-conformity amongst entrepreneurs ('modest rule breaking' never hurt them). Yet, the fact is that education and entrepreneurship are *highly correlated* – the more education you have, the more likely you will intend to exploit entrepreneurial opportunities.
- *Yes, but can you actually learn entrepreneurship?* Again, yes and no. You most definitely can learn it if someone helps you discover that spark and passion within yourself. What this book and good teachers do is create a world for you where you can experiment/experience being an entrepreneur and cultivate a creative, confident habit of mind using scientific method to identify and exploit opportunities. And

the answer can be no when you think of most classrooms. In those precious minutes together with learners, entrepreneurship educators supply just-in-time content that is both enabling and experiential, where you can sit at the elbow of real entrepreneurs, be challenged by the real problems of an entrepreneur, be given access to tools and techniques to work through those problems and ultimately, where you can learn the theory, process and practice of being an entrepreneur.

Teaching entrepreneurship is not new – it was well underway by the early nineteen eighties.[2] From the beginning, there was considerable consensus that entrepreneurship was distinguishable from management education, and that studying it can positively influence entrepreneurial attributes.[3] By the end of the millennium, there was a ranking of entrepreneurship schools.[4] Now, entrepreneurship education has spread widely around the world, has diversified its teaching approaches, sports a vigorous research literature, and has become a well-established academic discipline. Baptista and Naia's literature review shows that theoretical contributions about entrepreneurship education has been increasing and improving.[5]

One of our field's challenges is that entrepreneurship education is offered predominantly only in business schools, even though it does not totally belong there. If entrepreneurship is isolated to the business faculty, then it may not reach out to other non-business disciplines, with potentially more enterprising potential. Fortunately, it is now expanding into arts, sciences, design, engineering, and most any subject. Entrepreneurship education is becoming university-wide, drawing on cross-disciplinary programs with diverse missions, rather than existing simply as a subspecialty in business or engineering programs.[6]

PATHWAYS, GYRES AND PINNACLES

For entrepreneurs, education is like a *gyre* (jī(ə)r). Have a look at one, the inside steps (right) of the Bell Rock Lighthouse off the coast of Scotland, scene of innumerable wrecks on a huge reef just below the surface. Entrepreneur-architect Robert Stevenson built a lighthouse on rocks exposed only two hours a day! Rising from the sub-surface reef, inside the lighthouse, is a *gyre*, a stairway that moves from the base progressively *higher and narrower*. That is the metaphor for the entrepreneur's heroic journey. Through education, we are reaching higher levels of achievement as we narrow in on our goals at the top.

Source: Adapted from https://commons.wikimedia.org/wiki/File:Joseph_Mallord_William_Turner_-_Bell_Rock_Lighthouse_-_Google_Art_Project.jpg; Wikimedia/George Gastin: https://creativecommons.org/licenses/by-sa/3.0/deed.en.

How to reach the pinnacle of the gyre? This book outlines an approach that we might call the 'Etappe Method'. In many languages, e*tappe* means 'a step in a journey'.[7] In the famous bicycle race *Tour de France,* we call each stage '*une étape*. For your authors, Etappe also stands for a method – 'Entrepreneurship Theory Process and Practice for the Environment' – because in addition to social and business entrepreneurship, our method stresses the environment. We use *etappe, step,* or *pathway* to signify the entrepreneur's heroic journey from 'mind to implementation'. Whoever you are, whether in art, architecture, or zoology, entrepreneurs are the enterprising people who initiate creative ideas and formulate them into actionable visions. You will see that Chapter 4 is entirely dedicated to these many entrepreneurial pathways.

This new method of entrepreneurship education rests on the deep base of knowledge that is our latest fifth Asia-Pacific edition. Our method is based on best practices now used throughout the world. Looking back at our intellectual antecedents, here are the progenitors:

- This book descends directly from the work of pioneering educators Donald F. Kuratko and Richard M. Hodgetts, who in 1989 published the world's first comprehensive entrepreneurship textbook.[8] Indiana University's "Dr. K" has passionately published ten editions of the North American edition.[9] Howard Frederick joined Kuratko and Hodgetts in 2007 to create the first Asia-Pacific edition for the needs of Australasian entrepreneurs and Allan O'Connor joined the team in 2013. Here we remain – Frederick, O'Connor, and Kuratko (Cengage, 2019), one of the most widely used learning manuals for entrepreneurs.
- Beyond this solid base, we have integrated the latest thinking in 'lean entrepreneurship'. Steve Blank's 2013 *Harvard Business Review* article 'Why the Lean Start-up Changes Everything' and his other works showed that time had arrived for this new pedagogical approach.[10] Eric Ries's books and articles, particularly *The Lean Start-up,* systematised Blank's approach scientifically into 'hypothesis-driven entrepreneurship'.[11] Alberto Savoia opened up our minds to diverse ways of testing minimum viable products and ideas through 'pretotyping'.[12] Other important influences include the educational material by Stanford and Hasso-Plattner-Institut[13], IDEO[14], Rotman[15] and others[16] that support cross-disciplinary teaching of lean entrepreneurship.
- Another important influence on this book comes from principal author Howard Frederick's residence at the Tecnológico de Monterrey, the world's only university that requires entrepreneurship of every graduate.[17] Each semester, 120 professors of entrepreneurship teach the course to some 8,000 students – using the '*lean approach to entrepreneurship education'*.

What is 'Lean Entrepreneurship', the concept that suffuses this approach? It means launching and testing hypotheses fast and furiously. It means finding out if there is a market for your bright idea by testing your minimum viable product. Contrast this with the standard thinking about entrepreneurship, which is too frontloaded: do research upfront, write the business plan upfront, get investors upfront, develop the product and so on – even before having one customer. In our method, we use the *Build-Measure-Learn* feedback loop to solve 'pains' of real people, test our assumptions, and then pivot our concept. Done well, you can co-create your bright solutions with actual customers in real time. Lean entrepreneurship means start small and fast, and build as you go. The methodology is hardly a secret formula anymore, as it is in use in hundreds of university entrepreneurship courses globally.

HOW THE BOOK IS ORGANISED

Text, cases and exercises that appear in this edition bring together, in one place, the most significant resources for developing new and emerging business and social ventures. We present these resources in an exciting, organised and challenging manner. We put together this book in order to compact and synthesise a large body of knowledge for the budding entrepreneur and enterprising spirit of all types. Our aims are to simplify, condense, organise and translate a vast area of knowledge into a form useful for building commercially viable, socially and environmentally responsible projects of all sorts.

We have sourced ideas from multiple places and repackaged them to make a new whole. As the American Historical Association says, textbooks are different from other scholarly writing in the 'form of attribution, and the permissible extent of dependence on prior scholarship'.[18] Every attempt has been made to trace and acknowledge copyright holders. Where the attempt has been unsuccessful, the publishers welcome information that would redress the situation. Within our organisation and accumulation of knowledge on Asia-Pacific entrepreneurship, we have cited many authors in the field and aim to provide ready access to their works, including more than 1,600 of hyperlinks. At the end of each chapter, you will find a wealth of references that have been carefully selected and updated to 2019 in order to provide professors and students with a thorough background of the latest research that relates to the entrepreneurship material being presented.

Here are the 14 chapters that compose four Parts to the book, along with additional material in the online environment CourseMate.

CHAPTER SUMMARY	NEW AND REVISED MATERIAL
PART 1: ENTREPRENEURSHIP IN THE TWENTY-FIRST CENTURY	
In Chapter 1 'Entrepreneurship: evolutionary development, revolutionary impact', we see how entrepreneurs drive the economy through innovation. Entrepreneurship has many meanings around the world, but there are overriding themes that unite them. The ancient history of entrepreneurs gives us an appreciation of our current predicaments. A survey of theoretical approaches helps us distinguish between the different kinds of entrepreneurs. We look particularly at high-growth businesses that propel societies forward.	New section on the role of entrepreneurs in 'transformative innovation' of society and the planet. Re-tooled section on Schools of Thought. Refreshed section on our Entrepreneurial Economy and updated insights into the social and economic contributions of high growth businesses.
Chapter 2 'The entrepreneurial mind-set: Cognition and Career' leads us to a contextual and cognitive view entrepreneurship. From that, we map the most common characteristics exhibited by successful entrepreneurs. This depends upon their growing capabilities and their entrepreneurial mind-set (which even has a dark side). Are you a social entrepreneur, ecopreneur, intrapreneur, or family-preneur?	Re-imagined chapter on fundamentals of the entrepreneurial mind and cognition. The Career section is now introductory and moved to conclude the chapter to improve the flow of the text. The demography section replaced with international perspectives and strengthening of entrepreneurial leadership and motivation. New cases and boxes.

continue

continue

CHAPTER SUMMARY	NEW AND REVISED MATERIAL
With Chapter 3 'Ethical, social, sustainable entrepreneurship' we show that social entrepreneurs have a great many of the same characteristics as business entrepreneurs, but their underlying motivations are different. Entrepreneurs around the world are some of the planet's best hopes to solve the big problems. Entrepreneurs face many ethical decisions, including corruption and bribery in many countries. There is also a criminal side to entrepreneurship. There are differently-abled and disadvantaged entrepreneurs. The chapter finishes with a look at how entrepreneurship affects ecology. Entrepreneurs have greatly undervalued biodiversity and ecosystems.	New discussion about 'destructive entrepreneurs'. Corruption and organised crime statistics update. New section on 'Differently-Abled' Entrepreneurs' to complement 'Disadvantaged Entrepreneurs'. Sections on Indigenous Entrepreneurs and Entrepreneurial Ecology retained from third edition.
Chapter 4 'Pathways to entrepreneurial ventures' examines primary routes to building an entrepreneurial career. Entrepreneurs come in all shapes, sizes and types and so too do their ventures. Social ventures, family ventures, new ventures from within other organisations often use similar planning tools to regular business ventures, but at each step, there are different considerations.	Updated with content on family entrepreneurs and intrapreneurs. New and refreshed content on pathways and careers. Reduced the attention given to the career models of small and franchised businesses and re-positioned these as options in the growth sections of this book.
PART 2: DESIGNING RESILIENT ENTREPRENEURSHIP: FROM OPPORTUNITY IDENTIFICATION TO BUSINESS MODEL	
Chapter 5 'Opportunity identification and the creative pursuit of ideas' looks at how to identify 'really big' ideas that are commercialisable in the business sense and/or are high-impact in the social sense. We learn techniques for identifying and assessing opportunities and for creating that all-important value proposition.	This new chapter focuses on lean entrepreneurship as a scientific approach to create ventures. Reimagines new content on opportunity identification, the creative pursuit of innovative ideas, and assessment of entrepreneurial opportunities. All new 'Experiencing Entrepreneurship' boxes and chapter cases and examples.
Chapter 6 'Design Thinking for entrepreneurial ventures' goes on to develop your entrepreneurial capacity through imagination, creativity and design. You will learn the techniques of creativity blockbusting and Design Thinking, which will help you to construct the exact solution that your customers are looking for.	This entirely new tools-oriented chapter focuses on 'designerly ways of knowing' about nature, mind-sets, human sense perception, addressable problems, and cognitive and reasoning perspectives. Includes a new 'Design Thinking Process Model' from preparation to launch.
In Chapter 7 'Lean entrepreneurship and identifying customer needs' you will learn how to create inexpensive but a market tested 'minimum viable product' that you can show to your customers to get that all important feedback. Then, the validation process will help you with decision making to either pivot (change course), persevere, or abandon the start-up.	This new chapter brings alive the 'lean method' widely used in entrepreneurship education. Particularly important are the toolkits such as value proposition and validation. Five new Experiencing Entrepreneurship exercises.
In Chapter 8 'Lean marketing and business model design', we put it all together using the techniques of Business Modelling, and see how Lean Marketing lends itself to scientific, hypothesis-based entrepreneurship.	This new chapter conforms to the latest entrepreneurship pedagogy about 'Lean Marketing' and extends hypothesis testing to the marketing space. It includes lean planning techniques to bolster the customer segmentation and behaviour sections.

continue

continue

CHAPTER SUMMARY	NEW AND REVISED MATERIAL
PART 3: GROWING AND PLANNING ENTREPRENEURIAL VENTURES	
Chapter 9 'Strategic entrepreneurial growth' puts our learnings into action. You need to position yourself strategically in the 'market', while minimising your competition. What if you want to grow? If you have the entrepreneurial frame of mind, you could go global.	We strengthened the link between business growth and planning to illustrate the validity of planning as new ventures expand by number of employees, market penetration or expansion, and product portfolio. Consolidated international opportunities, franchising and other growth avenues into the one chapter.
In Chapter 10 'Legal and regulatory challenges' we dive into the regulatory environment. Entrepreneurs must comply with local and national laws but also be aware of overseas havens that rob your intellectual property rights. Equally important is to examine the advantages and disadvantages of major forms of legal organisation for your new venture.	Updated chapter and strengthened the reference to non-profit organisations. Included more on the strategic value and preparation of IP and when the IP decision should be addressed. Addressed open innovation and replaced an 'In Practice' box with relevant content to support this alternate viewpoint.
In Chapter 11 'Lean and sustainable business planning', we learn that there are many kinds of business plans, depending on how it will be used, and for whom. Whether lean or long-form, entrepreneurs develop business plans as communication tools, as an instrument to raise funding, as a tool for analysis and to lessen uncertainty, as an action plan, and as a builder of the new venture's reputation.	This new chapter covers 'lean' and 'traditional, long-form' business planning. In a departure with custom of previous editions, we point to business planning resources instead of providing a long form plan. More attention is paid to contrarian views on business planning.
PART 4: FINANCIAL MATTERS FOR ENTREPRENEURIAL VENTURES	
Chapter 12 'Financial performance for entrepreneurial ventures' is a plus especially for non-accountants. All ventures need performance measures. We describe the principles of traditional financial accounting to entrepreneurs. Finally, we look at ratio analysis to show relationships between financial statement accounts.	Updated chapter included refreshed and current endnotes. Replaced aging 'When Currency loses its value' with a box on a Kiwi entrepreneur who crosses break-even after ten years.
Chapter 13 'Sources of capital' lays out paths to source and acquire financial capital for an entrepreneurial venture through revenue growth, self-funding or external sources. There are more sources of capital than most people know about. We have special sections on venture capital and informal capital. We also discuss socially responsible investors. Then come some very twenty-first-century ways to raise funding through peer-to-peer lending, crowdfunding, and cryptocurrency.	Updated sections and focused the chapter on issues of finance. Refreshed the micro-finance and micro-credit sections and strengthened the crowdfunding section. Added references to new advances in cryptocurrencies and block chain.
Finally, Chapter 14 'Valuing and harvesting entrepreneurial ventures' is for those entrepreneurs ready to 'harvest' the value they have created. Here we learn how to valuate a business for either purchase or sale. Another consideration for many entrepreneurs is succession in a family business. The most fortunate amongst us will want an IPO.	Re-introduced this chapter on valuation and harvest in this edition as an advanced topic for entrepreneurship. Three principle techniques of valuation are introduced which underpin the decision-making process relating to harvest strategies and timing. Various means of harvest from succession to initial public offering are discussed.

We also include an exceptional new set of teaching PowerPoints developed for teachers by teachers. In addition to the experiential exercises, we know that teachers must convey serious content, and that reading, listening and watching are good ways to accomplish that.

ENDNOTES

1 For inspiring this definition, we credit Lackéus, M., Lundqvist, M., & Middleton, K. W. (2016). Bridging the traditional-progressive education rift through entrepreneurship. *International Journal of Entrepreneurial Behavior & Research*, *22*(6), 777–803. https://doi.org/10.1108/IJEBR-03-2016-0072. See also Lackéus, M. (2013). *Developing Entrepreneurial Competencies - An Action-Based Approach and Classification in Education*. Chalmers University of Technology. https://research.chalmers.se/publication/186625; Lackéus, M. (2014). An emotion based approach to assessing entrepreneurial education. *The International Journal of Management Education*, *12*(3), 374–396. https://doi.org/10.1016/j.ijme.2014.06.005; Lackéus, M. (2015). *Entrepreneurship in education: What, why, when, how*. OECD. https://www.oecd.org/cfe/leed/BGP_Entrepreneurship-in-Education.pdf; Lackéus, M., Lundqvist, M., & Middleton, K. W. (2011). Obstacles to Establishing Venture Creation Based Entrepreneurship Education Programs. *Nordic Academy of Management Meeting (NFF) Conference, Stockholm*. https://research.chalmers.se/publication/142642; Lackéus, M., & Middleton, K. W. (2015). Venture creation programs: bridging entrepreneurship education and technology transfer. *Education + Training*, *57*(1), 48–73. https://doi.org/10.1108/ET-02-2013-0013.

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7 For example, used in Czech *etapa*; Danish *Etape*; Dutch *Etappe*; English *step*; Estonian *etapp*; Finnish *etappi*; French *étape*; German *Etappe*; Italian *tappa*; Lithuanian *etapas*; Norwegian *etappe*; Polish *etap*; Portuguese *etapa*; Romanian *etapă*; Russian этап; Slovak *Etapa*; Slovenian *etapa*; Spanish *etapa*; Swedish *Etapp*; Turkish *etap*.

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Allan now enjoys the thrill of higher learning and revels in the challenges of an entrepreneurial academic career. Increasingly, Allan is engaged in research designed to advise governments in matters of innovation and entrepreneurship that drives regional competitiveness. With the assistance of funding from the South Australian state government, in 2014–15 Allan led the development of the Australian Cluster Observatory, and has embarked on pioneering research into the entrepreneurial ecosystem in South Australia. His growing portfolio of more than fifty research publications including internationally peer reviewed journal articles, book chapters, conference papers, and research reports, is testament to the significance of his research agenda and contribution to his research field.

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ENDNOTES

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ACKNOWLEDGEMENTS

The authors would like to thank all of the staff at Cengage Australia who made this work possible. This includes Michelle Aarons, Rachael Pictor, Laura Di Iorio, Sutha Surenddar and Stephanie Ayres.

Cengage would also like to say a big thank you to Jodyanne Kirkwood of Otago Polytechnic for her pre-proposal and draft manuscript reviews, and the following reviewers for their incisive and helpful feedback:

- Frances Chang – Macquarie University
- Afreen Huq – RMIT Univesity
- Fara Azmat – Deakin University
- George Comodromos – Victoria University
- Alex Maritz – La Trobe University
- Jochen Schweitzer – University of Technology Sydney
- Morgan P. Miles – University of Canterbury
- Gregory Mowle – University of Canberra
- Stuart Schonell – University of Tasmania
- Anna Jenkins – The University of Queensland
- Gary Hancock – The University of Adelaide
- Eddy Widjaja – Western Sydney University
- Dennis Foley – University of Canberra

Howard Frederick would like to thank his life partner Hanna Fejerdy Frederick for her support and sacrifices throughout the five editions of this work. For their personal and institutional support during the writing of this book, he would like to thank:

- Colleagues at the Eugenio Garza Lagüera Entrepreneurship Institute at the Monterrey Institute of Technology / Tecnológico de Monterrey (ITESM): Margarita Herrera Avilés, Sergio Ortíz Valdés, Yazmin Morales Serrano, Lizbeth Alicia Gonzalez Tamayo, Alejandra Peña Romero, Aura Elena Moreno Guzmán, Patricia Lopez Molina, Manuel Calderon, Hilda Margarita Ortiz Martínez, José Ernesto Amorós.
- Colleagues in the Innovation & Entrepreneurship Cluster at Plymouth State University: Robyn Parker, Eric Spieth, Tom Guarino, Bonnie Bechard, Deborah Brownstein, Roy Stever.

Allan O'Connor is blessed with an understanding and thoroughly supportive spouse and soul mate, Suzi, whose unwavering support is largely responsible for making the contributions to this book possible and to whom a deep debt of gratitude will forever be owed, thank you. There are numerous others without whose support and encouragement over the years would leave too much entrepreneurship learning undiscovered. In addition to my co-authors, these include colleagues Gary Hancock, Scott Gordon, Kai Du, Huanmei (Mushui) Li, Manjula Dissanayake, Xu Ting, Chis Medlin, Lisa Daniel, Retha Scheepers, Martin Bliemel, Morgan Miles, Nita Cherry, Shahid Yamin, and more recent mentors David Audretsch, Colin Mason and Erik Stam. Allan would also like to acknowledge and thank Martin Pannall of Madderns Patent and Trademark Attorneys for his particular assistance with and contributions to the legal chapter and peers who have provided advice and feedback on previous editions of this book in use. He also wishes to acknowledge and thank all his entrepreneurship students who over the years provide the reason and purpose for the work created.

As authors we jointly wish to express our gratitude to our case authors Jodyanne Kirkwood, Tracey Dodd and Maria Eugenia Buteler who provide relevant, current and targeted articles that assist us to stretch our students' knowledge and experience.

PART ONE

ENTREPRENEURSHIP IN THE TWENTY-FIRST CENTURY

CHAPTER 1

ENTREPRENEURSHIP: EVOLUTIONARY DEVELOPMENT, REVOLUTIONARY IMPACT

Those Australian and American values, democracy, freedom, the rule of law, enterprise, enabling the spirit of enterprise, these values are timeless.

Malcolm Turnbull
Australian Prime Minister, 2018[1]

Most of what you hear about entrepreneurship is all wrong. It's not magic; it's not mysterious; and it has nothing to do with genes. It's a discipline and, like any discipline, it can be learned.

Peter F. Drucker,
Innovation and Entrepreneurship[2]

Humanity cannot survive without functional ecosystems, and the actions of all people are needed to act together as a species on a planetary scale.

John Liu,
Filmmaker and Ecologist[3]

CHAPTER OBJECTIVES

1. To illustrate today's entrepreneurial context
2. To examine different definitional perspectives and conclude a comprehensive definition
3. To examine the historical development of entrepreneurship
4. To identify the major theoretical approaches to entrepreneurship
5. To distinguish between types of entrepreneurs
6. To demonstrate the global revolution and interests in entrepreneurship

ENTREPRENEURS AND INNOVATORS AT THE CORE OF THE ECONOMY

Entrepreneurs are individuals who recognise opportunities where others see chaos, contradiction and confusion. They are aggressive catalysts for change within the marketplace. They have been compared to Olympic athletes challenging themselves to break new barriers, to long-distance runners dealing with the agony of the miles, to symphony orchestra conductors balancing different skills and sounds into a cohesive whole, and to top-gun pilots continually pushing the envelope of speed and daring. Whatever their passion, entrepreneurs are heralded as the heroes of today's marketplace. They start companies and create jobs. The global economy rests on their efforts, and the world now largely embraces free enterprise as the most significant force for economic development. The passion and drive of entrepreneurs moves the world of business forward.

As this book focuses on the needs of Australia, New Zealand, and the Asia-Pacific, let's have a look at our own entrepreneurial environment. Typical of most developed countries, Australian small businesses account for almost two-thirds of employment.[4]

The quote from Malcolm Turnbull, Australia's Prime Minister at the time of writing, at the opening of this chapter signals the importance of the enterprising spirit as a shared value for large developed economies such as the USA and Australia. Nonetheless, some commentators claim of Australia that 'The confronting fact is we are not entrepreneurial, we are not enterprising, we don't demonstrate initiative'[5] and that Australia does not produce high-growth and high-value companies. The data simply do not bear out this pessimistic assessment.

According to the Global Entrepreneurship Monitor (GEM; we will frequently refer to GEM throughout this book), data on the rates of new venture **start-up** in Australia and the USA are actually quite similar.

We can readily identify a number of companies listed on the Australian Stock Exchange founded by entrepreneurs that have today reached greater than AUD$1 billion market valuations (see Table 1.1).[6] And this doesn't even include ventures started by entrepreneurs *from within* larger companies (we call these people *intrapreneurs*), nor does it include Australian and New Zealand companies *listed on foreign stock exchanges*. In the Australian context, the impact of these companies is huge. The 15 companies in Table 1.1 alone, each starting with less than a handful of people in their team, today combined have around 30 000 employees.[7] This kind of job creation is the magic of the entrepreneurial economy.

One cautionary note, though. As you can see, Table 1.1 ends at 2010. It can take time to build businesses with high valuations that employ significant numbers of people; it isn't achieved in the blink of an eye. Many entrepreneurs have started or managed businesses before walking into this sort of success. They may have struggled through early survival and made choices that put not only their own and/or others' money on the line but also risk their family lives and personal health. But this is the way of the entrepreneur.

As you work through the contents of this book, we provide much of what is needed to professionalise your journey into entrepreneurship, to help you reduce and manage **risk**, and to provide guidance on what is and isn't a worthwhile idea and opportunity. Even with all this assistance though, it is ultimately the choices you make that define your pathway through the winding road of **entrepreneurship**.

start-up
A new business or new venture – such as self-employment, a new business organisation or the expansion of an existing business by starting a new related venture – by an individual, team of individuals or established business.

intrapreneurs
Entrepreneurs who start ventures from *within* larger companies.

risk
In an entrepreneurship context, the possibility of economic, personal or reputational loss faced by the entrepreneur and their backers, financial or otherwise, acquired through new-venture activity and as a result of the initiation, conversion and exploitation of an idea as a new venture. (See *calculated risk taking*, *career risk*, *financial risk*, *psychic risk*, *risk propensity*.)

entrepreneurship
The practice of starting new organisations, particularly new businesses; the process of innovation and new-venture creation; the commercialisation of innovation.

TABLE 1.1 AUSTRALIA AND NEW ZEALAND AUD$1 BILLION ENTREPRENEURIAL COMPANIES

COMPANY (LISTED ON THE AUSTRALIAN STOCK EXCHANGE UNLESS NOTED OTHERWISE)	APPROX. VALUATION (AS AT 1 FEBRUARY 2018, IN AUD$BILLION UNLESS OTHERWISE NOTED)	FOUNDED	ENTREPRENEUR(S) (AUSTRALIAN START-UP UNLESS OTHERWISE NOTED)	DESCRIPTION
Resmed	17.6	1989	Peter C. Farrell	Global manufacturer of products for sleep-disordered breathing, chronic obstructive pulmonary disease and other respiratory conditions
MYOB	2.09	1991	Christopher Lee	Cloud-based business management solutions provider
Iress	1.84	1993	Peter Dunai, Neil Detering and Hung Do	Software systems and services for financial markets and wealth management
Corporate Travel Management	2.15	1994	Jamie Pherous	Corporate travel management
WiseTech Global	3.36	1994	Richard White	Provider of software solutions to the logistics industry globally
REA Group	10.33	1995	Karl Sabljak, Carmel Sabljak, Steve Sabljak, Marty Howell	A global online real estate advertising company
Carsales	3.44	1996	Gregory Paul Roebuck	Operates a portfolio of automotive and related industry websites, including an automotive classifieds website
Seek Ltd	7.13	1997	Andrew Bassat, Paul Bassat, Matt Rockman	Matching jobseekers and employment opportunities
Sirtex Medical	1.54	1997	Dr Bruce Gray	Medical device company, providing a radioactive treatment for inoperable liver cancer
Webjet	1.22	1998	David Clarke, Allan Nahum, John Lemish	Travel booking company
Aconex	1.56	2000	Leigh Jasper, Robert Phillpot	Providing mobile and web-based collaboration technologies for project information and process management
Atlassian (NASDAQ listed)	(USD) 12.37	2002	Mike Cannon-Brookes, Scott Farquhar	Enterprise software company
Xero Ltd	4.2	2006	Rod Drury (NZ)	Cloud-based accounting software for small and medium-sized businesses
Vocus	1.47	2008	James Spenceleyas	A wholesale and business telecommunications provider
NextDC	1.92	2010	Bevan Slattery	Development and operation of independent data centres in Australia

Source: Author created from Australian Stock Exchange ASX300 data files, company and media reports.

ENTREPRENEURIAL EDGE

WHAT ENTREPRENEURS CAN EXPECT IN THE TWENTY-FIRST CENTURY

FIGURE 1.1 ROLLER COASTER ENTREPRENEUR CARL MILER'S MASTERWORK, DESTROYED BY RISING SEA LEVELS AFTER GLOBAL WARMING–INDUCED HURRICANE SANDY (U.S.)

Source: Flickr/Anthony Quintano, Flickr.com (2013). Attribution 4.0 International (CC BY 4.0). https://creativecommons.org/licenses/by/2.0/legalcode. https://www.flickr.com/photos/quintanomedia/8506303672/sizes/l.

Here's just one story that shows you how unexpected your world has become: Carl Miler and his brilliant idea that made him millions – the portable roller coaster. He recounted:

> The secret is to come up with a good collapsible rig that's as exciting as any you've ever ridden, but that can be taken down and moved at short notice. And it's worth a lot of patents, I can assure you.[8]

How could Miler possibly guess that within half a century one of his great innovations, the Jet Star portable roller coaster at Casino Pier, New Jersey (USA), would be swept away by the rising seas of a global warming-induced hurricane (see Figure 1.1)? Today, entrepreneurs have to take such calamities into account. What is today's entrepreneur to do? Perhaps invent a floating portable roller coaster?

Needless to say, the garden is not all roses for entrepreneurs. With the benefit of hindsight, since the Industrial Revolution in the late eighteenth and early nineteenth centuries – a time of high hope for many for better lifestyles, greater production and stronger economies – many business entrepreneurs around the world have plundered and exploited the environment in ignorance of or without any thought for sustainability. It is no exaggeration to say that entrepreneurs such as Thomas Edison and Henry Ford have played a major role in contributing to the climate crisis. It is also no joke to think that today's entrepreneurs – perhaps like Elon Musk, with his electric car that uses new battery technology, his Tesla automobile, and his SpaceX Mars program – can help ease the problem.

This was and is the promise of entrepreneurship. The entrepreneurial behaviour of individuals can have transformative impacts on our economies and our societies. Elon Musk has even launched his Tesla into space![9] In 100 years we could be condemning our hero for leaving a trail of space junk that litters the interplanetary super highway. Or Musk could be honoured as a pioneer in fields of business previously untapped. Who knows? The point is those who create new ventures have a responsibility to look to the future and question what they do and why they do it. In this book, we encourage you to take entrepreneurial steps but we also seek to equip you with tools that make those steps mindful and rewarding.

Industrial Revolution
Usually dated from 1750 to 1900, the movement from an agricultural economy to an industrial economy based on production of factories and machine labour. A period characterised by many industrial innovations and discoveries.

sustainability
Avoidance of depletion of natural resources; pursuit of solutions with the long term (several hundred years or more) in mind. Applies to many disciplines, including economic development, environment, food production, energy and lifestyle.

TRANSFORMATION OF SOCIETY: WHY WE ARE HOPEFUL

wicked problems
Some problems are 'tame' – the path to solution is short and clear. Wicked problems are not well defined and do not have a clear process toward solution. They are difficult to formulate; involve many decision makers with conflicting values; have resource constraints; and/or, are interconnected with other wicked problems.

How can we as entrepreneurs stop (or at least ameliorate) **wicked problems**? It's not rocket science. In fact, most of the technologies we need to improve the situation already exist, developed by entrepreneurs and inventors in the last quarter-century. What we need is a commitment to take what we already know how to do, make it cheaper and spread it to every corner of every economy in the world. Business as usual is dead and green growth is the answer to both climate and economic problems. Again, who is best positioned to commercialise existing innovations and create new technologies? It's entrepreneurs!

Economies around the world have evolved and have been repeatedly revitalised because of the efforts of entrepreneurs and entrepreneurial characteristics such as passion, promotion, networking and drive that move society forward.[10] They take the unknown as a challenge and continuously influence the path of the future. It is their ideas, savings, investment and innovation that lead to development.

Entrepreneurs are unleashing a wave of creativity not seen since the Industrial Revolution. As Nobel Prize winner and one-time chairman of the Intergovernmental Panel on Climate Change (IPCC), Rajendra Pachauri, has said: 'Entrepreneurs who respond to the [climate] challenge will reap commercial success – while businesses which fail to do so face oblivion.'[11] Throughout the world, there is enough entrepreneurial energy to build a world that does not succumb to the challenges of wicked human-induced problems. That's what this book is all about. It is about entrepreneurial leadership for '**transformative innovation**'. The demarcation of 'transformative' means it describes those changes in the economy, environment, social welfare – indeed entire systems on Earth.[12] As Joseph Schumpeter pointed out, entrepreneurs generate innovations that 'strike not at the margins of the profits and the outputs of existing firms, but at their foundations and their very lives'.[13]

transformative innovation
Innovation that provides significant improved value and change in economic, social and/or environmental systems and the way societies are accustomed to doing things; can create opportunity spaces for entrepreneurs and give rise to entirely new industries.

Innovation has been classified into four different types (see Table 1.2). In order of increasing originality, they are:

- *duplication* – simply reproduces an already existing product, service or process
- *extension* – extends an existing product, service or process
- *synthesis* – combines existing concepts and factors into a new formulation
- *invention* – truly creates a new product, service or process, one that is novel or untried.

TABLE 1.2 INNOVATION IN ACTION

TYPE	DESCRIPTION	EXAMPLES
Duplication	Creative replication of an existing concept	Bill Hamilton (NZ) – Hamilton Jet Boat Dean Kamen (US) – Segway Human Transporter Dan and Frank Carney (US) – Pizza Hut John Britten (NZ) – Britten motorcycle
Extension	New use or different application of an already existing product, service or process	Mervyn Victor (AUS) – lawnmower Sir Edmund Hillary (NZ) – farm tractors for ice exploration Robert Dane (AUS) – solar panel yacht sail Ray Kroc (US) – McDonald's Bill Gallagher (NZ) – electric fence Mark Zuckerberg (US) – Facebook
Synthesis	Combination of existing concepts and factors into a new formulation or use	Howard Schultz (US) – Starbucks John Neustroski (NZ) – portable fur plucker for possums Ben Lexcen (AUS) – America's Cup–winning winged keel design Alan Gibb (NZ) – Aquada (car on water) Paul Beckett (NZ) – Blokart (wind sailing on land)

continue

continue

TYPE	DESCRIPTION	EXAMPLES
Invention	Totally new product, service or process	Wright brothers (US) – aeroplane Henry Sutton (AUS) – fax machine Thomas Edison (US) – light bulb Sir Ernest Rutherford (NZ) – atom splitting

These types of innovation give rise to different effects on markets and societies, such as:

- *Innovation that sustains* – as in 'business as usual', improves the efficiency and prolongs the life of existing systems
- *Innovation that disrupts* – shakes things up in the short term before being mainstreamed to help sustain existing systems or further developed to lead to genuine industrial or social transformations
- *Innovation that transforms* – transforms entire industries, social segments or ecological systems; leads to a whole new way of doing business and providing value.

Innovations can accumulate into large-scale transformations. For instance, mobile phones have disrupted and transformed our day-to-day lifestyles. The technology dates back to 1947 when 'signal duplexing' allowed two-way flow, but not 'turn-taking', and sped up transmission. But it took years for the regulatory environment to catch up so that mobile phone technology could be primed for the consumer market.[14] Meanwhile, Motorola pioneered the small size; Apple and Android the operating systems. The mobile phone market was later *disrupted* through miniaturised computing technology (led by Apple iPhone particularly).[15] Huge manufacturers like Motorola and Nokia rose and fell, again disrupting the market and opening the door to smartphones that have transformed lifestyles, workplaces and social expectations.

Transformative innovation (TI; 'innovation that transforms') requires many actors, such as businesses, suppliers, universities and knowledge institutes, government, public interest groups and users.[16] This kind of innovation delivers a fundamental shift toward new patterns of viability in tune with our aspirations for the future.[17] You can see TI elegantly in the United Nation's famous 'Sustainable Development Goals', published in 2015.[18] These goals predict far-reaching changes in technology, affecting several branches of the economy, as well as giving rise to entirely new sectors. The industrial age led to inequality, resource intensity, carbon lock-in and environmental degradation, but today, transformative innovation can adapt, reverse, learn from and anticipate solutions.[19]

While not all innovation is transformative, there is no shortage of disruption. Table 1.3 illustrates a number of disruptive innovations. Examples of truly transformative innovations are easy to find. Just in the business world we can count such TIs as the cold chain, bookkeeping, department store, tax haven, shipping containers, insurance, Google, barcode, robots, ad infinitum.

TABLE 1.3 EXAMPLES OF DISRUPTIVE INNOVATION

DISRUPTIVE INNOVATION	DISPLACED OR PRESSURED PRODUCT CATEGORY
Personal computers	Mainframe computers
Smart mobile technologies	Personal computers
No-frills airlines	Full-service airlines
Digital cameras	Photographic film

continue

continue

DISRUPTIVE INNOVATION	DISPLACED OR PRESSURED PRODUCT CATEGORY
Mass-market mobile telephony, EFTPOS and e-commerce	Cash registers
Boutique steel mini-mills	Vertically integrated steel mills
Wikipedia	Encyclopaedia Britannica
Tablet computers	Typewriters
Blogging	Phototypesetting and manual paste-up
Mobile or cellular telephones	Fixed-line telephones
Container ships and containerisation	Cargo ships and wharf labourers

DEFINITIONS OF ENTREPRENEURSHIP

The recognition of entrepreneurs as a class dates back to eighteenth-century France, when Irish French banker and investor Richard Cantillon associated entrepreneurs with 'risk-bearing' activity in the economy.[20] In England during the same period, the Industrial Revolution was growing and the entrepreneur played a visible role in risk taking and the transformation of resources.[21]

entrepreneur
(1) An innovator or developer who recognises and seizes opportunities; converts these opportunities into workable/marketable ideas; adds value through time, effort, money or skills; assumes the risks of the competitive marketplace to implement these ideas; and realises the rewards from these efforts. (2) An individual who organises and manages labour, capital and natural resources to produce goods and services to earn a profit, but who also runs the risk of failure.

undertaker
The original translation of the French word entrepreneur, taken from the verb entreprendre, 'to undertake'. Unfortunately the term 'undertaker' in English language is already used by another profession, namely funeral directors.

The word **entrepreneur** is derived from the French *entreprendre*, meaning 'to take in between' or 'to undertake'. English doesn't really have its own word for entrepreneur – or better said, it once had such a word but tragically lost it. We use the French word in English because the proper word for entrepreneur, '**undertaker**' (someone who undertakes, used by the original theorists of entrepreneurship), is now used by another profession. Undertakers today are morticians and funeral directors! So, in English and in most Romance languages, the term 'entrepreneur' has been adopted and used to describe someone who undertakes to organise, manage and assume the risks of a business.

However, the definition has broadened so that today an entrepreneur is considered to be a social or business innovator or developer who recognises and seizes opportunities; converts those opportunities into workable/marketable ideas; adds value through time, effort, money or skills; assumes the risks of the competitive marketplace to implement these ideas; and realises the rewards from those efforts.[22] This includes a huge mob of characters. There are even some special words. For example, an *impresario* is a theatre entrepreneur. We also use the word 'entrepreneur' as the base for other words: 'seniorpreneur', 'intrapreneur', 'mumpreneur' and many others.

Not all languages follow the 'undertaker model', though.[23] In Malay, *usahawan* means someone who does a commercial activity at some financial risk. In the Thai language, the word for entrepreneur is *pupagongan,* which means literally 'someone who assembles other people together'. In Indonesian, *wiraswasta* has the signification of 'courageous private sector'. In the Garinagala language of Australian Aborigines, they use *egargal* or 'story-teller' to mean entrepreneurs. The Māori language of the Polynesians of New Zealand has two words for entrepreneurship: *ngira tuitui,* 'the needle that binds things together', and *tinihanga a Māui*, 'the tricks of Māui'. Māui in Polynesian mythology is a demigod and cultural hero famous for his exploits and trickery. Māori admire his entrepreneurial spirit, heroism, altruism and brashness. Take the following story, for example:

> Every day Māui's brothers went fishing, but they always refused to take Māui with them because they were afraid of his magical tricks. One day, however, Māui hid in their canoe and revealed himself when they were far out to sea. Māui drew out his fishhook made from the

> magical jawbone of his grandmother, baited it with some blood from his nose, and then lowered it deep down in the ocean … Māui pulled the greatest of all fishes into the boat … and it miraculously turned itself into land that became the islands of New Zealand.[24]

However we say it, entrepreneurs are the aggressive catalyst for change in the world of business. They are independent thinkers who dare to be different in a background of common events. Research reveals that many entrepreneurs have certain characteristics in common, including the ability to consolidate resources, management skills and a desire for autonomy and risk taking. Other characteristics include brashness, competitiveness, goal-oriented behaviour, confidence, opportunistic behaviour, intuitiveness, pragmatism, the ability to learn from mistakes and the ability to employ human relations skills.[25]

Economists have long claimed the word as their own. In fact, until the 1950s, the majority of definitions and references to entrepreneurship had come from economists. For example, Richard Cantillon (1680–1734), renowned French economist Jean Baptiste Say (1767–1832) and twentieth-century economic genius Joseph Schumpeter (1883–1950) all wrote about entrepreneurship and its impact on economic development.[26] Such was Schumpeter's influence that many academics today still subscribe to a **Schumpeterian** viewpoint.

Schumpeterian
Someone who believes that innovation and technological change comes from the 'wild spirits' or 'fiery souls' of entrepreneurs who engage in a process of 'creative destruction'.

Over the decades, writers have tried to define what entrepreneurship is all about. Here are some early examples:

> Entrepreneurship … consists in doing things that are not generally done in the ordinary course of business routine; it is essentially a phenomenon that comes under the wider aspect of leadership.[27]
>
> Entrepreneurship, at least in all non-authoritarian societies, constitutes a bridge between society as a whole, especially the non-economic aspects of that society, and the profit-oriented institutions established to take advantage of its economic endowments and to satisfy, as best they can, its economic desires.[28]
>
> In … entrepreneurship, there is agreement that we are talking about a kind of behaviour that includes: (1) initiative taking, (2) the organizing or reorganizing of social economic mechanisms to turn resources and situations to practical account, and (3) the acceptance of risk of failure.[29]

Economists have argued whether or not an entrepreneur exploits equilibrium (that is, stabilises a market) or creates disequilibrium (disrupts a market). But research shows the entrepreneur is risk-bearing, capital-owning, exceptional, a leader, a combiner of factors and more innovative or more alert than the general population.[30] Ronstadt's definition is helpful:

> Entrepreneurship is the dynamic process of creating incremental wealth. This wealth is created by individuals who assume the major risks in terms of equity, time, and/or career commitment of providing value for some product or service. The product or service itself may or may not be new or unique but value must somehow be infused by the entrepreneur by securing and allocating the necessary skills and resources.[31]

free enterprise
Private ownership of the means of production and enterprise management that is free and independent from state control. The allocation of productive resources is decentralised and obeys the decisions of free individuals who act guided by their own interest.

capitalism
An economic system based on private ownership of the means of production. Individuals, companies or corporations invest in, own and share in profits (or losses) of the entities that produce goods, distribute products or provide services.

In the twentieth century, the word entrepreneur has become linked with **free enterprise** and **capitalism**. Also, it is generally recognised that entrepreneurs serve as agents of change; create innovative, exploitable ideas; and help businesses grow and become profitable. The term entrepreneur has now become associated with people who create added value, whether that be social or business value. Think Australian Instagram influencers such as Steph Claire Smith and Rebecca Judd, who have created empires on social media and are paid by brands to endorse products to their thousands of followers. But be aware of other reactions. Just the reverse, there are people out there who complain about 'rampant entrepreneurialism'; the word entrepreneur sometimes carries a negative connotation outside the U.S. and Australia.

In recognising the importance of the evolution of entrepreneurship into the twenty-first century, we have developed an integrated definition:

> Entrepreneurship is a dynamic process of adding value to society, business and environment. It requires you to apply energy and passion toward the creation and implementation of new value-adding ideas and creative solutions. You need to take calculated risks; build an effective venture team; assemble the needed resources; conceive and convince others of a solid business model and plan; and finally be able to recognise opportunity where others see chaos, contradiction and confusion.

ENTREPRENEURIAL EDGE

SPENDING THE OLD MAN'S DOUGH

Ivan is a successful first-generation Australian entrepreneur who emigrated from Russia. He started out as a mechanic in Melbourne and dreamed of building a better future for his new (Australian) children. Ivan was thrifty and disciplined. Although in a low-status occupation, he was very proud of how hard he worked. He took a few punts that paid off until he could open his own garage, and he now runs a successful franchise business of several dozen oil and lube operations, where he trains other immigrants.

Ivan is a classical entrepreneur, but how should he teach his children? Should he encourage them to follow his lead and create financial success as entrepreneurs? The chances are he won't. Fewer than one in five do.

Sure enough, Ivan wanted his children to have a 'better' life. He encouraged them to spend many years at university. He wanted his children to become physicians, lawyers, accountants, executives and so on. But in encouraging them to do so, Ivan essentially discouraged his children from becoming entrepreneurs. He unknowingly had them postpone their entry into the labour market until they had finished the finest education that Australia has to offer. And, of course, he encouraged them to reject his lifestyle of thrift and self-imposed environment of scarcity, and instead to be consumers of material goods.

Ivan defines 'better' as having better 'stuff': finer homes, new luxury cars, quality clothing and club memberships. What he doesn't include are the elements that were the foundations of his own success: hard work, risk taking and perseverance.

Ivan does not realise that being well educated has certain economic drawbacks. What Ivan's well-educated children learn by the time they are adults is to be grand consumers of material goods. And at the same time, they are underperformers as entrepreneurs. They are the opposite of their father, the blue-collar, successful business owner. They are part of the high-consuming, self-employment-postponing generation, and what's worse they still live at home, enjoying the old man's wealth!

Questions

1 In your own experience, what are the social and cultural reasons that Ivan's children are underachievers?
2 Do you know people who are like Ivan's children? Are you like them?
3 What would you recommend to 'kick some sense' into their heads?
4 Is more schooling, or different schooling, the right answer?

ENTREPRENEURSHIP THROUGH THE AGES

individualism
Degree of emphasis placed on individual accomplishment rather than on collectivism or group accomplishment.

Throughout history there have been enterprising individuals who spotted and exploited smart opportunities. But as humans developed a sense of **individualism**, these 'dreamers who often face daunting, even life-threatening challenges to realise their dreams. Entrepreneurs frequently experienced prejudice, discrimination and even death for their beliefs and activities. When xenophobia raises its ugly head, it is often enterprising immigrant entrepreneurs (e.g. Somali shopkeepers in South Africa) who are first killed.[32]

Were there entrepreneurs in the Palaeolithic period 40 000 years ago? From a Darwinian perspective, perhaps there were. Taking risks probably generated an evolutionary advantage. In today's terminology, we might say that a primitive hunter-gatherer who developed a new weapon might have been seeking niche advantage in the wild marketplace. As hunting technology developed, some people started to accumulate a surplus and then turned from their struggle for mere survival into using their accumulated wealth and knowledge to start settled communities. Some clever people must also have decided to lend their capital and knowledge to others for personal gain or the benefit of the clan, but in a collective society it was sometimes better to hide your wealth and assets.

niche advantage
An advantage created by offering a valuable and unique product and/or service specifically to a single, narrow market or customer segment. A market niche is usually a subset of a larger market or customer segment that has specific needs not addressed by competitors who seek volume sales from less-defined and larger customer groupings.

Data from anthropology tell us that entrepreneurial wealth creation has existed for millennia. Excavated business tablets show that innovation and entrepreneurship were key aspects in civilisations that have long disappeared.[33] Ancient Assyrians (their empire was in today's Iraq) carried out innovation transfer, had a corps of knowledge workers and developed business communication.[34] The Assyrians inherited a system of private enterprise from Sumer and Babylon.

Wingham believes that entrepreneurship as we know it today developed in the eleventh century BCE in ancient Phoenicia, located in today's Lebanon.[35] A sailing nation of merchants and traders, the Phoenicians peacefully connected a commercial empire that ranged from Syria in the east to Spain and even Ireland in the west. Phoenician traders were the Star Trekkers of their age – true entrepreneurs who took risks, explored the unknown and faced chaos on a daily basis. Certainly they returned profit to investors, merchants and themselves. This peaceful trading nation was swept aside by the bellicose and avaricious Persian Empire, and with it the concept of the risk-taking 'undertaker'.

In biblical times an enterprising individual with high ability and independence faced prejudices that societies had against usury (charging a fee for the use of money), which in the Bible was viewed as a great crime. Ezekiel 18:13 says: 'He who lends at usury and takes excessive interest. Will such a man live? He will not! Because he has done all these detestable things, he will surely be put to death and his blood will be on his own head.' Imagine how dangerous loan sharking was in those times.

usury
The lending of money at exorbitant interest rates.

The Romans did permit usury, but, curiously, not by Romans themselves. Any actual business enterprise by a nobleman led to loss of prestige. Wealth accumulation was highly valued as long as it did not involve a nobleman's own participation in industry or commerce.[36] In Rome, to be sure, there was no absence of wealth creation, only of commerce. Landholding and usury were the usual routes to wealth creation: 'Money poured in from booty, indemnities, provincial taxes, loans and miscellaneous extractions'.[37] This aversion to commerce among the Roman nobility left the way open for entrepreneurial freedmen, who were former slaves set up by their masters to run the businesses. Slavery may have been one of the few avenues to commercial advancement for people of the lower classes.

Amazing as it may sound, in ancient Rome, innovation and profit were completely disconnected. Certainly, Romans made considerable advances in technology, but this was divorced from commerce. Pliny writes that one day an inventor came before Emperor Tiberius to show him his invention of an unbreakable glass window and to beseech him for an inventor's fee. Tiberius asked whether he had told anyone the formula. The man assured him that the invention was absolutely secret, whereupon the emperor immediately cut his head off 'lest gold be reduced to the value of mud'. The sad lesson of this story is that the inventor had to turn to the emperor for a reward rather than to a venture capitalist for investment – and he couldn't even protect his intellectual property![38]

Turning now to medieval China, how could an entrepreneur begin a venture when the monarch owned all the property? When the emperor needed cash, he simply seized it from his wealthy noblemen. This meant that no one would invest in a productive enterprise for fear of losing it so easily. Only scholarship and officialdom were routes to success, and value was tied up in land, not enterprise. Wealth came to those who passed examinations and gained government positions.

In contrast, Islam has always promoted business entrepreneurship. Though Islam prohibited pork, alcohol, gambling, prostitution and usury, Muslims were otherwise free to invest their money in any economic activity, and to produce, trade and consume in whatever way they wished. Trade and commerce have always been a part of Islam. From pre-Islamic days, the Holy City of Mecca has been the centre of commercial activities. There is no basic conflict between good business practice and profit making in Islam. One scholar of entrepreneurship from Turkey writes that in the spring of 595 CE, businesswoman Lady Khadija had a dream telling her to hire a particular man named Mohammed as her trade agent because of his honesty and stamina on the long camel routes. Indeed, writes Adas, had the Prophet Mohammed lived today, 'on his business card it would have been written "exporter and importer".'[39]

Meanwhile in Europe in the Middle Ages, great wealth and power came not from business acumen but from military conquest. Innovations such as armour, the crossbow and gunpowder were needed for military campaigns, not retail shops. As Europe moved from a feudal economy to nascent capitalism, conditions began to change. Merchant entrepreneurs excelled in shipbuilding, built global trading networks and used advanced weaponry to protect them. Forms of usury appeared, such as loans to rulers, leased monopolies, buying on credit, fixed exchange rates and so forth. Merchant entrepreneurs became major players in European politics, and the owners of shipping fleets and banks produced descendants who, like the Medici, could become secular rulers or even popes.[40] By the late Middle Ages, the revival of towns saw tax-free zones and emancipated serfs, leading to the growth of an entrepreneurial spirit.

The sad fact is that in the Industrial Revolution of the nineteenth to twentieth centuries, in Europe at least, an entrepreneur's life could lead to decapitation, death on the battlefield or appropriation by the emperor. Hardly a conducive environment!

As perilous as the profession may have been, the entrepreneurial spirit has driven many of humanity's achievements. Indeed, some say not much has really changed. Multinational corporations existed in Assyria. Ancient Greeks had brand-name competitions. Business travel was not unknown to Marco Polo. There were industry clusters in Phoenicia. Creative and innovative forms of free enterprise endured, sometimes for centuries.[41]

Humanity's progress from caves to campuses has been explained in numerous ways, but central to virtually all of these explanations has been the role of the agent of change, the force that initiates and implements material progress. New thinking even sees a Darwinian aspect. Just like selected organisms in biological systems, entrepreneurs are at the cutting edge of developing, retaining and selecting information useful to survival.[42]

rugged individualist
A person who cherishes individual liberty and self-reliance.

Today, we recognise that the agent of change in human history has been and most likely will continue to be the entrepreneur.[43] **Rugged individualists**, those who cherish individual liberty and self-reliance, frequently found themselves opposed to authority and to controls over the individual. At the core of it was the mantra that entrepreneurs 'mind their own business' (as in take charge of or look after themselves).

sovereign individual
A person or a business that is not beholden to a nation. For example, someone who resides on the internet and selects where to do business based on cost versus profit.

Entrepreneurs today may well be the prototypical **sovereign individuals**. In *The Sovereign Individual*, Davidson and Rees-Mogg see history as a series of roughly 500-year cycles – from Athens' glory and decline (500 BCE), to the dawn of Christianity and the fall of Rome (500 CE), to the emergence of feudalism (1000 CE) and its subsequent collapse (around 1500 CE). Each cycle sees the rigid grip of the governmental system ultimately breaking down and the (temporary) liberation of individuals from undesirable controls. The authors say that in the modern age citizens no longer need to be beholden to the authority of a nation-state. Tomorrow's entrepreneurs will reside on the internet and select where to reside and do business based on cost versus profit. They will comparison-shop for services (utilities, police protection and even currency) in a marketplace no longer dominated by state monopolies.[44]

THEORETICAL APPROACHES TO ENTREPRENEURSHIP

To understand the nature of entrepreneurship and better recognise its emerging importance, let's now consider some of its theory. The research on entrepreneurship has grown dramatically over the years. Research methodology has progressed from empirical surveys of entrepreneurs to more contextual and process-oriented research. Theory development is what drives a field of study. Entrepreneurship theory has been developing for at least 40 years and it is apparent that the field is growing. It is important to understand some of that development to better appreciate the discipline of entrepreneurship. The study of the basic theories in the field also helps to form a foundation upon which a student can build an understanding of the process and practice of entrepreneurship.

A **theory** of entrepreneurship is defined as a verifiable and logically coherent formulation of relationships or underlying principles that explain entrepreneurship. These principles predict entrepreneurial activity (for example, by characterising conditions that are likely to lead to value creation or social opportunities and the formation of new enterprises), or provide normative guidance (that is, prescribe the right action in particular circumstances).[45] In the new millennium, it has become increasingly apparent that we need to have some cohesive theories or classifications to better understand this emerging field.

theory
A well-substantiated explanation of some aspect of the natural world; an organised system of accepted knowledge that applies in a variety of circumstances to explain a specific set of phenomena.

In the study of entrepreneurship, one concept recurs: entrepreneurship is **interdisciplinary**, which means combining fields and crossing boundaries between disciplines or schools of thought. As such, it contains various approaches that can increase one's understanding of the field.[46] Therefore, we need to recognise the diversity of theories as representative of an emergence of entrepreneurial understanding. One way to examine these theories is within a 'schools of thought' approach, which divides entrepreneurship into specific activities. These activities may be within a macro view or a micro view, yet all address the conceptual nature of entrepreneurship.

interdisciplinary
Relating to more than one branch of knowledge.

SCHOOLS OF ENTREPRENEURIAL THOUGHT

A **school of thought** is a body of belief, literature or theory that is accepted as authoritative by a group of scholars or writers. In this section we will highlight the ideas emanating from the macro (meaning 'wide-scale' perspective) and micro (meaning 'small-scale') views of entrepreneurial thought. We will further break down these two major views into seven distinct schools of thought (see Figure 1.2). We don't claim to limit the number of schools of thought to these seven. It is simply organising some of our knowledge in an efficient way.

school of thought
Opinion subscribed to by a group of scholars, theorists or researchers.

FIGURE 1.2
ENTREPRENEURIAL SCHOOLS OF THOUGHT

The macro view

The **macro view of entrepreneurship** presents a broad array of external factors, such as education, physical infrastructure, culture and financing that relate to success or failure in contemporary entrepreneurial ventures. This assortment of factors includes external processes that are sometimes beyond the control of the individual entrepreneur, for they exhibit a strong **external locus of control** point of view. Four schools of entrepreneurial thought represent a breakdown of the macro view. The first of these is the broadest and most pervasive school.

- The **social and cultural school of thought** deals with external factors and surrounding conditions and influences that affect a potential entrepreneur's lifestyle. These contexts can be either positive or negative forces in the moulding of entrepreneurial desires. The focus is on institutions, values and social mores that, grouped together, form a sociopolitical environmental framework that strongly influences the development of entrepreneurs.[47] For example, if a middle manager experiences the freedom and support to develop ideas, initiate contracts or create and institute new methods, the work environment will serve to promote that person's desire to pursue an entrepreneurial career. (We call this type of person an 'intrapreneur'; see Chapter 8.) Another environmental factor is their social group. The atmosphere of friends and relatives can influence the desire to become an entrepreneur. Migrants are also more entrepreneurial than native residents of a country. In Australia and the rest of the world, certain immigrant groups, such as Koreans, Jewish people, Greeks and Italians, have been more likely to launch start-ups.[48]
- The **financial/capital school of thought** is based on the capital-seeking process; the search for seed and growth capital is the entire focus of this entrepreneurial emphasis. Certain literature is devoted specifically to this process, whereas other sources tend to treat it as but one segment of the entrepreneurial venture. In any case, capital seeking is vital to an entrepreneur's development. Business planning guides and texts for entrepreneurs emphasise this phase, and development seminars often focus on the funds application process. This school of thought views the entire entrepreneurial venture from a financial management standpoint.[49]
- The **displacement school of thought** focuses on the negative side of group phenomena, in which someone feels out of place – or is literally displaced – from the group. This theory holds that sometimes the social group hinders a person from advancing or eliminates certain critical factors needed for that person to advance. As a result, the frustrated individual will be projected into an entrepreneurial pursuit out of his or her own motivations to succeed. As researchers have noted, individuals fight adversity and tend to pursue a venture when they are prevented or displaced from doing other activities.[50]

  Three major types of entrepreneurial displacement illustrate this school of thought. Each leads some people to becomes entrepreneurs.
  - *Political displacement:* This is caused by factors ranging from an entire political regime that rejects free enterprise to governmental regulations and policies that limit or redirect certain industries.
  - *Cultural displacement:* This deals with social groups precluded from professional fields. Ethnic background, religion, race and sex are examples of factors that figure in the minority experience. Increasingly this experience will turn various individuals from standard business professions toward entrepreneurial ventures.
  - *Economic displacement:* This is concerned with the economic variations of recession and depression. Job loss, capital shrinkage or simply bad times can create the foundation for entrepreneurial pursuits, just as they can affect venture development and reduction.

macro view of entrepreneurship
A view of entrepreneurship that examines the huge array of external processes and factors that are sometimes beyond the control of the individual entrepreneur, such as the environment and financial markets. (See also *micro view of entrepreneurship*, *external locus of control*.)

external locus of control
The perception that factors external to the self are responsible for the outcome of an event.

social and cultural school of thought
The school of thought that deals with external factors, surrounding conditions and influences that affect a potential entrepreneur's lifestyle.

financial/capital school of thought
Refers to the need for capital and focuses on the relationship between entrepreneurs and investors, funding sources, performance of entrepreneurial investments and returns for investors and entrepreneurs, and public policy issues.

displacement school of thought
Entrepreneurial school of thought that focuses on factors that prevent (or displace) a person from doing other activities, such as a political regime or a regulatory environment that blocks free enterprise; cultural aspects that might prevent a person from choosing self-employment; or economic factors such as job loss or even full employment, and the effect these factors might have on the choice to become an entrepreneur.

These examples of displacement illustrate the external forces that can influence the development of entrepreneurship. Cultural awareness, knowledge of political and public policy and economic indoctrination will aid and improve entrepreneurial understanding under the displacement school of thought. The broader the educational base in economics and political science, the stronger the entrepreneurial understanding.

- The relatively new **ecological school of thought** comes from the growing perception of the natural world and our relationship to it as entrepreneurs. It is based on the idea that everything is related to everything everywhere. The systems that uphold life on the planet can no longer endure the wanton exploitation and consumption that entrepreneurs have subjected them to. This school of thought is based on the fields of green economics and ecological economics. It is defined by its focus on intergenerational equity, irreversibility of environmental change, uncertainty of long-term outcomes and sustainable development. Ecological entrepreneurship looks at the metabolism of new venture creation; that is, the study of the flows of energy and materials that enter and exit entrepreneurial businesses.[51]

ecological school of thought
School of entrepreneurial thought that focuses on our perception of the natural world and our relationship to it as entrepreneurs. Based on the idea that everything is related to everything everywhere. Encompasses intergenerational equity, irreversibility of environmental change, uncertainty of long-term outcomes and sustainable development.

The micro view

The **micro view of entrepreneurship** examines the factors that are specific to entrepreneurship and are part of one's *internal locus of control*.[52] The potential entrepreneur has the ability, or control, to direct or adjust the outcome of each major influence in this view. As part of this approach we present entrepreneurial trait theory (sometimes referred to as the 'people school of thought'), venture opportunity theory and the strategic planning theory of entrepreneurship. Unlike the macro approach, which focuses on events from the outside looking in, the micro approach concentrates on specifics from the inside looking out. The first of these schools of thought is the most widely recognised in the field of entrepreneurship research.

micro view of entrepreneurship
A view of entrepreneurship that examines factors that are within the entrepreneur's ability to direct or adjust. (See also *macro view of entrepreneurship*, *internal locus of control*.)

- The **entrepreneurial trait school of thought** is grounded in the study of successful people who tend to exhibit similar characteristics that, if copied, would increase success opportunities for the emulators. Many researchers and writers have been interested in identifying **traits** common to successful entrepreneurs.[53] For example, achievement, creativity, determination and technical knowledge are four factors that usually are exhibited by successful entrepreneurs. Family development and educational incubation are also examined. Is education important? Some argue that education and success as an entrepreneur are highly correlated, while others believe it stands in the way of the creative and challenging nature of entrepreneurship, and that the best entrepreneurs actually drop out of school.[54] (In Chapter 2, the concepts of entrepreneurial cognition and metacognition, which are beginning to take hold in the research on entrepreneurs, are discussed.)
- The **venture opportunity school of thought** focuses on the opportunity aspect of venture development. The search for idea sources, the development of concepts and the implementation of venture opportunities are the important interest areas for this school. Creativity and market awareness are viewed as essential. Additionally, according to this school of thought, developing the right idea at the right time for the right market niche is the key to entrepreneurial success.[55]

entrepreneurial trait school of thought
A micro view of entrepreneurship that seeks to identify traits common to successful entrepreneurs (e.g. achievement, creativity, determination and technical knowledge). (See also *micro view of entrepreneurship*.)

traits
Personal characteristics that distinguish individuals, including entrepreneurs.

venture opportunity school of thought
A micro view of entrepreneurship that focuses on sources of ideas and development of concepts within the context of creativity and market awareness: developing the right idea at the right time for the right market. (See also *micro view of entrepreneurship*.)

pathways principle Belief that proper preparation in the interdisciplinary business segments will enhance the ability to recognise venture opportunities.

strategic formulation school of thought A micro view of entrepreneurship that views strategic planning as interwoven into the entire fabric of management, not as something with a separate office and staff. Emphasises planning, leveraging of unique markets, unique people, unique products and unique resources. (See also *micro view of entrepreneurship*.)

mountain gap strategies Strategies that leverage new and unique markets by identifying existing major market segments and going after the gaps in between larger markets.

great chef strategies System of strategy involving leveraging and building the business around great and unique people with special skills or talents.

better widget strategies Strategies that leverage unique products that open up existing markets or stake out new markets.

water well strategies Strategies that leverage unique resources (land, labour, capital, raw materials) that no one else has.

integrative approach An entrepreneurial approach that incorporates a 'from outside' analysis of five key components to justify the choice of one opportunity over another.

Another development from this school of thought – one that greatly influences how this book is put together – is the **pathways principle**. New pathways or opportunities will arise that lead entrepreneurs in different directions. The ability to recognise these opportunities when they arise and to implement the necessary steps for action is a key factor. Roman philosopher Seneca's maxim that 'Luck is what happens when preparation meets opportunity' underlies this pathways principle. Proponents of this school of thought believe that proper preparation in the interdisciplinary business segments will enhance the ability to recognise venture opportunities. You will see that this book presents various pathways toward becoming an entrepreneur.

- The **strategic planning school of thought** emphasises the planning process in successful venture development.[56] Strategic planning is inextricably interwoven into the entire fabric of management; it is not something separate and distinct from the process of management. One way to view strategic formulation is as a leveraging of unique elements. Unique markets, unique people, unique products or unique resources are identified, used or constructed into effective venture formations. The interdisciplinary aspects of strategic adaptation become apparent in the characteristic elements listed here with their corresponding strategies.
  - *Unique markets:* Mountain versus **mountain gap strategies**, which refers to identifying major market segments as well as interstice (in-between) markets that arise from larger markets.
  - *Unique people:* **Great chef strategies**, which refers to the skills or special talents of one or more individuals around whom the venture is built.
  - *Unique products:* **Better widget strategies**, which refers to innovations that tap into new or existing markets.
  - *Unique resources:* **Water well strategies**, which refers to the ability to gather or harness special resources (land, labour, capital, raw materials) over the long term.

Without question, the strategic planning school emphasises a breadth of managerial capability that requires an interdisciplinary approach.[57]

PROCESS APPROACHES TO ENTREPRENEURSHIP

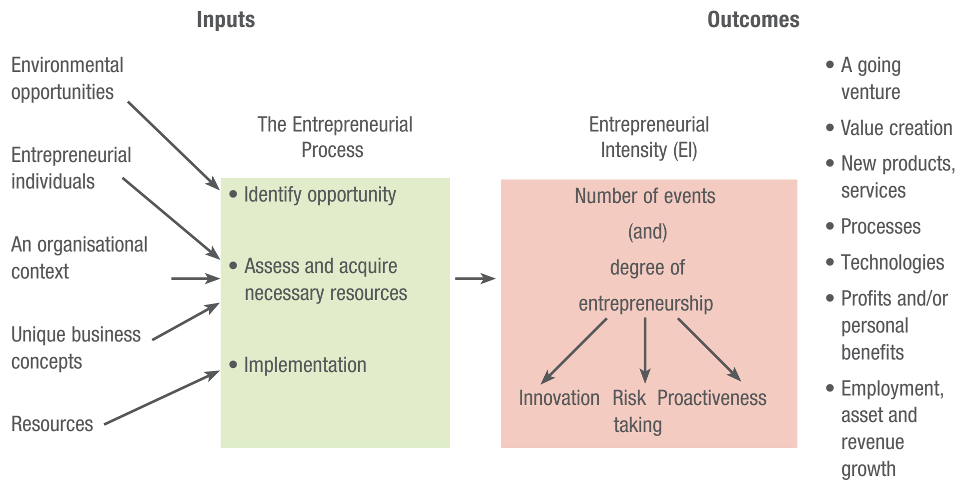
Another way to examine the activities involved in entrepreneurship is through a process approach. There are many methods and models that structure the entrepreneurial process and its various factors. We shall examine two of the more traditional process approaches here.

The **integrative approach** to entrepreneurship is built around the concepts of input to and outcomes from the entrepreneurial process.[58]

- The input aspect has five components. First are the opportunities that arise from such things as demographic change, development of a new technology or a modification to current regulations. Next is the individual entrepreneur, the person who assumes personal responsibility for conceptualising and implementing a new venture. The entrepreneur develops some type of business concept to capitalise on the opportunity (e.g. a creative approach to solving a particular customer need). Implementing this business concept typically requires some type of organisational context, which could range from a sole proprietorship run out of the entrepreneur's home or a franchise of some national chain to an autonomous business unit within a large corporation. Finally, a wide variety of financial and non-financial resources are required on an ongoing basis. These key elements are then combined throughout the stages of the entrepreneurial process. Stated differently, the process provides a logical framework for organising entrepreneurial inputs.

- The outcome aspect of Figure 1.3 can result in any number of entrepreneurial events and can produce events that vary in their 'entrepreneurial intensity'. Outcomes can range anywhere from failure to value creation, new products and processes, new technologies, profit, jobs and economic growth.

FIGURE 1.3 AN INTEGRATIVE MODEL OF ENTREPRENEURIAL INPUTS AND OUTCOMES



Source: Morris, M. H., Lewis, P. S., & Sexton, D. L. (1994). Reconceptualizing entrepreneurship: An input–output perspective. *SAM Advanced Management Journal*, 59(1), 21–31. Reprinted with permission.

This entrepreneurial process model not only provides a fairly comprehensive picture of the nature of entrepreneurship, it also can be applied at different levels. For example, the model describes the phenomenon of entrepreneurship in any context, from business and social to environmental and community entrepreneurship.

Dynamic states approach

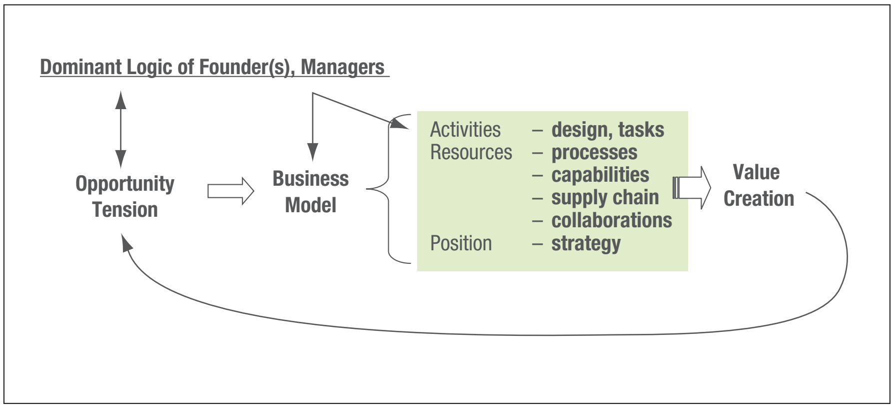
The **dynamic states model** depicts ventures being dependent on their contextual environment for survival. A dynamic state is a network of relationships and systems that convert opportunity tension into value for a venture's customers, generating new resources that maintain the dynamic state. Businesses choose a strategy for value creation through their business models, which are derived from the emerging dominant logic of the business. These elements of the dynamic states model are pictured in Figure 1.4. The dynamic states model is more optimistic for entrepreneurs, suggesting that smaller and newer businesses have more flexibility in making ongoing changes. Thus, it may be easier for new ventures to create a high degree of interdependence between themselves and their environment, enabling entrepreneurs to organise for the current and anticipated demands of their market.[59]

dynamic states model
A network of relationships and systems that convert opportunity tension into value for a venture's customers, generating new resources that maintain the dynamic state.

A FRAMEWORK OF FRAMEWORKS APPROACH

Researchers contend that theories or frameworks based on theoretical combinations offer a more dynamic view of the phenomenon of entrepreneurship. Much like the 'multiple lens' approach that characterises general management, the theories based on combinations can delve into some of the particular aspects of entrepreneurship with greater granularity.[60] As one researcher noted in regard to entrepreneurial decision making, 'there are numerous opportunities for multilevel research to make a substantial contribution to the field of entrepreneurship'.[61]

FIGURE 1.4
DYNAMIC STATES APPROACH



Dynamic State

Source: Levie, J., & Lichtenstein, B. B. (2010). A terminal assessment of stages theory: Introducing a dynamic states approach to entrepreneurship. *Entrepreneurship Theory and Practice*, 34(2), 332. Reproduced with permission of John Wiley & Sons Ltd.

The schools-of-thought approaches that exist in the field of entrepreneurship are based on a phenomenon that incorporates many diverse and heterogeneous dimensions; only a comprehensive framework approach might afford researchers the capacity to explore and expand the knowledge base. A sizeable body of research has developed that supports the individual frameworks, including the schools of thought or process models, but the integration of previously disparate aspects of entrepreneurship may be particularly valuable to advancing the field of entrepreneurship. As such, greater knowledge could be gained from the extrapolation of particular insights from each of the frameworks presented in this approach. Thus a '**framework of frameworks**' that allows for the profession to move forward in identifying the static and dynamic elements of new theories, typologies or frameworks could be an important approach to growing the knowledge base of the field. Figure 1.5 depicts the framework of frameworks approach for entrepreneurship as the nexus of the major strands of entrepreneurship frameworks currently employed.

framework of frameworks
A synthesis of entrepreneurial frameworks that allows for entrepreneurship theory to move forward in identifying the static and dynamic elements of new theories, typologies or frameworks.

TYPES OF ENTREPRENEURS

There are many kinds of entrepreneurs. The word 'entrepreneur' is very flexible in the English language. A **seniorpreneur** is someone who starts a business after the age of 55. A **copreneur** is someone who works with the entrepreneur, such as the spouse, an accountant or a supplier. Biopreneurs work in biotechnology, biology and the environment. There are (believe it or not!) academicpreneurs (we call them pracademics, such as your authors). There are cross-cultural entrepreneurs, mediapreneurs, end-poverty entrepreneurs, transparency-and-fairness entrepreneurs, social entrepreneurs, social-privatisation entrepreneurs, world-citizen entrepreneurs, intrapreneurs, knowledge-collaboration entrepreneurs, cultural entrepreneurs and biodiversity entrepreneurs. But for the present we will look at, and distinguish between, three main types.

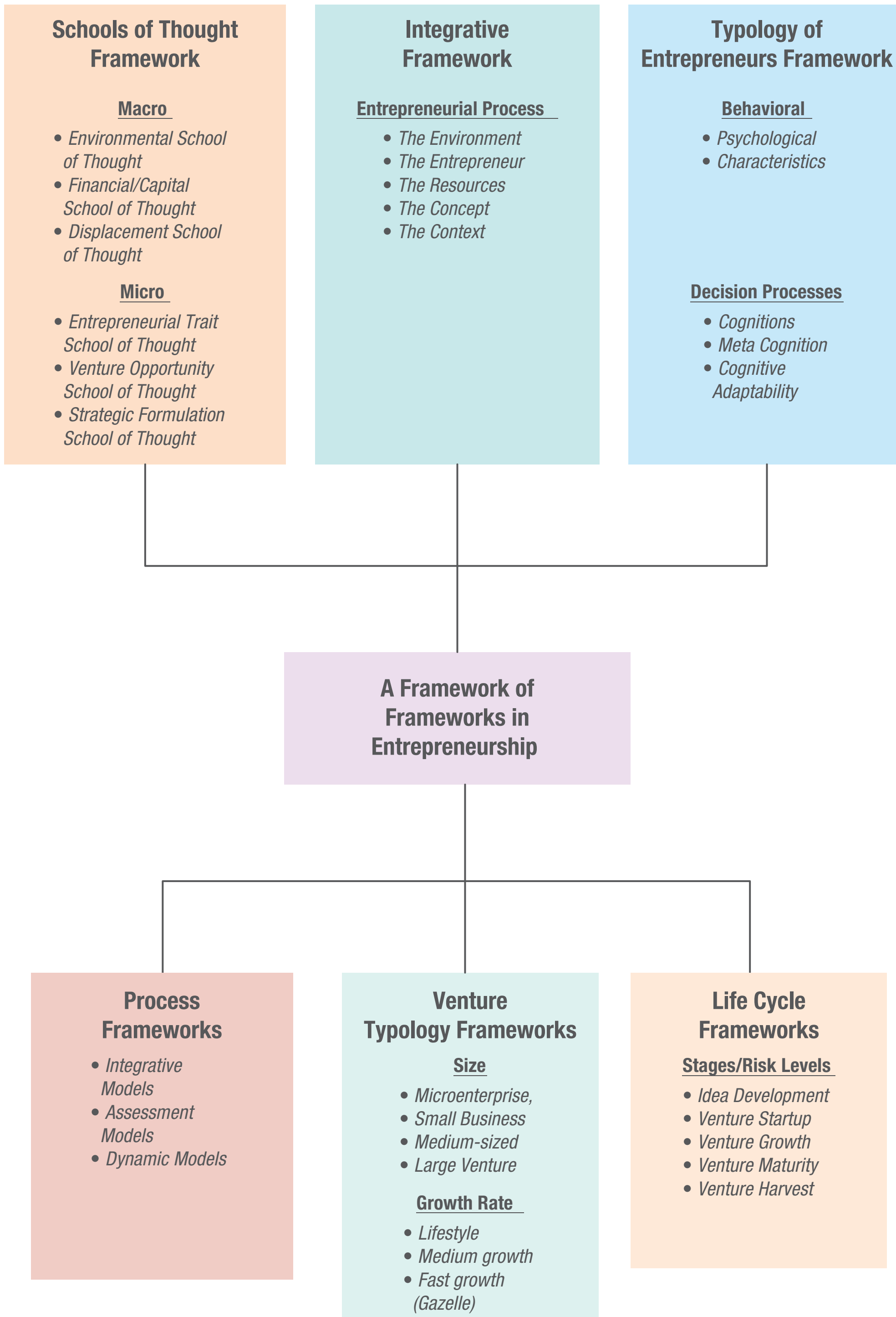
seniorpreneur
Someone who starts a business after the age of 55.

copreneurs
Couple with a personal relationship in addition to a business relationship.

Business entrepreneurs are driven by the profit motive. They seek growth and profits within the business world. They are constant innovators and always trying to capture larger market shares from a competitive marketplace. They are pioneering individualists who create one venture after another and one innovation after another.

business entrepreneur
An entrepreneur driven by the profit motive (as opposed to social entrepreneurs), who seeks growth and profits within the business world.

FIGURE 1.5
A FRAMEWORK OF FRAMEWORKS APPROACH



Source: Kuratko, D. F., Morris, M. H., & Schindehutte, M. (2015). Understanding the dynamics of entrepreneurship through framework approaches. *Small Business Economics*, 45(1), 9. Berlin, Germany; Springer Publishing.

social entrepreneur
An entrepreneur driven by a mission, who seeks to find innovative ways to develop and promote solutions or products that add value both to the company's bottom line as well as to society and the planet. Also called corporate social entrepreneur.

Social entrepreneurs have many of the same personality characteristics as business entrepreneurs, but they are driven by a mission and seek to find innovative ways to solve problems that are not being or cannot be addressed by either the market or the public sector.[62]

Both business and social entrepreneurs seek innovation and growth. They thrive in both small enterprises and large organisations. They have a mindset that separates them from the rest of the population.

The terms entrepreneur and small-business owner are sometimes used interchangeably, but that is incorrect. Although some situations encompass both terms, it is important to note the difference in the following definition.

small-business owners
As opposed to entrepreneurs, those business owners who, once they have captured an opportunity, do not seek to expand or grow the business, preferring a more stable and less aggressive approach to running the business.

Small-business owners may once have captured an opportunity like an entrepreneur but then they rest on their laurels go no further, perhaps because either they or the opportunity – or both – do not continue to be entrepreneurial. The business may never grow in any significant way and the business owner may prefer a more stable and less aggressive approach to running their business. Many small-business owners like stable sales and profits and modest growth and want to keep the business at a size they can personally manage and control. These are not entrepreneurs but small-business owners and managers.

The difference is that small-business owners would rather exploit existing equilibrium opportunities and optimise supply and demand in established markets. Entrepreneurs, on the other hand, aim to exploit innovative venture opportunities and create new markets at home and abroad.

In this book, we concentrate on business and social entrepreneurs. Much of the content relates to the broadest range of sectors, from profit to non-profit and from government institutions to large businesses. As far as small business is concerned, many of the particular points in this book may apply to both small-business owners and entrepreneurs. However, keep in mind that our focus is on the aspects of innovation and growth associated with business and social entrepreneurs, not with small-business managers and managing a small venture. Nevertheless, entrepreneurial businesses may go through a small business phase and small business ownership provides skills development opportunities in business management.

ENTREPRENEURS HAVE A PARTICULAR ENTERPRISING MINDSET

entrepreneurial mindset
All the cognitive characteristics and elements that compose the entrepreneurial potential in every individual.

CourseMateExpress

What is your EQ (entrepreneurial quotient)? See how you rate on CourseMate Express.

Entrepreneurship is more than the mere creation of a business or a social enterprise. Although that is certainly an important facet, it is not the complete picture. The characteristics of seeking opportunities, taking risks beyond security and having the tenacity to push an idea through to reality combine into a special perspective that permeates entrepreneurs. Some people are born with it while others, as Peter Drucker says in the epigraph at the top of this chapter, can develop an **entrepreneurial mindset**. This mindset can be exhibited inside or outside an organisation, in profit or non-profit enterprises and in business or non-business activities for the purpose of bringing forth creative ideas. Thus entrepreneurship is an integrated concept that permeates an individual's enterprise in an innovative manner. It is this mindset that has revolutionised the way business and social ventures are conducted at every level and in every country.

Look at the mindset of the crew of the Starship Enterprise in the famous TV show *Star Trek*. They definitely had entrepreneurial qualities. The mission of the Starship Enterprise was 'to boldly go where no [one] has gone before'. This means having the nerve to face the unknown. 'Space … the final frontier' is all about finding new markets. 'These are the voyages of the Starship Enterprise' is all about planning for the future. 'To explore strange new worlds, to seek out new life and new civilisations' is just like the entrepreneur's ability to explore, learn and adapt.

Today, the word **enterprise** (or enterprising) is still used as an 'attitude to life, an attitude of exploring, of developing, of leading and of taking initiatives'.[63] Enterprise – as in an *enterprising individual* – is the process of identifying, developing and bringing a vision to life, be it an innovative idea or simply a better way of doing something. Enterprise applies not only to business ventures, but also to political and social decisions.

enterprise
The process of identifying, developing and bringing a vision to life, be it an innovative idea or simply a better way of doing something. Enterprise applies not only to business ventures, but also to political decisions and social decisions.

English is fortunate in having two complementary words. (Some languages do not make this distinction.) Enterprising means 'marked by imagination, initiative and readiness to undertake new projects'. **Entrepreneurial** means 'willing to take risks in order to create value'. Anyone – from an artist to a zoologist – can be enterprising. Entrepreneurship has a more business connotation. Both mean that a person is the **sole proprietor of the rest of their life**, of their own destiny.

entrepreneurial
Describes a person who has the mindset to spot opportunities, has a social or enterprising spirit, is willing to take calculated risks and wishes to enjoy a good outcome for themselves and the community.

sole proprietor of the rest of their life
Controller of one's own destiny. A free and sovereign individual.

Here are the components of an enterprising mindset:

- *Self-efficacy* – 'I can do this, and I can make a difference.'
- *Collaboration* – 'I know how to build a team and share roles.'
- *Identify opportunities* – 'I can spot and validate problems and solutions.'
- *Empathy* – 'I can stand in the shoes of another and see their perspective.'
- *Design perspective* – 'I am a master of human-centred design.'
- *Communication* – 'I can tell a compelling story about an opportunity.'
- *Representation* – 'I can build what I can imagine and get feedback from others.'

THE ENTREPRENEURIAL REVOLUTION: A GLOBAL PHENOMENON

It is clear that we are experiencing an **Entrepreneurial Revolution** across the world. This revolution will continue to be as important (if not more!) to the twenty-first century as the Industrial Revolution was to the nineteenth and twentieth centuries. Let's have a look at some of the main hallmarks of this global phenomenon. What contributions do entrepreneurs make to worldwide wellbeing? How does entrepreneurship relate to levels of global development? What about differences in generations? And how does entrepreneurship fit into personal freedom and liberty?

Entrepreneurial Revolution
A global trend toward increasing associations between entrepreneurship and economic performance, including job creation, growth, firm survival, innovation and technological change, productivity increases and exports.

OUR ENTREPRENEURIAL ECONOMY

Entrepreneurship is the symbol of business tenacity and **achievement**. Entrepreneurs are the pioneers of today's business successes. Their sense of opportunity, their drive to innovate and their capacity for accomplishment have become the standard by which free enterprise is now measured. This standard is taking hold within free and open economies throughout the world. Just consider the potential in the top Asian countries, with a combined population of 2.5 billion.[64] Add to that another 1.7 billion in South Asia. A whopping East Asia & Pacific GDP of $22 trillion[65] buys more than 65 per cent of Australia's exports.[66] Two-thirds of the new middle class resides in Asia.[67]

achievement
Accomplishing a business goal successfully through skill, risk-taking or perseverance.

Entrepreneurial companies make two indispensable contributions to the economy. First, they are an integral part of the renewal process that pervades and defines market economies. Entrepreneurial companies play a crucial role in the innovations that lead to technological change and productivity growth. In short, they are about change and competition because they change market structure. The economies of the **Asia-Pacific** region are dynamic entities, always in the process of becoming. Entrepreneurial companies focused on prospects for the future, not on the inheritance of the past.

Asia-Pacific
Political and economic term used to designate the economies on the edges of the Pacific Ocean as well as the various island nations within the region.

Second, entrepreneurial companies are the essential mechanism by which millions enter the economic and social mainstream of society. Small-business entrepreneurs enable millions of people, including women, ethnic minorities, Indigenous peoples and immigrants, to find prosperity for themselves and their families. Another benefit is the way that entrepreneurship can play a positive role in delivering health, education and welfare services efficiently. Social enterprises encourage the participation of stakeholders in the management and delivery of such services, enhancing innovation and client orientation. Such an approach can supplement public resources and extend the range of services offered to consumers.

As we can see, entrepreneurship is not just a developed-world phenomenon. The poor in the developing countries can and do get richer through enterprise. Former UN Secretary-General Kofi Annan has said 'entrepreneurs have the power to create the greatest change for their own countries'.[68]

Global Entrepreneurship Monitor (GEM)
A global study conducted yearly since 1999 that analyses the level of entrepreneurship in nearly 100 countries.

What about entrepreneurship and levels of development? The **Global Entrepreneurship Monitor (GEM)** sees different qualities of entrepreneurship as determined by the stage of economic development (see Table 1.4).

TABLE 1.4 STAGES OF ECONOMIC DEVELOPMENT AS THEY RELATE TO ENTREPRENEURSHIP

Stage one	*Factor-driven economies* compete based on their factor endowments, primarily unskilled labour and natural resources.	Factor-driven economies with high early-stage entrepreneurial activity include: Cameroon, Uganda, Botswana and Bolivia.
Stage two	*Efficiency-driven economies* develop more efficient production processes and increase product quality. They compete more on higher education and training, efficient goods markets, efficient labour markets, developed financial markets, the ability to harness the benefits of existing technologies and market size.	Efficiency-driven economies with high early-stage entrepreneurial activity include: Mexico, Ecuador, Peru, Chile and Thailand.
Stage three	*Innovation-driven economies* go beyond basic requirements or efficiency enhancers. At this stage, companies compete by producing new and different goods using the most sophisticated production processes and through innovation. The outcome of the model is national economic growth through, for example, job creation and technical innovation.	Innovation-driven economies with high early-stage entrepreneurial activity include: United States, Australia, New Zealand and Singapore.

LOOK OUT FOR GAZELLES AND UNICORNS

gazelle
A business establishment with at least 20 per cent sales growth every year for five years, starting with a base of at least $100 000.

New, micro, small and medium businesses account for most jobs. However, the companies that create significant numbers of new jobs are fast-growing businesses. David Birch of Cognetics, Inc., has named these businesses **gazelles**. A gazelle, by Birch's definition, is a business establishment with at least 20 per cent sales growth every year (for five years), starting with a base of at least $100 000. Despite the continual downsizing in major corporations during the 1990s, the gazelles then and now produce millions of jobs globally. Their extraordinary performance and contribution warrants recognition.[69] Gazelles are leaders in innovation. Some authors have even extended the idea to labelling particular standout businesses after the mythical unicorn.

unicorn
A rapid-growth private company that reaches a valuation of $1 billion or greater within 10 years of start-up.

Unicorns are defined as private entrepreneurial companies that reach a $1 billion valuation within 10 years.[70] As the name suggests, unicorns are extremely rare in most places around the globe. For example, from the hundreds of thousands of businesses in Australia, from Table 1.1 you will note that Australia can claim two businesses (at least, there may be others) that fit that definition at the time of writing. Nevertheless, the combination of gazelles with the occasional unicorn underpins jobs growth and innovation in an economy.

Australia performs strongly in high-growth ventures according to the *Financial Times*' 'FT 1000: High-Growth Companies Asia-Pacific in 2018', with 113 Australian companies making the list.[71] However, there are a number of myths about gazelles:

- *Myth 1: Gazelles are the goal of all entrepreneurs*. Creating a gazelle can be rewarding not only financially but professionally. But not all entrepreneurs are suited for the high-stress environment that running a gazelle entails. The more successful a business becomes, the more society scrutinises the actions of the management. Once the world is watching, keeping a gazelle growing takes not only tenacity but composure under extreme pressure.
- *Myth 2: Gazelles receive venture capital*. Although venture capital (VC) businesses prefer to invest in gazelles, many gazelles have never received VC funding. Less than 2 per cent of these companies have received VC funding, even in boom times.
- *Myth 3: Gazelles were never mice*. By definition, gazelles are companies created with the intent of high growth and wealth creation, whereas mice are companies created with the goal of merely generating income and no intention of growth. Companies can be gazelles at birth; however, many businesses become gazelles later in life. As many as 20 per cent of gazelles have been in operation for more than 30 years.
- *Myth 4: Gazelles are high tech*. To be classified as a gazelle, a company must have grown sales by 20 per cent for at least a five-year period, which can include businesses in any industry. This myth most likely stems from the high margins enjoyed by most technology-based companies; however, gazelles are commonly also found in low-tech sectors.
- *Myth 5: Gazelles are global.* The scope of a business has no role in its distinction as a gazelle, so even though some gazelles are operating on a global scale, it is not a necessary characteristic. Making the decision to expand overseas prematurely can just as quickly lead to the death of a business as it can lead to its success.

How can you tell a gazelle when you see one?

- *Growth rate*. They will definitely come from companies that have a growth rate higher than 25 per cent yearly. As they say, a rising tide floats all boats, and there will be many, many companies in the category.
- *Scalability.* If a company can scale, it means it can produce its products for ever-increasing margins (that is, the thousandth widget costs less to make than the tenth).
- *Competitive advantage*. The company will have 'unfair' competitive advantage and will own its own proprietary intellectual property (that is, patents, proprietary systems and business processes, trademarks, and trade secrets)). It will be able to stop other entrants from feasting on the buffet. Gazelles will be able easily to differentiate their offerings from their competitors'.
- *Look for the 10× rule*. The gazelle has to offer a solution that is 10× faster, 10× better, 10× more secure, 10× cheaper and so on.[72]

SUMMARY

This chapter has opened up the world of entrepreneurship for exploration and learning. We commenced by examining some of the key characteristics of entrepreneurship as it is understood today. The importance of the field is conveyed through its impact on job and wealth creation when measured at the level of an economy. Entrepreneurs drive the economy by creating new businesses that open up and expand markets and by employing others. Inherent in this activity is the concept of novelty and innovation, doing things differently and taking on market and business challenges that others dare not tackle. Doing new things such as this, though, calls for mindfulness with respect to the intended and unintended consequences of new products and business models.

Next we discussed the role that entrepreneurs play in the transformative innovation of society and the planet. There are many kinds of innovations, but only transformative innovation leads to truly new ways of running start-up enterprises and providing value for real customers.

We next sought to establish a definition of what is meant by entrepreneurship. There are many words used in the description of what entrepreneurs do and there is variation among languages and cultures with respect to precise or exact meanings. Nevertheless, there are overriding themes in all these definitions, which we attempted to capture in a comprehensive definition.

With some understanding of what we mean by entrepreneurship, the chapter then took a journey through history to outline how the understanding of and activity of entrepreneurship has evolved. Through the lens of history, it becomes apparent that entrepreneurs have had a love-hate relationship with various communities. At times entrepreneurs have been seen as a menace to society and at other times they have been the champions. However we view them, there is no disputing that it was entrepreneurs that drove change and progress, and it was economists who first recognised the value they create in an economy, although not without personal risks to the entrepreneur.

This book covers the theory, process and practice of entrepreneurship. As a starting point in your studies it is valuable to not only gain a view of entrepreneurship as it has evolved in practice and how it is experienced in today's context, but also to start to appreciate its theory. Therefore, we introduced the theoretical approaches to entrepreneurship and the schools of thought that have emerged that seek to understand and explain it as a contemporary phenomenon. To place these schools into context, we concluded with a framework of frameworks approach. Through this, we consider how each school relates to the others and develop overall theoretical lines of enquiry that provide a foundation for the rest of the material you will encounter in this book.

A further point we considered is the various types of entrepreneurs that come into the frame of study. In this section, while we acknowledged the various categories and terms that are used to describe entrepreneurs, we outlined three main distinctive types. The first two types were the business and the social entrepreneur. The third type, the small-business owner, is a truncated or abbreviated entrepreneur in that while they start businesses of various types and forms, they do not progress or pursue the opportunity in terms of growth and expansion. The main focus of this book is on the first two types of entrepreneurs. However, it is difficult to disentangle the small-business owner from the entrepreneur, as at some point an entrepreneur starts with a small business (in either the business or social category) that they own, but they then build and seek out opportunities for sustained growth and expansion. In this way they move beyond the small-business owner who prefers instead to keep their business at a manageable size.

We closed the chapter with a brief overview of the global nature of the Entrepreneurial Revolution. Here we targeted our discussion on the various global economic contexts within which entrepreneurship has a role. We also outlined how high-growth businesses such as gazelles and unicorns play a vital part in determining a nation's social (employment opportunities) and economic (wealth creation) performances. Entrepreneurship is at the heart of our socioeconomic evolution, providing new jobs, creating new wealth and influencing change in our social and industrial landscape.

KEY TERMS & CONCEPTS

achievement
Asia–Pacific
better widget strategies
business entrepreneurs
capitalism
copreneur
displacement school of thought
ecological school of thought
economic growth
enterprise
entreprendre
entrepreneur
entrepreneurial
entrepreneurial mindset
Entrepreneurial Revolution
entrepreneurial trait school of thought
entrepreneurship
external locus of control
financial/capital school of thought
free enterprise
gazelles
Global Entrepreneurship Monitor (GEM)
great chef strategies
greenhouse gases
human freedom
individualism
Industrial Revolution
interdisciplinary
Intergovernmental Panel on Climate Change (IPCC)
internal locus of control
job creation
Joseph Schumpeter
macro view of entrepreneurship
micro view of entrepreneurship
mountain gap strategies
niche advantage
pathways principle
Richard Cantillon
rugged individualists
school of thought
self-efficacy
self-employment
seniorpreneur
small-business owners
social and cultural school of thought
social entrepreneurs
sole proprietor of the rest of their life
sovereign individual
start-up
strategic formulation school of thought
sustainability
theory
traits
undertaker
usury
venture opportunity school of thought
water well strategies

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Review key terms with interactive flashcards.

REVIEW & DISCUSSION QUESTIONS

1 Why is entrepreneurship considered important in today's context? Explain how entrepreneurship addresses some of today's major challenges.
2 What is transformative innovation and what role do entrepreneurs play in solving wicked problems?
3 Briefly describe what is meant by the term 'entrepreneurship'.
4 Why do we use the French word 'entrepreneur' instead of an English equivalent?
5 Is there a distinction between 'enterprising' and 'entrepreneurial' in your language? If so, what is it?
6 How were entrepreneurs historically viewed? What challenges did they face throughout history?
7 In your culture, what is the history of enterprise and entrepreneurship?
8 When was the word 'entrepreneur' first used in economic literature?
9 Name four major schools of thought in entrepreneurship theory, describe them and explain how they differ.
10 Why is a framework of frameworks useful in entrepreneurship theory?
11 What is the difference between social entrepreneurs and business entrepreneurs?
12 What is the difference between entrepreneurs and small-business managers?
13 What are the generational differences in entrepreneurial activity?
14 Is entrepreneurship really another word for 'human freedom'?

EXPERIENCING ENTREPRENEURSHIP

Finding your own personal entrepreneurial ecosystem

Just as an ecosystem in the physical environment is a balanced, interdependent quasi-stable community of organisms living together, so its industrial analogue, the business ecosystem, is a 'balanced, quasi-stable collection of interdependent firms belonging to the same economy'.[73] We can refer to geographical environments that influence you in supporting your quest for entrepreneurship.[74] According to Isenberg, entrepreneurs are most successful when they have access to the human, financial and professional resources they need, and operate in an environment in which policies encourage and safeguard entrepreneurs. This network is described as the 'entrepreneurship ecosystem'.[75] Aulet describes the relevant components of a successful innovation ecosystem as individuals; organisations; and resources, specifically including government, demand, invention, funding, infrastructure, entrepreneurs and culture.[76]

Here are some ways to be sure your own personal entrepreneurship ecosystem is in place.

1. Within your own culture, find those success stories and role models who tolerate honest mistakes, take honourable failure in their stride, permit risk taking and cultivate contrarian thinking. Who is it within your own personal circle who respects entrepreneurship as a worthy occupation?
2. Identify knowledgeable people who have experience in creating organisations; hiring; and building structures, systems and controls.
3. Find mentoring organisations and industry associations that help investors and entrepreneurs network and learn from one another.
4. Locate educational institutions (or even online tutorials) that teach financial literacy and entrepreneurship.
5. Pay attention to the public infrastructure you will need, such as transportation (roads, airports, railways, container shipping) and communication (digital, broadband, mobile).
6. Think about relocating yourself to a geographic location that has a concentration of people who think like you do. This might be close to universities, training institutions, suppliers, consulting companies and professional associations.
7. Subscribe to, or become a member of, formal or informal groups that link entrepreneurs in the country or region and diaspora networks – in particular, high-achieving expatriates.
8. Always be on the lookout for fellow travellers who, like you, are pursuing venture-oriented professions, such as lawyers, accountants and market and technical consultants.
9. Stay in touch with your potential customers who are willing to give advice, particularly on new products or services.[77]

EXPERIENCING ENTREPRENEURSHIP

Understanding your beliefs about successful entrepreneurs

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Experience this activity online.

Read each of the following 10 statements and indicate your agreement or disagreement. If you fully agree with the statement, score 10. If you totally disagree, score 1. If you tend to agree more than you disagree, give a response between 6 and 9 depending on how much you agree. If you tend to disagree, give a response between 2 and 5.

1. Successful entrepreneurs are often methodical and analytical individuals who carefully plan out what they are going to do and then do it.
2. The most successful entrepreneurs are born with special characteristics, such as a high achievement drive and a winning personality, and these traits serve them well in their entrepreneurial endeavours.
3. Many of the characteristics needed for successful entrepreneurship can be learned through study and experience.

4 The most successful entrepreneurs are those who invent a unique product or service.
5 Highly successful entrepreneurs tend to have very little formal schooling.
6 Most successful entrepreneurs admit that dropping out of school was the best thing they ever did.
7 Because they are unique and individualistic in their approach to business, most successful entrepreneurs find it hard to socialise with others; they just do not fit in.
8 Research shows that although it is important to have adequate financing before beginning an entrepreneurial venture, it is often more important to have managerial competence and proper planning.
9 Successful entrepreneurship is more a matter of preparation and desire than luck.
10 Most successful entrepreneurs do well in their first venture, which encourages them to continue; failures tend to come later on as the enterprise grows.

Put your answers in the table below in this way:

- enter your answers to numbers 1, 3, 8 and 9 just as they appear
- subtract your answers to 2, 4, 5, 6, 7 and 10 from 11 and enter the results.

For example, if you gave an answer of 8 to number 1, enter an 8 in the box marked 1. If you gave an answer of 7 to number 2, enter a 4 (11 – 7) in the box marked 2.

Finally, add the scores in both columns and enter your total in the space provided.

Scoring block

AS THEY APPEAR	SUBTRACT FROM 11
1	2
3	4
8	6
9	7
	5
	10
Total score:	

Interpretation

This exercise measures how much you believe the myths of entrepreneurship. The lower your total, the stronger your beliefs; the higher your total, the less strong your beliefs. Numbers 1, 3, 8 and 9 are accurate statements; numbers 2, 4, 5, 6, 7 and 10 are inaccurate statements. Here is the scoring key:

- 80–100 – excellent; you know the facts about entrepreneurs.
- 61–79 – good, but you still believe in a couple of myths.
- 41–60 – fair; you need to review the chapter material on the myths of entrepreneurship.
- 0–40 – poor; you need to reread the chapter material on the myths of entrepreneurship and study these findings.

EXPERIENCING ENTREPRENEURSHIP

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Are you a high achiever?

One of the most important characteristics of a successful entrepreneur is the desire to be a high achiever. The following 10 questions are designed to help identify your achievement drive. Select the letter that best matches your answer and write it down. Scoring information is provided below.

1 An instructor in one of your classes has asked you to vote on three grading options. Which of these options would you choose?
  - a Study the course material, take the exams and receive the grade I earn
  - b Roll a die and get an A if I roll an odd number and a D if I roll an even number
  - c Show up for all class lectures, turn in a short essay and get a C

2 How would you describe yourself as a risk taker?
  - a High
  - b Moderate
  - c Low

3 You have just been asked by your boss to take on a new project in addition to the many tasks you are already doing. What would you tell your boss?
  - a 'Since I'm already snowed under, I can't handle any more.'
  - b 'Sure, I'm happy to help out; give it to me.'
  - c 'Let me look over my current workload and get back to you tomorrow about whether I can take on any more work.'

4 Which one of these people would you most like to be?
  - a Steve Jobs, founder of Apple Computers
  - b Elon Musk, of PayPal, SpaceX, Tesla, SolarCity, Hyperloop, and Neuralink fame
  - c Richard Branson, Virgin Airlines

5 Which one of these games would you most like to play?
  - a Monopoly
  - b Bingo
  - c Roulette

6 You have decided to become more physically active. Which one of these approaches has the greatest attraction for you?
  - a Join a neighbourhood sports team
  - b Work out on my own
  - c Join a local health club

7 With which one of these groups would you most enjoy playing poker?
  - a Friends
  - b High-stakes players
  - c Individuals who can challenge me

8 Which one of these people would you most like to be?
  - a A detective solving a crime
  - b A politician giving a victory statement
  - c A millionaire sailing on their yacht

9 Which one of these activities would you prefer to do on an evening off?
   a Visit a friend
   b Work on a hobby
   c Watch television
10 Which one of these occupations has the greatest career appeal for you?
   a Computer salesperson
   b Corporate accountant
   c Criminal lawyer

Scoring

Transfer each of your answers to the following scoring key by circling the appropriate number (e.g. if your answer to question 1 is c, you will circle the number 2 in row 1). Then total all three columns to arrive at your final score.

QUESTION	A	B	C
1	10	0	2
2	2	10	2
3	6	2	10
4	7	10	5
5	10	0	0
6	2	10	6
7	4	2	10
8	10	7	4
9	4	10	4
10	10	5	10

High achievers	**76–100**
Moderate achievers	**50–75**
Low achievers	**<50**

Interpretation of each question

1 High achievers take personal responsibility for their actions. They do not like to rely on luck. Option (c) assumes the class time saved by not having to study for exams will be used to study for other classes; otherwise the answer would be a zero.
2 High achievers are moderate risk takers in important situations.
3 High achievers like to study a situation before committing themselves to a course of action.
4 Jobs was a high-achieving individual but was more interested in design and engineering than in goal accomplishment. Musk is an extremely high achiever who sets lofty goals.
5 Monopoly allows the high achiever to use their skills. Bingo and roulette depend on luck.

6 The high achiever would work out on their own. The second-best choice is to join a health club, which allows less individual freedom but gives the chance to get feedback and guidance from individuals who understand how to work out effectively.
7 High achievers like challenges but not high risks. If you are a very good poker player and you chose (b), you then can raise your score on this question from 2 to 10.
8 Because high achievers like to accomplish goals, the detective would have the greatest appeal for them. The politician is more interested in power and the millionaire is simply enjoying life.
9 High achievers like to do constructive things that help them improve themselves, so working on a hobby would be their first choice.
10 The computer salesperson and the criminal lawyer have a much higher need to achieve than does the corporate accountant.

CASE STUDIES

CASE 1.1

PAUL CAVE

'Our job is to enable our customers to make heroes of themselves.'

Using creative thought and determination, Paul Cave, founder and chairman of BridgeClimb, has created a $50 million business in just a few years, effectively monopolising an internationally famous Australian icon brand he doesn't own, capitalising on huge advertising he doesn't pay for and sending a personally delivered word-of-mouth recommendation through one million customer heroes to arguably 100 million prospects around the world. And this is just the beginning.

Paul Cave made no fewer than 52 presentations in the late 1990s in an attempt to raise $12 million to fund a business that would enable millions of people to climb the Sydney Harbour Bridge. The predominantly merchant-banking targets, thought it was a fascinating opportunity, but not for their money. In the end, it was another entrepreneur, Brett Blundy, who Cave says 'put money into this within 60 seconds of my telling him about it and became my first major shareholder'. Analytical minds struggle when there is no precedent to rely upon. Clearly Blundy, like Cave, was searching for opportunities where there was no precedent.

Just three years after BridgeClimb opened, 300 000 people per annum (two-thirds of them international visitors) were climbing, and the business was achieving a turnover of $50 million. More than 2.5 million people have since climbed. Cave talks privately of a bottom line that would make Warren Buffett green with envy. Since commencement, the company has distributed over $1 million in special thank-you bonuses to its 280 staff. Cave isn't really surprised at the success of BridgeClimb. After he first conceived the idea over a decade ago while on a bridge climb with his YPO (Young Presidents Organisation) forum, he was forced to take plenty of time to think the concept through.

'As an entrepreneur, you couldn't have found anything [the barriers] more frustrating. The first letter from the government basically gave 64 reasons why not', he says. Having been on the receiving end of so many 'No' answers has made Cave decidedly a 'Yes' man. Having now made it possible for blind and deaf people to make the climb, the next challenge to overcome is to allow people in wheelchairs to climb – and he is confident of success.

Fortunately, Paul Cave's analytical economics background has not masked his creative marketing ability – not only to sense a basic business opportunity that has been staring Australians in the face since 1932, but also to see beyond the simple climb to the higher-order, monopolisable value that is already generating extraordinary wealth for the company. BridgeClimb projects that it will pay an estimated $130 million to the Roads and Traffic Authority of New South Wales over 20 years for exclusive tourism rights to arguably Australia's most internationally recognised man-made icon. This cost pales into insignificance when one considers the real value of the asset 'leased'.

While the Sydney Harbour Bridge itself is perhaps worth a billion dollars as a structure, its value as an established international brand and icon is far greater, probably in the order of tens of billions. The brand is being built further and maintained by word of mouth and advertising in an extraordinary manner. Being a world-first bridge-climbing experience gives a powerful first-mover advantage. But being on an already world-famous bridge in the centre of Australia's largest and most visited tourist city is another monopoly.

But that's by no means all. Cave says: 'The Australian Tourist Commission has spent some $20 to $30 million showing commercials featuring BridgeClimb to the rest of the world to bring people here.

'Eleven hundred journalists climbed the bridge during the 2000 Olympic Games and the publicity they generated could have reached an estimated 2.5 billion people worldwide. That advertising and publicity has come to us at no cost.'

The way Cave has harnessed more than a million climbers as compelling promoters of his company's message further exemplifies the man's intuitive ability to market without money through customer word of mouth. The value delivery system – company culture, defined procedure, staff training, climber preparation, climber satisfaction measure and so on – is designed, as Cave puts it, to delight 'every climber, every time and there is no exception to that'. Climbing, now permitted 24 hours a day, 7 days a week, happens as often as every 10 minutes whether it is hot, cold, raining or foggy, and 99 per cent of the customer ratings of the experience are excellent or good regardless of conditions.

Price is not an issue, but providing extraordinary value is, Cave insists. The average price per person is $145 and a further $30 is spent on merchandise. He admits that the value people ascribe to the 'Climb of Your Life' experience is a voyage of discovery for him. Once discovered, however, his mind has pursued each aspect of that value like a dog with a bone. For example, 400 (known) proposals of marriage have been made on BridgeClimb, with only one rejection. A technique has been devised so that the ring can be passed safely and securely down a piece of cord to seal the acceptance. Integrated value indeed!

The advice that Paul Cave offers budding entrepreneurs is deceptively simple when one considers the lengths to which he has gone to implement his formula: Be clear about what it is and don't stray from that course. Keep driving in pursuit of that goal. He admits that BridgeClimb operating on the Sydney Harbour Bridge is 'a dream come true' and his international team is working on other icon bridges around the world.

Don't try to be all things. Be famous for just one thing, says Cave: 'We are doing a very simple thing. We are a facilitator only, taking people to the top of the bridge. Our job is to enable our customers to make heroes of themselves. If prospective staff find that unreasonable (that is, the 'every climber, every time, constant measurement' philosophy), please don't come here', Cave says.

Source: Marketing without money' by John Lyons and Edward de Bono, published by Pennon Publishing. Copyright © 2003 by John Lyons. Used by permission.

QUESTIONS

1 What was the opportunity that Cave saw that allowed him to market someone else's product without any money?
2 Cave gives meaning to the I Ching (an ancient Chinese 'book of changes') hexagram 'in adversity, it furthers one to be persevering'. Give your own interpretation of this. What does Cave mean when he discusses enabling the customers to become heroes?
3 What entrepreneurial traits did Cave exhibit in starting this business?

ONLINE STUDY RESOURCES

Visit http://login.cengagebrain.com and use the access code that comes with this book for 12 months' access to the resources and study tools for this chapter.

CourseMateExpress

The CourseMate Express website contains:

- take it further activities
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CHAPTER 2

THE ENTREPRENEURIAL MINDSET: COGNITION AND CAREER

[Entrepreneurs] are not diverted or discouraged by scepticism from 'experts' or from those from whom they seek backing or support, but willing to weigh all advice and select that which will be helpful. They are prepared not just to work seriously hard but to back their judgement with a personal investment at a level that will cause problems if they are wrong about the opportunity. They understand that achievements are the result of teamwork and know how to choose the necessary blend of talents and inspire them with their vision.

Chris Oakley OBE,
Chairman, Chapter Eight web design company[1]

How do I evaluate a potential entrepreneur investment? What I care about is how they look and smell. Do they have rumpled hair and look like they have been up all night? Do they have sweaty palms from anticipation? Do they smell like they live in a garage? Do they smell like p!*s and vinegar? That's the kinda people I invest in.

Rohit Chowdri,
Pasadena Angels[2]

CHAPTER OBJECTIVES

1. To discover the fundamentals of the entrepreneurial mind
2. To examine contextual influences for entrepreneurs
3. To examine entrepreneurial motivation
4. To identify and discuss the most commonly cited characteristics and perceptions of successful entrepreneurs
5. To examine entrepreneurial cognition
6. To discuss the 'dark side' of entrepreneurship
7. To introduce the variety in entrepreneurial career pathways

FUNDAMENTALS OF THE ENTREPRENEURIAL MIND

As discussed in Chapter 1, entrepreneurship represents the ultimate source of economic dynamism and empowerment. It is transformative at the societal, organisational and individual levels. Researchers Donald F. Kuratko and Michael H. Morris use the metaphor of 'fire in a bottle'. From a leadership perspective, entrepreneurship has become the symbol of business tenacity and achievement. Entrepreneurs' sense of opportunity, their drive to innovate and their capacity for accomplishment have become the standard by which true leadership is now measured. If leadership is the capacity to lead, and 'entrepreneurial' relates to the pursuit of innovation, then combining the two capacities – the capacity to lead and the capacity to risk pursuing innovative opportunities – results in **entrepreneurial leadership**. It is leadership in discovering new possibilities, opening up new horizons, promulgating a new vision, combining resources in new ways and inspiring others while implementing new-venture concepts. And it is leadership in dealing with the externalities and ethical dilemmas that surround entrepreneurial action. Entrepreneurial leadership may be one of the most significant phrases in the twenty-first century, and it serves as our ultimate vision for your achievement through this book.[3]

entrepreneurial leadership
An entrepreneur's ability to anticipate, envision, maintain flexibility, think strategically and work with others to initiate changes that will create a viable future for their organisation.

Why do people become entrepreneurs? Although certainly not an exact science, examining the entrepreneurial mind provides an interesting look at the entrepreneurial drivers and potential within every individual.[4] Most entrepreneurs have a strong desire to be independent. Some, from an early age, seek autonomy. Others find it unfulfilling to work on another person's dreams to help them become rich. They may see limited opportunities for advancement or they may become bored with the same work every day. Ultimately, they want to be their own bosses, and while wealth creation may be part of the motivation, often it is not the dominant one. Entrepreneurs believe it is better to invest in themselves than to park their earnings in a low-interest savings account. Job satisfaction, achievement, opportunity and money are often thought to be primary motivations for people to launch their own venture. These are what we call **opportunity-driven** entrepreneurs.

opportunity-driven
Describes an entrepreneur who opts to start a business because they have spotted an available opportunity, and is prepared for and has the resources to carry it out. (See also *necessity-driven*.)

On the other side of the spectrum are **necessity-driven** entrepreneurs. Their decision to start a business comes out of some kind of adversity. These entrepreneurs are predominantly found in poorer socioeconomic groups and low-wealth nations. Maybe a person is made redundant and, with no better option for meeting their needs, they turn to entrepreneurship. Around the world, economic dislocation and even civil war push people to become necessity-driven entrepreneurs, those who have no better choice for work than to become an entrepreneur.[5]

necessity-driven
Describes an entrepreneur who starts a business because there are no better options for work, rather than because they see an opportunity. (See also *opportunity-driven*.)

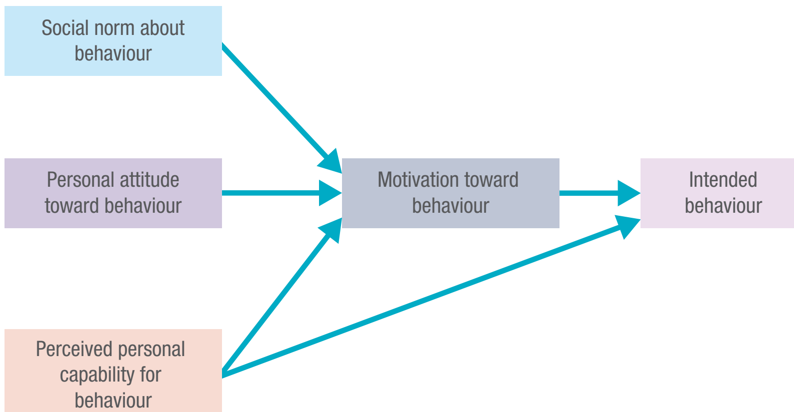
Sometimes entrepreneurs emerge from deprived, minority or marginal classes of society. 'I'll show them', they say. That's called **self-efficacy**, a belief in oneself. It propels them to be entrepreneurial, to overcome the psychological disequilibrium between their own 'prodigious' talents and the discrimination or disadvantage they face. We often see entrepreneurial people among the youth, Indigenous people or immigrants; for example, female Indian immigrants in London, Chinese people living in Singapore, LGBTQI entrepreneurs in Sydney or San Francisco, Palestinians in the Arab Gulf or enterprising religious minorities, such as Sikhs in Australia.

self-efficacy
Self-assessed conviction or confidence about personal abilities to muster the motivation, perform the cognitive tasks and conduct the actions needed to successfully execute a specific task within a given context.

In this chapter we take a more personal look at entrepreneurs and portray a more complete perspective of what is involved with entrepreneurial behaviour as influenced by the entrepreneurial mind. It is what goes on in the mind that shapes the intention preceding entrepreneurial behaviour. Intentions encompass motivations that influence how hard a person will strive to achieve and perform a behaviour.

According to social psychologist Icek Azjen,[6] behavioural intention is influenced by social norms, attitudes and perceived capabilities. How 'normal' a particular behaviour is considered within a community reflects the term *social norm*, and how much social pressure an individual feels to conform to that social norm is a significant influence on motivation toward that behaviour. The second influence on motivation is the extent to which a person is favourably disposed to a particular behaviour, which is recognised as their *attitude* toward a behaviour. Third, the *self-confidence* a person has in their ability to achieve a particular behaviour will also influence their intention to undertake that behaviour. Although researchers have examined these combinational influences on entrepreneurial motivation or intention many times (see Figure 2.1 below for a model of these relationships), it is only recently that a study has produced compelling evidence that social norms, attitudes and perceived capability are the key factors that combine to influence actual entrepreneurial behaviour.[7]

FIGURE 2.1
THE THEORY OF PLANNED BEHAVIOUR



Source: Adapted from Azjen, I. (1991). The theory of planned behaviour. *Organizational Behavior and Human Decision Processes*, 50, 179–211; Kautonen, T., van Gelderen, M., & Fink, M. (2015). Robustness of the theory of planned behavior in predicting entrepreneurial intentions and actions. *Entrepreneurship Theory and Practice,* 39(3), 655–74. ISSN 1042-2587 (printed). DOI: 10.1111/etap.12056.

Motivation theory attempts to explain how the mind influences entrepreneurs to take up or begin certain behaviours. But entrepreneurial cognition research examines how the mind influences what an entrepreneurial individual does during that behaviour. *Cognition* refers to the mental processes of an individual – the mental functions, mental processes (thoughts) and mental states of intelligent humans. The term comes from the Latin *cognoscere*, which means 'to know', 'to conceptualise' or 'to recognise', and refers to a faculty for processing information, applying knowledge and changing preferences. Social cognition theory introduces the idea of *knowledge structures* – mental models (cognitions) that are ordered in such a way as to optimise personal effectiveness within given situations – to the study of entrepreneurship. Increasingly, concepts from cognitive psychology are being found to be useful tools to help probe entrepreneurial-related phenomena, and the applicability of the cognitive sciences to the entrepreneurial experience is being cited in the research literature.

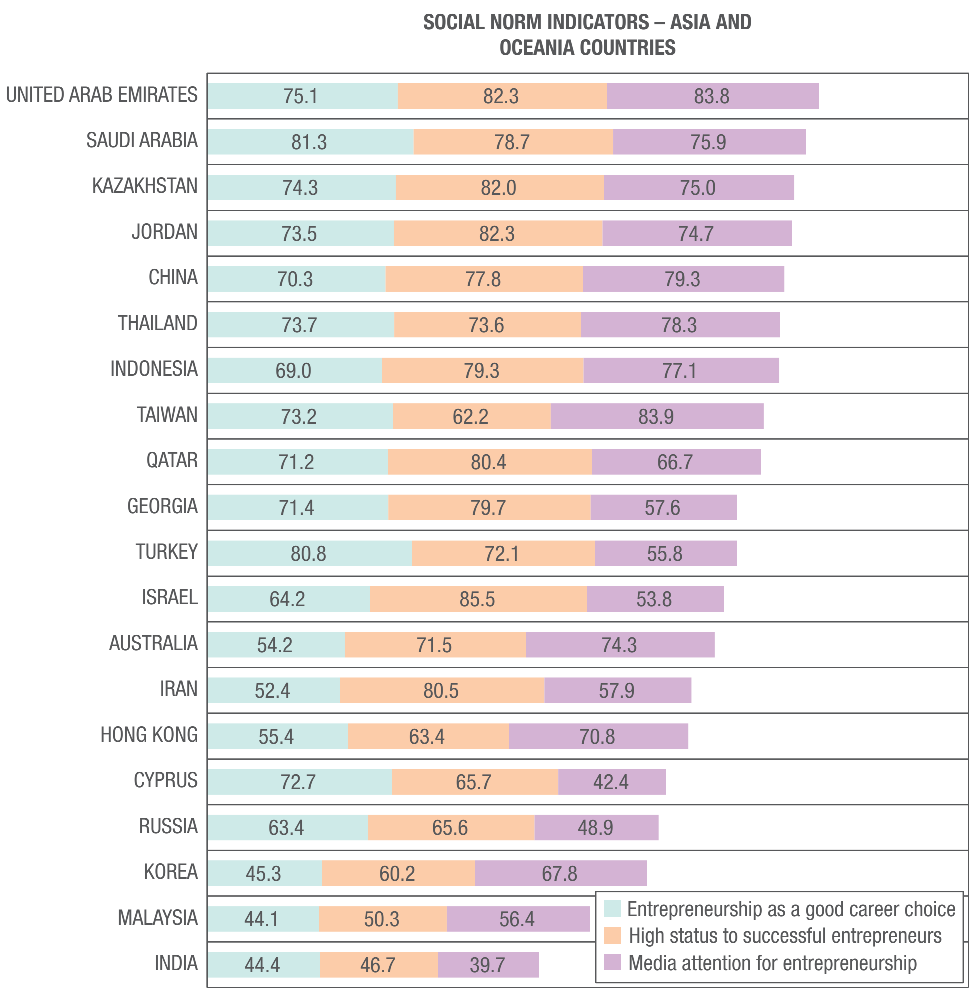
Researchers Ronald K. Mitchell, Lowell Busenitz, Theresa Lant, Patricia P. McDougall, Eric A. Morse and J. Brock Smith define entrepreneurial cognition as 'the knowledge structures that people use to make assessments, judgments or decisions involving opportunity evaluation, venture creation and growth'.[8] In other words, entrepreneurial cognition is about understanding how entrepreneurs use simplifying mental models to piece together previously unconnected information that helps them to identify and invent new products or services, and to assemble the necessary resources to start and grow businesses. Specifically, then, the entrepreneurial cognitions view offers an understanding as to how entrepreneurs think and 'why' they do some of the things we recognise as entrepreneurial behaviour.

This is important because later we will go into the various pathways you can take toward an entrepreneurial career actually come from your cognitive processes.

CONTEXTUAL INFLUENCES

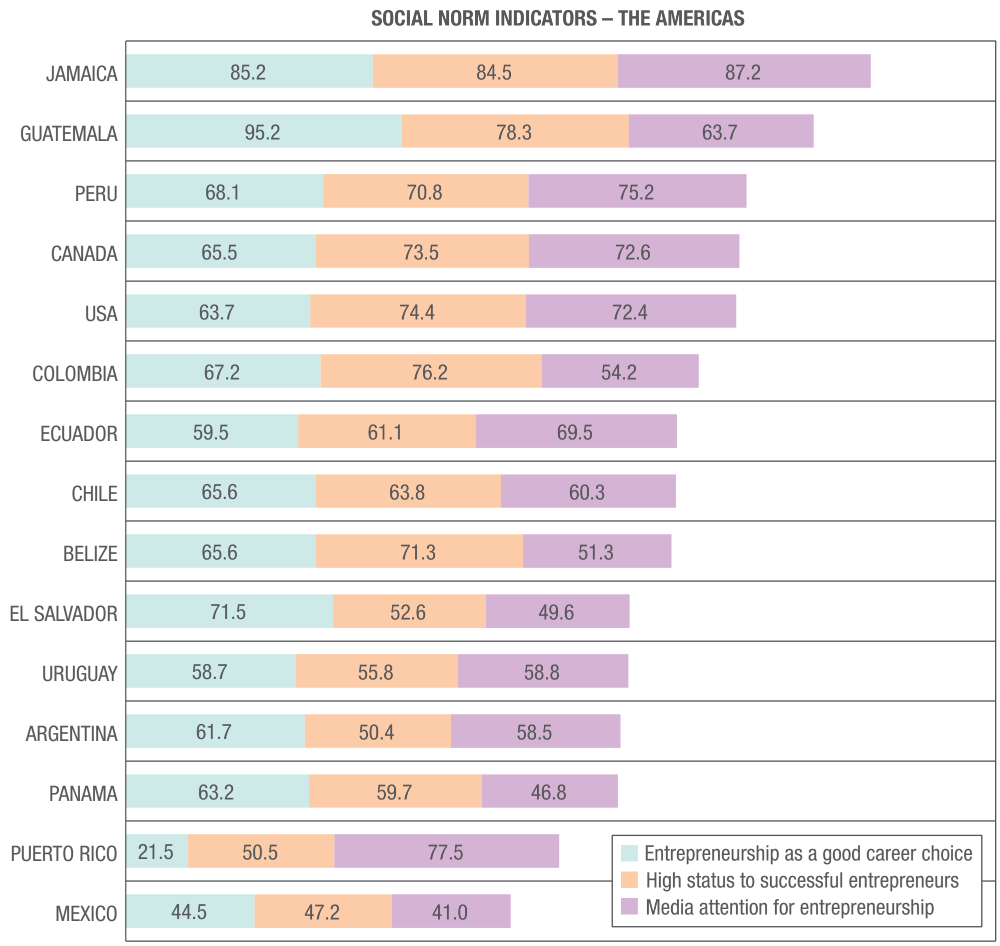
In this section we look more specifically at the variety of national contexts for entrepreneurship. We start with the 'social norm' (see Figures 2.2 and 2.3) and then consider attitudes and capability (see Figures 2.4 and 2.5). Drawing upon the 2016 Global Entrepreneurship Monitor (GEM) data, we can observe variations among nations in whether entrepreneurship is considered a good career choice, whether entrepreneurs enjoy high status in their community and whether entrepreneurs are regularly featured in the general media. These variations across countries do not fully account for the rates of

FIGURE 2.2 THE PERCENTAGE OF ADULT POPULATION INDICATING THE STRENGTH OF VARIOUS SOCIAL NORMS INFLUENCING ENTREPRENEURSHIP IN ASIAN AND OCEANIC COUNTRIES



Source: Authors derived from Global Entrepreneurship Monitor, *2015/2016 global report data*. Used with permission.

FIGURE 2.3 THE PERCENTAGE OF ADULT POPULATION INDICATING THE STRENGTH OF VARIOUS SOCIAL NORMS INFLUENCING ENTREPRENEURSHIP IN THE AMERICAS



Source: Authors derived from Global Entrepreneurship Monitor, *2015/2016 global report data*. Used with permission.

entrepreneurship within a country, but they do serve to indicate how much social norms influence how easy it is for an entrepreneur to make the choice to pursue entrepreneurship as a career option. For example, the United Arab Emirates (UAE) has a high social-norm indicator toward entrepreneurship, but counterintuitively they have one of the lowest rates of total entrepreneurial activity. It is likely that the wealth of the UAE, generated through its dominant industry (petroleum and petrochemicals) and a large employment pool in services (public sector), may act as a disincentive toward an entrepreneurial career – employment opportunities are easier than pursuing one's own venture.

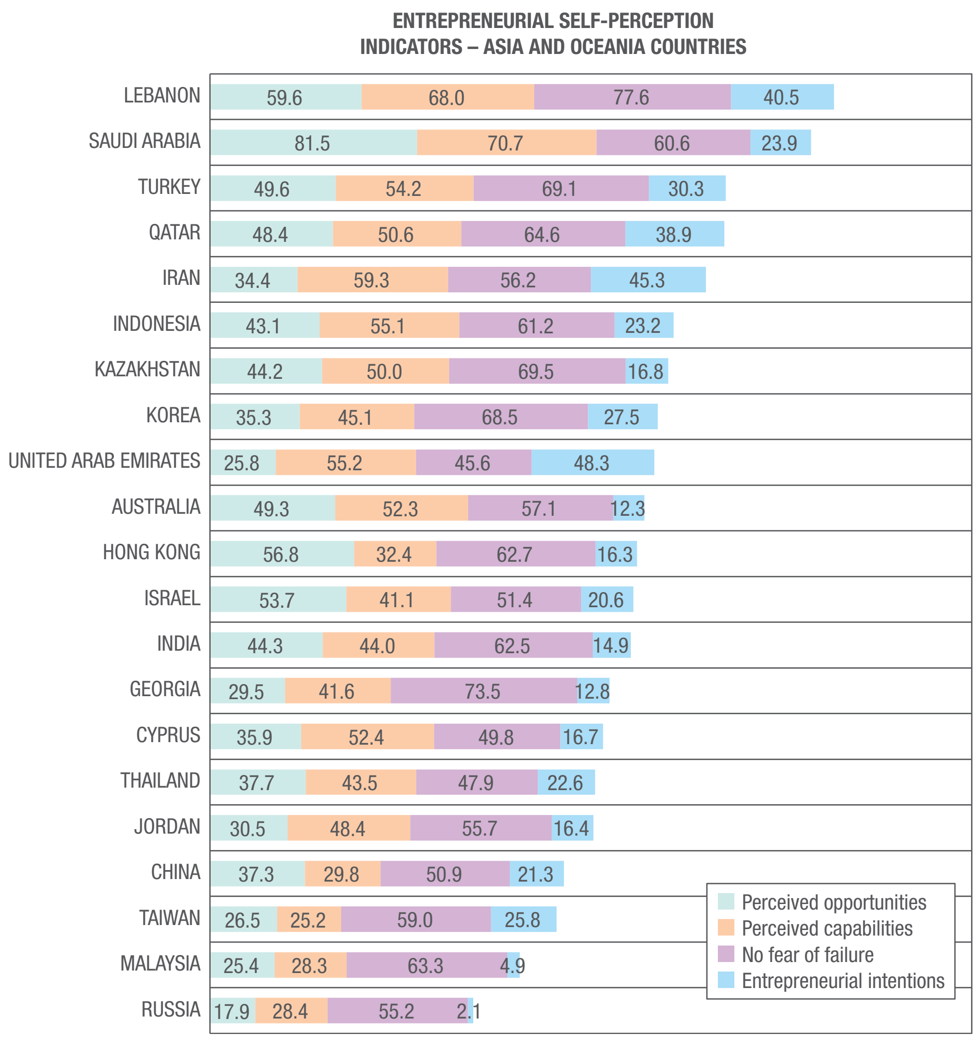
Conversely, Australia scores well in terms of total entrepreneurial activity among the innovation economy countries but has a comparatively moderate social-norm indicator. The transitioning of the economy in Australia away from a manufacturing base may increase the propensity for entrepreneurship, but those who elect to follow that path are swimming against the social-norm tide.

As a further contrast, among the Americas, USA and Canada show fairly strong social-norm indicators, and both score in a similar range of total entrepreneurial activity as Australia among the innovation economy countries. This suggests that although the propensity toward entrepreneurship is similar across the three countries, Australians will find the going tougher than their North American counterparts to follow an entrepreneurial career.

It is worth noting that much is being done to strengthen the social norm toward entrepreneurship in Australia as it seeks to navigate through the transition of its economy. Similarly, much is being done in the United Arab Emirates to shift the attitude toward entrepreneurship to support the strong social norm and assist its economy to diversify further from reliance on the petroleum and petrochemical industry.

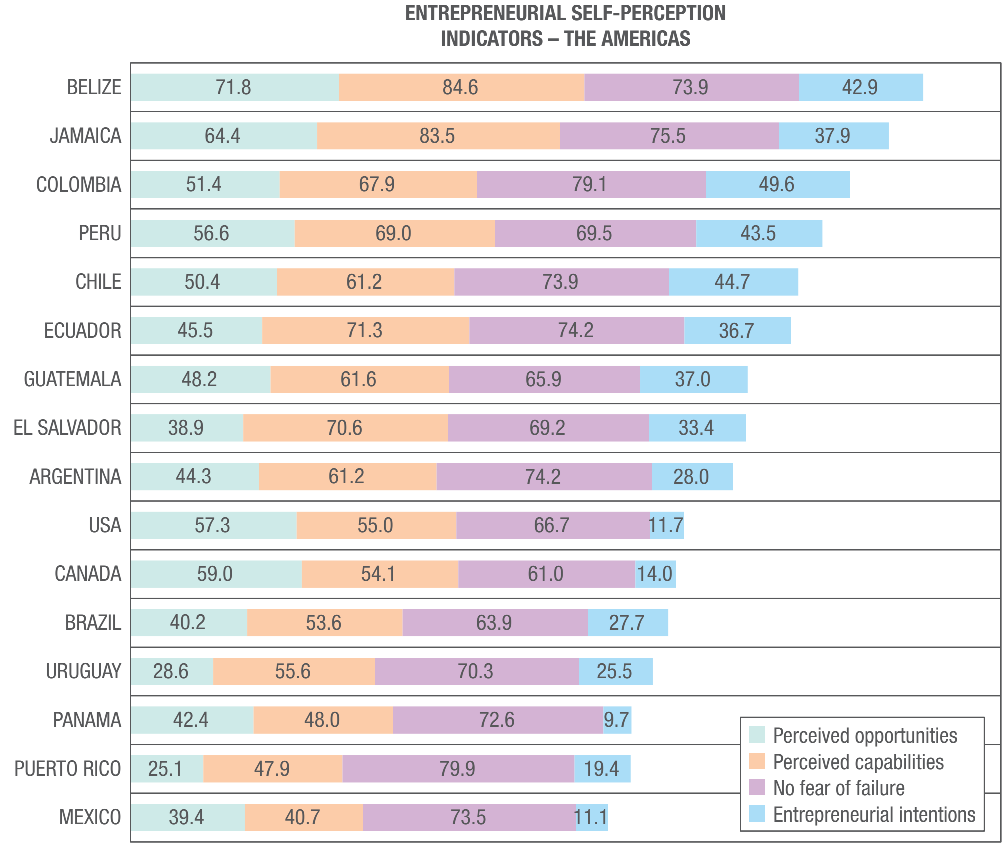
To complete our comparison of international variations that surround the Asia-Pacific, we can also derive from the GEM data a general view of population attitudes and self-perceptions of capabilities. The GEM data provides four useful population indicators of motivations: two of attitude ('perceived opportunities' and 'fear of failure'), one of perceived capabilities (appropriately named 'perceived capabilities') and one specifically of 'entrepreneurial intentions' (see Figures 2.4 and 2.5). Note: To construct a unidirectional indicator we calculated the inverse of the 'fear of failure' metric (by

FIGURE 2.4 THE PERCENTAGE OF ADULT POPULATION INDICATING THE STRENGTH OF VARIOUS ATTITUDES AND PERCEIVED CAPABILITY INFLUENCING ENTREPRENEURSHIP IN ASIAN AND OCEANIC COUNTRIES



Source: Authors derived from Global Entrepreneurship Monitor, *2015/2016 global report data*. Used with permission.

FIGURE 2.5
THE PERCENTAGE OF ADULT POPULATION INDICATING THE STRENGTH OF VARIOUS ATTITUDES AND PERCEIVED CAPABILITY INFLUENCING ENTREPRENEURSHIP IN THE AMERICAS



Source: Authors derived from Global Entrepreneurship Monitor, *2015/2016 global report data*. Used with permission.

subtracting the percentage score from 100) to obtain a positive 'no fear of failure' metric in line with the other positive mentions of intention.

An entirely consistent case of the 'planned behaviour theory' – that a low social norm along with low attitude and capability creates low entrepreneurial intentions and consequently low entrepreneurial behaviour – is Russia. Russia is among the lowest-scoring countries in terms of entrepreneurial behaviours, as indicated by the total entrepreneurial activity across all countries. Particularly telling is that it is the lowest-scoring among the least wealthy nations categorised as factor-driven economies. Consistency can also be found in Malaysia, China and Taiwan, although notably both China and Taiwan score a little higher in total entrepreneurial activity (approximately 10 and 8 per cent respectively, compared with Malaysia at just under 5 per cent), which may be influenced also by the higher 'social norm' indicators.

In contrast to the theoretically consistent cases, we can look at Saudi Arabia, which shows high indicators of both 'social norms' and the composite 'attitudes', 'perceived capability' and 'intentions' indicators, yet the actual entrepreneurial behaviour is relatively low when compared to other nations in the 'efficiency economy' category. Clearly, other forces are at work that influence entrepreneurship within an economy.

As a final comparison, let's consider Australia, USA and Canada as three relatively comparable innovation economy countries. It is notable that all three countries score similarly across all three indicators, although as noted earlier Australia scores lower in the 'social norm' metric. Nevertheless, the total entrepreneurial activities in each country are similar.

While the comparisons discussed here are by no means sufficient to be conclusive in any way about the relationships between motivations and intentions and actual entrepreneurial behaviour at a country level, there is a strong suggestion that the relationships observed by psychologists at the individual level may have some bearing on country-level performance when indicators are generalised across a population.

It is for this reason that the examination of the entrepreneurial mind is worthwhile.

We believe that every motivated person – be they astronomer or zoologist – can become the sole proprietor of their own destiny at some point in their lives and carve out a career in entrepreneurship. Regardless of the circumstances that surround these motivations for an entrepreneurial career, we also point out in the subsequent sections the capability profile of entrepreneurs and how capabilities change in accordance with the development of the business concept and the growth of the business itself. Knowing the critical contributions of specific capabilities that shape the development of ideas and venture opportunities will assist in mapping out preparations for an entrepreneurial career. Being motivated for entrepreneurship is one thing; being prepared and ready to succeed is another!

ENTREPRENEURIAL MOTIVATION

Examining why people start businesses and how they differ from those who do not (or from those who start unsuccessful businesses) may help explain how the motivation that entrepreneurs exhibit during start-up is linked to the sustaining behaviour exhibited later. Lanny Herron and Harry J. Sapienza have stated, 'Because motivation plays an important part in the creation of new organizations, theories of organization creation that fail to address this notion are incomplete.'[9] Bradley Johnson, in his review of achievement motivation and the entrepreneur, said, 'It remains worthwhile to carefully study the role of the individual, including his or her psychological profile. Individuals are, after all, the energizers of the entrepreneurial process.'[10]

Thus, although research on the psychological characteristics of entrepreneurs has not provided an agreed 'profile' of an entrepreneur, it is still important to recognise the contribution of psychological factors to the entrepreneurial process.[11] In fact, the quest for new-venture creation as well as the willingness to *sustain* that venture is directly related to **entrepreneurial motivation**.[12]

entrepreneurial motivation
The willingness of an entrepreneur to sustain his or her entrepreneurial behaviour.

One research study examined the importance of satisfaction to an entrepreneur's willingness to remain with the venture. Particular goals, attitudes and backgrounds were all important determinants of an entrepreneur's eventual satisfaction.[13] In that vein, another research approach examined the motivational process an entrepreneur experiences, concluding that the decision to behave entrepreneurially is the result of the interaction of several factors.[14]

One set of factors are the individual's personal characteristics, context and goal set; the relevant business environment; and the existence of a viable business idea.[15] You compare your perception of the probable outcomes with the personal expectations you have in mind. Next, you study how your own **entrepreneurial behaviour** affects the expected outcomes. According to this approach, the entrepreneur's expectations finally are compared with the actual or perceived business outcomes. Future entrepreneurial behaviour is based on the positive results of all of these comparisons. When

entrepreneurial behaviour
The actions, thoughts and deeds to initiate a new venture regardless of social, project or business form.

outcomes meet or exceed expectations, the entrepreneurial behaviour is positively reinforced, and the individual is motivated to continue to behave entrepreneurially – either within the current venture or possibly through the initiation of additional ventures, depending on the existing entrepreneurial goal. When outcomes fail to meet expectations, the entrepreneur's motivation will be lower and this will have a corresponding impact on the decision to continue to act entrepreneurially. These perceptions also affect succeeding strategies, strategy implementation and management of the business.[16]

entrepreneurial persistence
An entrepreneur's choice to continue with an entrepreneurial opportunity regardless of counterinfluences or other enticing alternatives.

Another line of new research examined the specific motivations behind how and why entrepreneurs persist with a venture. **Entrepreneurial persistence** is an entrepreneur's choice to continue with an entrepreneurial opportunity regardless of counterfactual influences or other enticing alternatives.[17] Researchers Daniel V. Holland and Dean A. Shepherd found that the decision to persist was influenced by personal characteristics as well as by feedback from the environment relative to certain thresholds of adversity. Their findings demonstrate that the decision policies of entrepreneurs regarding persistence differ based on their level of experience with adversity and individual values.

BUILDING ENTREPRENEURIAL CAPABILITIES

In creating a sustainable enterprise, you have three parallel experiences: the opportunity seemingly arises out of the shadows; the venture emerges and forms through application of creativity and diligence; the entrepreneur themselves then emerges and identifies as an entrepreneur. None are predetermined or fixed – they define and are defined by one another.[18] Together, they make up your personal lived experience.

entrepreneurial capabilities
The set of skills and abilities that support an individual in identifying an entrepreneurial/business opportunity and developing the resource base needed to pursue it.

This experiential view of the entrepreneur captures the time-dependent nature of entrepreneurship.[19] It moves us past a more static 'snapshot' approach and encourages us to consider a dynamic, *socially situated* process that involves numerous actors and events. This makes us look at how the many activities addressed as a venture unfolds are experienced by different actors in different ways over different ages.[20] Moreover, it helps us realise that venture creation actually soars above rational thought. It includes emotions, impulses and physiological responses as individuals react to a diverse, multifaceted and imposing array of activities, events and developments.[21]

Table 2.1 helps clarify the nature of **entrepreneurial capabilities** as they vary across the different stages of entrepreneurial activity. In the table, the stages of the business – *nascent* (preparing for

TABLE 2.1 VENTURE STAGES AND SIGNIFICANT ENTREPRENEURIAL CHARACTERISTICS/CAPABILITIES

VENTURE STAGES BE THEY BUSINESS, SOCIAL, OR ENVIRONMENTAL	SIGNIFICANT ENTREPRENEURIAL CHARACTERISTICS/ CAPABILITIES
Nascent (Defining and building the opportunity)	Risk propensity, opportunity propensity, entrepreneurial intentions, higher education, industry and/or market experience, social capital, balanced skills, ability to analyse complex dynamics
Survival (Establishing the business and establishing market presence)	Self-efficacy and coping skills, promotion capabilities, entrepreneurial passion and intentions, higher education, related start-up experience, social capital
Growth (Growing a profitable business and expanding market penetration)	Business planning, growth intentions, higher education, related business management experience

Source: O'Connor, A., Corral De Zubielqui, G., Li, H., & Dissanayake, M. (2014). Supporting entrepreneurship in high cost economies: What can governments do? In G. Roos & N. Kennedy (Eds.), *Global perspectives on achieving success in high and low cost operating environments* (pp. 290–392). IGI Global, Hershey, USA. Copyright 2014 by IGI Global. Used by permission.

business start-up), *survival* (hanging on) and *growth* (powering ahead) – can be compared with the **entrepreneurial characteristics** that are needed for success. Higher education and experience (e.g. previous industry and management roles) help through all three stages. Planning is a strong influencer during the growth stage but does not play a significant part during the nascent and survival stages of a venture.

Risk propensity and **opportunity propensity** are specially needed characteristics during the nascent stage. You will often hear that entrepreneurs have a great sense of self-efficacy. Bandura described self-efficacy as 'the belief in one's capabilities to organize and execute', a strong belief in your ability to succeed. He said this belief is the determinant of how people think, behave and feel. Do you personally have a high sense of self-efficacy? Do you continue to believe in your ability after a failure? Does your mindset tell you that a failure was simply insufficient learning/training, preparation or effort?[22] While Table 2.1 provides a guide to characteristics and capabilities that may fruitfully contribute to building an entrepreneurial career, and when they are most needed, remember, this represents what most often is observed and may not be evidentially the case for every entrepreneur.

entrepreneurial characteristics
The set of attitudes, behaviours and character traits associated with an individual who identifies opportunities and gathers the needed resources to pursue a new endeavour or venture.

risk propensity
The predisposition to take on more risk than the average person.

opportunity propensity
The predisposition to see and take on new ideas as new-venture opportunities

ENTREPRENEURIAL COGNITION

One of the most prolific topics in the research literature is entrepreneurial cognition: entrepreneurs actually think differently from other people. In science, **cognition** refers to mental processes, including paying attention, remembering, producing and understanding language, solving problems and making decisions. It means the ability to process information, apply knowledge and change preferences. **Social cognition theory** looks at situation-based mental models (cognitions) that optimise personal effectiveness. Mitchell and colleagues define **entrepreneurial cognition** as 'the knowledge structures that people use to make assessments, judgements or decisions involving opportunity evaluation, venture creation and growth'.[23] Entrepreneurs use simplifying **mental models** to piece together previously unconnected information that helps them to identify and invent new products or services, and to assemble the necessary resources to start and grow businesses.

Consider the entrepreneur challenged to give a sound explanation for a new venture to a venture capitalist. Even before evaluating alternative strategies, the entrepreneur must first formulate a strategy to frame *how he or she will 'think' about this task.*

Many people believe that entrepreneurs 'think' differently than other individuals. In the simplest of theoretical terms,

$$\textbf{Entrepreneurship} = \textbf{f (entrepreneur)}$$

This simple formula states that entrepreneurship is a function of the entrepreneur, a real individual with passions, experiences and knowledge living in a particular culture and time period. Looking at the characteristics of these real individuals helps us understand entrepreneurship. Does the following describe you or any of your friends?

> Would-be entrepreneurs live in a sea of dreams. Their destinations are private islands – places to build, create and transform their particular dreams into reality. Being an entrepreneur entails envisioning your island and even more important, it means getting in the boat and rowing to your island. Some leave the shore and drift aimlessly in the shallow waters close to shore, while others paddle furiously and get nowhere, because they don't know how to paddle or steer. Worst of all are those who remain on the shore of the mainland, afraid to get in the boat. Yet, all those dreamers may one day be entrepreneurs if they can marshal the resources – external and internal – needed to transform their dreams into reality.[24]

cognition
Refers to mental processes, including attention, memory, language production and comprehension, problem solving and decision making.

social cognition theory
Theory that introduces the idea of knowledge structures – mental models (cognitions) that are ordered in such a way as to optimise personal effectiveness within given situations – to the study of entrepreneurship. (See also *cognition*.)

entrepreneurial cognition
The knowledge structures used to make assessments, judgements or decisions involving opportunity evaluation, venture creation and growth.

mental models
The knowledge structures that people use to make sense of the world.

Entrepreneurs typically have skills like inner control, planning and goal setting, risk taking, innovation, reality perception, use of feedback, decision making, human relations and independence. They are also not afraid to come back from failure.

Research continues to expand our understanding of the entrepreneurial mind. Here we look at how entrepreneurs perceive, recognise, conceive, judge, sense, reason, remember and imagine. William Gartner examined the literature and found a diversity of reported characteristics.[25] Psychologists have put together a set of profile dimensions that characterise entrepreneurs. We will examine each in turn.

DETERMINATION AND PERSEVERANCE

More than any other factor, total dedication to success and focus on advantage can overcome obstacles and setbacks. Sheer determination and a stubborn, unwavering commitment to succeed often wins out against odds that many people would consider insurmountable. These characteristics can also compensate for personal shortcomings, although when a venture faces adversity, entrepreneurs who value such things as openness to change and the non-financial benefits of a business are also prone to making decisions to persist in spite of objective negative data, ultimately leading to failure.[26] Potential investors or angels take the measure of an entrepreneur by judging entrepreneurial determination. Is the entrepreneur willing to mortgage their own house, take a pay cut, sacrifice family time and reduce their standard of living for long-term gain?

DRIVE TO ACHIEVE

Entrepreneurs are self-starters who appear to others to be internally driven by a strong desire to compete, to excel against self-imposed standards and to pursue and attain challenging goals. This **drive to achieve** has been well documented in the entrepreneurial literature, beginning with David McClelland's pioneering work on motivation in the 1950s and 1960s.[27] McClelland suggested that the key to entrepreneurial behaviour lies in the **need to achieve**. High achievers take calculated risks. They examine a situation, determine how to increase the odds of winning and then push ahead. A high-risk decision for the average businessperson is often perceived as a moderate-risk decision by the well-prepared high achiever.

drive to achieve
A strong desire to compete, to excel against self-imposed standards and to pursue and attain challenging goals.

need to achieve
Characteristic of people with a high need for achievement, who seek to excel and thus tend to avoid both low-risk and high-risk situations.

OPPORTUNITY ORIENTATION

One clear pattern among successful, growth-minded entrepreneurs is their focus on opportunity rather than on resources, structure or strategy. **Opportunity orientation** is the constant awareness of the opportunities that exist in everyday life. Successful entrepreneurs start with the opportunity and let their understanding of it guide other important issues. They are goal oriented in their relentless pursuit of opportunities. Setting high but attainable goals enables them to focus their energies selectively to sort out opportunities and to know when to say 'no'. Their **goal orientation** also helps them to define priorities and provides them with measures of how well they are performing.

opportunity orientation
Focus on and relentless pursuit of opportunities by marshalling resources and utilising one's knowledge and understanding.

goal orientation
A predisposition to defining priorities and monitoring progress toward specific high but attainable goals to maintain focus and manage energy when faced with multiple opportunities.

PERSISTENT PROBLEM SOLVING

Entrepreneurs are not intimidated by difficult situations. In fact, their self-confidence and general optimism seem to translate into a view that the impossible just takes a little longer. Yet they are neither aimless nor foolhardy in their relentless attack on a problem or an obstacle that is impeding business operations. If the task is extremely easy or is unsolvable, entrepreneurs often will give up sooner than others. Simple problems bore them; unsolvable ones do not warrant their time. Moreover, although entrepreneurs are extremely persistent, they are realistic in recognising what they can and cannot do and where they can get help in solving difficult but unavoidable tasks.

FEEDBACK SEEKING

Effective entrepreneurs are often described as quick learners. Unlike many people, however, they also have a strong desire to know how well they are doing and how they might improve their performance. In attempting to make these determinations, they actively seek out mentors and use their feedback. Feedback is also central to their learning from their mistakes and setbacks.

INTERNAL LOCUS OF CONTROL

Successful entrepreneurs believe in themselves. They do not believe the success or failure of their venture will be governed by fate, luck or similar forces. They believe their accomplishments and setbacks are within their own control and influence and that they can affect the outcome of their actions. This attribute is termed **internal locus of control** and is consistent with a high-achievement motivational drive, the desire to take personal responsibility and self-confidence.

TOLERANCE FOR AMBIGUITY

Start-up entrepreneurs face uncertainty multiplied by constant change. This introduces ambiguity and stress into every aspect of the enterprise. Setbacks and surprises are inevitable; lack of organisation, structure and order is a way of life. Yet successful entrepreneurs thrive on the fluidity and excitement of such an ambiguous existence and generally have a high **tolerance for ambiguity**. Job security and retirement generally are of no concern to them.

CALCULATED RISK TAKING

Successful entrepreneurs are not gamblers – if they decide to participate in a venture, they do so in a very calculated, carefully thought-out manner. They do everything possible to get the odds in their favour and they often avoid taking unnecessary risks; instead they are **calculated risk takers**. Their strategies include getting others to share inherent financial and business risks with them – for example, by persuading partners and investors to put up money, creditors to offer special terms and suppliers to advance merchandise.

TOLERANCE FOR FAILURE

Entrepreneurs use failure as a learning experience and generally have a high **tolerance for failure**. The iterative, trial-and-error nature of becoming a successful entrepreneur makes serious setbacks and disappointments an integral part of the learning process. Entrepreneurs do not become disappointed, discouraged or depressed by a setback or failure. Many believe they learn more from their early failures than from their early successes. Entrepreneurs differentiate between noble failure and stupid failure.[28] Although failure can be an important source of information for learning, this learning is not automatic or instantaneous. The emotions generated by failure, such as grief, can interfere with the learning process.

HIGH ENERGY LEVEL

The extraordinary workloads and the stressful demands faced by entrepreneurs place a premium on energy. Many entrepreneurs fine-tune their energy levels by carefully monitoring what they eat and drink, establishing exercise routines and knowing when to get away for relaxation.

internal locus of control
The perception that factors internal to the self – that is, one's own actions – are responsible for the outcome of an event.

tolerance for ambiguity
Tolerance of the uncertainty inherent in new-venture formation, which is compounded by constant changes introducing ambiguity and stress into every aspect of the enterprise.

CourseMateExpress

Best known for his bold failures, one entrepreneur bets on the Yugo (Zastava Koral) and Chery automobiles. Find out more about him on CourseMate Express.

calculated risk taking
An entrepreneurial behaviour whereby information and/or expertise is sought to evaluate whether the risk involved in pursuing an opportunity is calculable and worthy of the potential loss.

tolerance for failure
Tolerance of the inevitable serious setbacks and disappointments that come with the iterative, trial-and-error nature of successful new-venture formation; an integral part of the entrepreneur's learning experience.

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Go online to learn more about how to deal with failure.

CREATIVITY AND INNOVATIVENESS

Creativity was once regarded as an exclusively inherited trait. Looking around the world we see that cultures differ very much in terms of creativity and innovation. Some, like Singapore, are known less for their innovation than for their industriousness. Others, like New Zealand, have a very strong streak of innovation running throughout the culture. It appears likely that creativity is less a genetic trait than a cultural characteristic – one that can be learned.

VISION

vision
In an entrepreneurship context, a stated long-term objective for a venture to create or achieve an altered future that to some may seem incredible or impossible but to the entrepreneur and others working with the venture is a very real possibility.

Entrepreneurs know where they want to go. They have a **vision** or concept of what their business can be. For example, Steve Jobs, one of the founders of Apple Computer Inc., wanted his business to provide microcomputers that could be used by everyone from schoolchildren to businesspeople. The computer would be more than a machine. It would be an integral part of the person's life in terms of learning and communicating. This vision helped make Apple a major competitor in the microcomputer industry. However, not all entrepreneurs have predetermined visions for their business. In many cases, this vision develops over time as the individual begins to realise what the business is and what it can become.

PASSION

Entrepreneurial passion is a fundamental emotional experience for entrepreneurs. Melissa Cardon has devoted much of her efforts to examining this element of the entrepreneurial mindset. She has found that entrepreneurs express and experience entrepreneurial passion as a way of reaching a coherent understanding of the emotional experience of intense arousal and energy mobilisation toward their venture. Moreover, entrepreneurial passion is characterised by a discrete emotion that is quite intense, having been described as an underlying force that fuels our strongest emotions; the intensity felt when engaging in activities that are of deep interest; or the energy that enables entrepreneurs to achieve peak performance. Thus, entrepreneurial passion is recognised as a fundamental component of the entrepreneurial mindset.[29]

TEAM-BUILDING SKILL

entrepreneurial team
The small group of people who work together to start a new venture. Often led by an entrepreneur, they all share entrepreneurial characteristics in various combinations.

The desire for recognition and autonomy does not preclude the entrepreneur's desire to build a strong **entrepreneurial team**. Successful entrepreneurs need to have highly qualified, well-motivated teams that help handle the venture's growth and development. Teams with past experience of working together can have an even stronger positive effect on the new venture's survival and successful growth.[30] In fact, although the entrepreneur may have the clearest vision of where the business is (or should be) headed, the personnel are often more qualified to handle day-to-day implementation challenges.[31]

While this is likely an incomplete list of entrepreneurial characteristics, it does provide an important backdrop for the discussion of the entrepreneurial mind. Importantly, these characteristics cannot always identify who is and who is not an entrepreneur.[32] At best, they serve as a guide and a single entrepreneur is unlikely to exhibit all traits.

Regardless, human curiosity drives many of us, and at the end of this chapter you will find an 'Experiencing entrepreneurship' link to an entrepreneurial assessment. Use it to understand your own strengths and weaknesses and then set about finding ways to compensate for weaknesses and capitalise on strengths. Next we consider how these traits relate to *being* an entrepreneur.

Read 'Entrepreneurship in practice: Are you cut out to be an entrepreneur?' to see what one entrepreneur says is important in building an entrepreneurial career.

ENTREPRENEURSHIP IN PRACTICE

ARE YOU CUT OUT TO BE AN ENTREPRENEUR?

Not everyone is cut out to be an entrepreneur, and with more than 30 per cent of small businesses failing in their start-up, it's worth checking out the traits that characterise some success stories before you start a business.

One of Australia's best-known entrepreneurs is Naomi Simson, founder of online gift retailer RedBalloon (www.redballoon.com.au). She is often asked what character traits are needed to succeed in business.

'I usually defer to businessman and entrepreneur Jack Cowin, who puts it better than I ever could,' Simson says. 'I saw Jack present at the EY Entrepreneurs workshop, where he opened with the quote ''an entrepreneur needs to be a cross between a microbiologist and an astronomer.'' He believes that true entrepreneurs are special in that they can be both detailed and visionary.'

Simson says great entrepreneurs are curious, persistent, in search of better ways to do things, endlessly positive and focused, and have exemplary people skills. While entrepreneurs can be born with these traits, she says some can also be learned.

'Curiosity and positivity are hard things to teach – you either have them or you don't,' she says. 'But characteristics like focus and persistence can be learned, and need to be – without them you're unlikely to make it as an entrepreneur or business owner.'

Simson attributes the success of her own business to tenacity and hard work. 'It was almost three months before RedBalloon made its first sale,' she says. 'People used to ask me ''when [are] you going to give up?'' but the thought never crossed my mind. I never, ever thought that it would not work and I never contemplated throwing in the towel.'

Australia's tall poppy syndrome can be a factor in potentially successful entrepreneurs falling by the wayside. Simson says entrepreneurs can be derided if they get 'above their post', take a risk and fail.

'This is not very productive in a country that needs strong, decisive leaders more than ever,' she says. 'As entrepreneurs – anywhere in the world – we often have trouble imagining failure in the first place. But that doesn't mean failing is a bad thing. Failure is very much a reality of being an entrepreneur – we take risks and sometimes those risks don't pay off.'

Source: Bryant, G. (2013, 5 August). Are you cut out to be an entrepreneur? *The Age, My Small Business*.

THE DARK SIDE OF ENTREPRENEURSHIP

A great deal of literature is devoted to extolling the rewards, successes and achievements of entrepreneurs. However, there is also a **dark side of entrepreneurship** (see also the discussion on criminal entrepreneurs in Chapter 4). In examining this dual-edged approach to the entrepreneurial personality, Manfred Kets de Vries shows that certain negative factors may surround entrepreneurs and dominate their behaviour.[33] You will always find those who have failed and destroyed something that was important to others. For some, it was an error of judgement. But the truth is, some entrepreneurs exhibit criminal behaviour. It is no accident that many people, associate the word 'entrepreneur' with rogues and wheeler-dealers. In *Entrepreneurs*, Bill Bolton and John Thompson have an entire chapter entitled 'Entrepreneurs in the shadows'. They examine:

dark side of entrepreneurship
A destructive side existing within the energetic drive of successful entrepreneurs.

- opportunist entrepreneurs who either adopt a flawed strategy or fail to deliver
- inventors who become failed entrepreneurs as they lack key project-championing capabilities
- empire-builders who grow too quickly and lose control – sometimes employing a creative cover-up strategy
- entrepreneurs who make mistakes, or whose businesses fail, but who determinedly make a comeback
- entrepreneurs who attract controversy
- dishonest entrepreneurs.[34]

In the following sections we discuss some of the darker effects of entrepreneurship.

THE ENTREPRENEUR'S CONFRONTATION WITH RISK

Entrepreneurs face a number of different types of risk. These can be grouped into four basic areas: (1) financial risk, (2) career risk, (3) family and social risk and (4) psychic risk.[35]

Financial risk

In most new ventures the individual puts a significant portion of their savings or other resources at stake, which creates a serious **financial risk**. This money or these resources will, in all likelihood, be lost if the venture fails. The entrepreneur may also be required to sign personally on company obligations that far exceed their personal net worth. The entrepreneur is therefore exposed to personal **bankruptcy**. Many people are unwilling to risk their savings, house, property and salary to start a new business.

financial risk
Type of entrepreneurial risk relating to the money or resources at stake in a new venture.

bankruptcy
Legal status of an organisation or person who cannot pay their debts to creditors to whom they owe money.

Career risk

A question frequently raised by would-be entrepreneurs is whether they will be able to find a job or go back to their old job should their venture fail. This **career risk** is a major concern to managers who have a secure job with a high salary and a good benefits package.

career risk
The entrepreneurial risk associated with the potential for career damage or loss. Managers with a secure job and benefits often experience this when they consider whether they can go back to their old job if their venture should fail.

Family and social risk

Starting a new venture uses much of the entrepreneur's energy and time. Consequently, their other commitments may suffer and there is increased **family and social risk**. Entrepreneurs who are married, especially those with children, expose their families to the risks of an incomplete family experience and the possibility of permanent emotional scars. In addition, old friends may vanish slowly because of missed get-togethers.

family and social risk
Type of entrepreneurial risk relating to the energy and time cost of starting a new venture. Entrepreneurs who are married, and especially those with children, expose their families to the risks of an incomplete family experience and the possibility of permanent emotional scars. In addition, old friends may vanish slowly because of missed get-togethers.

Psychic risk

The **psychic risk** may be the greatest risk to the wellbeing of the entrepreneur. Money can be replaced; a new house can be built; spouse, children and friends can usually adapt. But some entrepreneurs who have suffered financial catastrophes have been unable to bounce back, at least not immediately. The psychological impact has proven too severe for them.

psychic risk
Risk relating to the great psychological impact on the entrepreneur who is creating a new venture.

STRESS AND THE ENTREPRENEUR

Some of the most common entrepreneurial goals are independence, wealth and work satisfaction. Research studies of entrepreneurs show that those who achieve these goals often pay a high price.[36] A majority of entrepreneurs surveyed had back problems, indigestion, insomnia or headaches. To achieve their goals, however, these entrepreneurs were willing to tolerate these effects of stress. For them, the rewards justified the costs.

What is entrepreneurial stress?

In general, **entrepreneurial stress** can be viewed as a function of discrepancies between a person's expectations and ability to meet demands, as well as discrepancies between the individual's expectations and personality. If a person is unable to fulfil role demands, stress occurs. When entrepreneurs' work demands and expectations exceed their abilities to perform as venture initiators, they are likely to experience stress. One researcher has pointed out how entrepreneurial roles and operating environments can lead to stress. Initiating and managing a business requires taking significant risk. As previously mentioned, these risks may be described as financial, career, family and social, and psychic. Also, entrepreneurs must engage in constant communication activities – interacting with relevant

entrepreneurial stress
A function of discrepancies between one's expectations and one's ability to meet demands.

external constituencies, including customers, suppliers, regulators, lawyers and accountants – which can be stressful.

Lacking depth of resources, entrepreneurs must bear the cost of their mistakes while playing a multitude of roles, such as salesperson, recruiter, spokesperson and negotiator. These simultaneous demands can lead to role overload. Owning and operating a business requires a large commitment of time and energy, often, as noted previously, at the expense of family and social activities. Finally, entrepreneurs are often working alone or with a small number of employees and therefore lack the support from colleagues that may be available to managers in a large corporation.[37]

In addition to the roles and environment of an entrepreneur's experience, stress can result from a basic personality structure. Referred to as **Type A behaviour**, this personality structure describes people who are impatient, demanding and highly strung. These individuals gravitate toward heavy workloads and find themselves completely immersed in their business demands. Some of the distinguishing characteristics associated with Type A entrepreneurs are as follows:

Type A behaviour
Impatient, demanding and highly-strung behaviours that comprise the 'Type A' personality.

- *Chronic and severe sense of time urgency.* For instance, type A people become particularly frustrated in traffic jams.
- *Constant involvement in multiple projects subject to deadlines*. Type A people take delight in the feeling of being swamped with work.
- *Neglect of all aspects of life except work*. These workaholics live to work rather than work to live.
- *Tendency to take on excessive responsibility*. This is often combined with the feeling that 'only I am capable of taking care of this matter.'
- *Explosiveness of speech and a tendency to speak faster than most people*. Type A people are prone to ranting and swearing when upset.

Therefore, to better understand stress, entrepreneurs need to be aware of their particular personality as well as the roles and operating environments that differentiate their business pursuits.[38] See also 'Entrepreneurship in practice: The entrepreneurial life cycle' later in this chapter.

CourseMateExpress

Go online to learn more about sources of stress and tools for dealing with it.

ENTREPRENEURIAL EDGE

DEALING WITH STRESS

How can entrepreneurs improve the quality of their business and personal lives? Following are six specific ways entrepreneurs can cope with stress.

Networking

One way to relieve the loneliness of running a business is to share experiences by networking with other business owners. The objectivity gained from hearing about the triumphs and errors of others is itself therapeutic.

Getting away from it all

The best antidote to immersion in business, many entrepreneurs report, is a holiday. If vacation days or weeks are limited by valid business constraints, short breaks still may be possible. Such interludes allow a measure of self-renewal.

Communicating with employees

Entrepreneurs are in close contact with employees and can readily assess the concerns of their staff. Personal touches often unavailable in large corporations – such as company-wide outings, flexible hours and small loans to tide workers over until payday – are possible. In such settings, employees often are more productive than their counterparts in large organisations and may experience less stress.

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Finding satisfaction

Outside the company, countering the obsessive need to achieve can be difficult, because the entrepreneur's personality is inextricably woven into the company fabric. Entrepreneurs need to get away from the business occasionally and become more passionate about life itself; they need to gain some new perspectives.

Delegating

Implementation of coping mechanisms requires implementation time. To gain this time, the entrepreneur has to delegate tasks. Entrepreneurs find delegation difficult, because they think they have to be at the business all of the time and be involved in every aspect of the operation. But if time is to be used for alleviation of stress, appropriate delegates must be found and trained.

Exercising rigorously

Research by Goldsby and colleagues looked at two types of exercise – running and weightlifting – and their impact on sales volume, extrinsic rewards and intrinsic rewards. The results indicated that running is positively related to all three outcome variables, and weightlifting is positively related to extrinsic and intrinsic rewards. This study demonstrates the value of exercise regimens in relieving the stress associated with entrepreneurship.

Sources: Boyd, D. P., & Gumpert, D. E. (1983). Coping with entrepreneurial stress. *Harvard Business Review*, March/April, 46–56; Goldsby, M. G., Kuratko, D. F., & Bishop, J. W. (2005). Entrepreneurship and fitness: An examination of rigorous exercise and goal attainment among small business owners. *Journal of Small Business Management*, 43(1), 78–92; see also Levesque, M., & Minniti, M. (2006). The effect of aging on entrepreneurial behaviour. *Journal of Business Venturing*, 21(2), 177–94.

THE ENTREPRENEURIAL EGO

entrepreneurial ego
A self-centred characteristic exhibited by entrepreneurs obsessed with the importance of themselves and their ideas.

In addition to the challenges of risk and stress, the entrepreneur may also experience the negative effects of having an **entrepreneurial ego**, especially in countries that value modesty and circumspection. In other words, certain characteristics that usually propel entrepreneurs into success can also be exhibited to their extreme. We examine four of these characteristics that may hold destructive implications for entrepreneurs.[39]

An overbearing need for control

need to control
The strong desire entrepreneurs have to control both their venture and their destiny.

Entrepreneurs are driven by a strong **need to control** both their venture and their destiny. This internal locus of control spills over into a preoccupation with controlling everything. An obsession with autonomy and control may cause entrepreneurs to work in structured situations *only* when they have created the structure on *their* terms. This, of course, has serious implications for relationships within an entrepreneurial team since entrepreneurs can see others as a threat or infringement of their will. Thus the same characteristic that entrepreneurs need for successful venture creation also contains a destructive side.

Sense of distrust

To remain alert to competition, customers and government regulations, entrepreneurs are continually scanning the environment. They try to anticipate and act on developments that others might recognise too late. This distrustful state can result in their focusing on trivialities, causing them to lose sight of reality, to distort reasoning and logic and to take destructive actions. Again, distrust is a dual-edged characteristic.

Overriding desire for success

The entrepreneur's ego is involved in the desire for success. Although many of today's entrepreneurs believe they are living on the edge of existence, constantly stirring within them is a strong desire to succeed against the odds. Therefore, the entrepreneur rises up as a defiant person who creatively acts to deny any feelings of insignificance. The individual is driven to succeed and takes pride in demonstrating that success. Therein lie the seeds of possible destructiveness. If the entrepreneur seeks to demonstrate achievement through the erection of a monument – such as a huge office building, an imposing factory or a plush office – then the danger exists that the individual will become more important than the venture itself. Losing perspective like this can be the destructive side of the desire to succeed.

Unrealistic optimism

The ceaseless optimism that emanates from entrepreneurs (even through the bleak times) is a key factor in the drive toward success. Entrepreneurs maintain a high enthusiasm level that becomes an **external optimism**, which allows others to believe in them during rough periods.

external optimism Ceaseless optimism emanating from entrepreneurs as a key factor in the drive towards success.

However, when taken to its extreme, this optimistic attitude can lead to a fantasy approach to the business. A self-deceptive state may arise in which entrepreneurs ignore trends, facts and reports and delude themselves into thinking everything will turn out fine. This type of behaviour can lead to an inability to handle the reality of the business world.

These examples do not imply that all entrepreneurs fall prey to these scenarios, nor that each of the characteristics presented always give way to the 'destructive' side. Nevertheless, all potential entrepreneurs need to know that the dark side of entrepreneurship exists.

PERSONAL PATHWAYS TO AN ENTREPRENEURIAL CAREER

Simply put, an **entrepreneurial career** means finding the pathways toward creating ventures that are right for you. You will find stresses and tribulations, the agony and ecstasy, the perseverance and journey to bring your new ventures into being. It's like a painting that emerges based on how you interact with, feel and agonise over your creations. You don't just produce a venture; it comes out of you with pain and excitement. You don't somehow pre-exist as an entrepreneur; you emerge as a result of your own unique, novel, idiosyncratic experience of creating a venture. Venture creation is a lived experience that, as it unfolds, defines who you are as an entrepreneur. Successful ventures are nurtured first in the heart.

entrepreneurial career A career that involves the work and effort required to spot opportunities and pursue new endeavours or ventures.

There are various pathways that can help you build your personal qualities and start your entrepreneurial career, such as finding or creating an opportunity, becoming involved in the family business, working with an employer to commence a new-venture activity, seeking a franchise or buying an existing business to turn around or grow. Various pathways are discussed throughout the book, and are listed in the Preface as well, but here we will capture a sense of the person in a few specific entrepreneurial contextual pathways.

ENTREPRENEURS ARE VENTURESOME

Entrepreneurs are optimistic, hard-working, committed individuals who derive great satisfaction from being independent. Starting a new business requires more than just an idea; it requires sound judgement and planning along with an approach that reduces risk to provide the best chance of ensuring the survival and success of a new venture. In current times, as *The Economist* explains, the entrepreneur's job is like zeroing in on a target. First, you have to identify what the customer needs, then you build something that responds to those needs. You observe and assess the extent to which the new product/service addresses those needs successfully and continue to repeat the process until you achieve the right 'product-market fit'. There is no pay-off until you find the right combination of product (and/or service), customer need and market with sufficient potential to sustain a business.[40]

Bolton and Thompson define an entrepreneur as 'a person who habitually creates and innovates to build something of recognised value around perceived opportunities'. A *person* can also be a group of people, since it is possible to describe teams and even organisations as entrepreneurial. The word 'person', though, suggests that a personality, or personalities, are involved that cannot be replaced by a system. *Habitualness* is an important characteristic of entrepreneurs that distinguishes them from business owner-managers or people who build a business simply to achieve a comfortable lifestyle. Entrepreneurs just cannot stop being entrepreneurs![41] Some may focus their energies on a single venture while others may engage again and again in creating new ventures. (We jokingly call them 'repeat offenders'! But they are more commonly known as *serial entrepreneurs*.) Entrepreneurs are driven by intense commitment and determined perseverance. They are optimists who see the cup as half full rather than half empty. They strive for integrity. They burn with the competitive desire to excel. They use failure as a tool for learning. They have enough confidence in themselves to believe they personally can make a major difference in the final outcome of their ventures.[42]

In a nutshell, entrepreneurs are venturesome; they thrive on the new-venture experience regardless of its form. While the most recognised entrepreneurs are those involved with traditional new-venture start-ups, there are alternative pathways to shape an entrepreneurial career, including new venturing in social or environmental sustainability pursuits (becoming an *ecopreneur*), which is discussed in Chapter 3. There are also pathways from within the organisations of others, as employees, and in family business contexts. These and other pathways are discussed in Chapter 4. But before we move on, let's consider the person-career fit.

ENTREPRENEURSHIP IN PRACTICE

THE ENTREPRENEURIAL LIFE CYCLE

Read the following and answer the questions as they pertain to your own career.

In trying to understand the life journey of an entrepreneur, Ian Hunter took an interesting approach and examined a specific period of time, 1880 to 1910, in New Zealand history. By examining the lives of 130 colonial entrepreneurs active during that period, Hunter attempted to chart how an entrepreneur's career developed in the context of colonial economic development.

Hunter defined entrepreneurs as those who created a new economic enterprise; resurrected an enterprise; transformed a small business into a big business; or created a new enterprise from folding together previous businesses into an economically different form. Through this approach he isolated five stages of an entrepreneur's life.

- Stage 1 was the preparation stage, comprising the early years of an entrepreneur's life that led to eventual business activities. The key characteristics of this stage included early work experience, acquisition of technical skill, accumulation of capital, formation of initial networks, accumulation of trade and industry knowledge, and identification of a business opportunity. Transition to Stage 2 depended on recognising a subsequent new-venture behaviour.
- Stage 2 meant start-up operations, embarking on the new venture. The major hallmarks were difficulties in market acceptance of new product or service innovation; limited capital; expansion through reinvestment of profits; increase in trade networks and industry knowledge; fostering trust in regards to suppliers, customers and staff; and risk of venture failure. The transition to the next stage was commonly marked by either a cessation of the first venture to develop further opportunities or a marked change in practice.
- Stage 3, the exploration stage, saw the colonial entrepreneur starting further ventures. This stage was characterised by new initiatives, innovation, new partners, additional capital, commercial success and risk of failure. It was during this stage of the entrepreneur's career that they would typically embark on the venture that would be the most successful of their career. They would enjoy heightened levels of knowledge, trust, networks and decision-making skill. Adopting a stable management practice with the most rewarding venture generally signalled the transition to Stage 4.

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- Stage 4 was a time of focus and expansion; adopting particular growth strategies, the entrepreneur developed their enterprises. It was characterised by the entrepreneur concentrating on their most successful business venture to date. New capital often entered the business; the growth strategy of the entrepreneur became apparent; the entrepreneur began to invest in other ventures, with some diversifying their business interests; and family members entered the business. A major advance during this stage was the development of governance practices for the business as the entrepreneur prepared to transition to Stage 5.
- Stage 5 marked the end of the colonial entrepreneur's career. This period was often characterised by the changeover to the next generation, as leadership of the business often passed to the founder's family members, with associated changes in company structure. However, some ventures at this point ceased. When there was no heir apparent, the death of the founder effectively brought the venture to an end. Stage 5 typically occurred when the founder was in their 60s, 70s or 80s.

The progress of entrepreneurs from one stage to the next was not guaranteed, and at times some had to cease their undertaking to avoid further losses or, worse, some went into bankruptcy. The life of an entrepreneur was not one of continuous economic success; failure could occur at any point in the life cycle. Moreover, Hunter showed that even in cases of complete economic failure, the entrepreneurs had a propensity to return to entrepreneurial activity and once again accumulate wealth, establishing a recovery into entrepreneurial activity.

Answer the following questions:

1 You may not be in the colonial age, but what is the age you are presently in? Is it revolutionary, traditional, explosive, corrupt?
2 What could Hunter mean by 'folding together previous businesses into an economically different form'? Give some examples.
3 Which stage are you in? Can you envision the next stage?

Source: Adapted from Hunter, I. (2005). Risk, persistence and focus: A life cycle of the entrepreneur. *Australian Economic History Review*, 45(3), 244–72. Published by John Wiley & Sons, Inc. Copyright 2005.

ENTREPRENEURSHIP IN PRACTICE

VENTURESOME ENTREPRENEURS

Entrepreneurs and their ventures vary in accordance with the nature of perceived opportunities. Here is a sample of Australian and New Zealand entrepreneurs making their mark in industries as diverse as space rockets, fashion accessory design, solar power, an online community marketplace and consumer beverages.

Peter Beck, Founder, CEO and CTO, Rocket Lab, New Zealand

Peter Beck has been ambitious since childhood, dreaming of rockets, with space travel as his ultimate goal. He is now the founding visionary and chief engineer behind Rocket Lab, founded in 2006. His mission: to remove the barriers to commercial space travel by providing frequent and dedicated launch opportunities.

Today, Peter is redefining how we access space and reshaping the world's future. He led the development and launch of Atea-1 in 2009, making Rocket Lab the first private company in the Southern Hemisphere to reach space. With the backing of investors such as Khosla Ventures, Bessemer Venture Partners, Lockheed Martin and K1W1, the company's commercial flight manifest is fully booked.

Jenny Paradiso, Co-Founder and Managing Director, Suntrix, Australia

Jenny established Suntrix in 2009 after she and her husband failed to find a knowledgeable and affordable company to install solar power at their home. Jenny grew Suntrix from the kitchen table into a multimillion dollar company. During their first year of operation, Suntrix's turnover grew from AUD$250 000 to AUD$7.3 million. Despite the challenges of an unscheduled review of Federal Government incentives for the industry, which resulted in a downturn of the business, Jenny led her team to reorientate the Suntrix offering by diversifying and establishing new markets.

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Today, Suntrix's focus has evolved from residential to predominantly commercial, servicing businesses, consultants and all levels of government. In addition to solar energy solutions, Suntrix has introduced an innovative floating solar product to the Australian market and designed an energy monitoring system – myWatt – which is now being exported overseas.

Lana Hopkins, Founder, Mon Purse, Australia

In three years Lana Hopkins' Mon Purse has become a brand without a brand, allowing customers to design their own handbags and leather accessories without paying designer brand premiums.

After already blossoming into an AUD$12 million business, the value of Mon Purse continues to grow. Mon Purse has set up showrooms in Bloomingdale's in New York and San Francisco; in Selfridges in London, Manchester and Birmingham; and in Myer stores throughout Australia.

Lana says no other company has yet achieved mass customisation of affordable luxury handbags and accessories at this scale, in retail terms or digitally.

Tim Fung, CEO and Co-Founder, Airtasker, Australia

For the past five years, Tim Fung has been the inspiration behind Airtasker, a business which has become a byword for matching odd jobs with willing hands. Airtasker now has 1.1 million community members and puts more than AUD$75 million into the pockets of its workers.

New and innovative tasks such as furniture assembly or employing someone to wait in line for the latest iPhone have become Airtasker's mainstay. Tim believes the company will grow exponentially and he wants to give back. He sees Airtasker offering disaster relief or lending its many capable hands to community causes.

John McLean, CEO, Bundaberg Brewed Drinks, Australia

Bundaberg Brewed Drinks is an Australian family-owned company based in the small Queensland town that shares its name, Bundaberg. For generations, the company has been craft brewing premium non-alcoholic beverages using time-honoured brewing methods and quality ingredients.

John McLean took over as Chief Executive Officer in 2007 with a mission to grow the business both domestically and internationally while maintaining the strong entrenched family values.

Since then, the company's unique range of 12 brews have been exported to over 44 countries around the world, with a continued growth focus on both domestic and international market development.

Source: EY (Australia) (2017). Meet the 2017 entrepreneurs, Entrepreneur Of The Year®. http://www.ey.com/au/en/about-us/entrepreneurship/entrepreneur-of-the-year/ey-eoy-meet-the-2017-entrepreneurs. EY (2017). Entrepreneurial Winning Women™ Asia-Pacific program, Class of 2017. http://www.ey.com/cn/en/services/strategic-growth-markets/ey-asia-pacific-entrepreneurial-winning-women-class-of-2017. EY (New Zealand) (2017). Entrepreneur Of The Year®, Country Winners. http://www.ey.com/gl/en/about-us/entrepreneurship/entrepreneur-of-the-year/world-entrepreneur-of-the-year—country-winners.

INTRAPRENEURS: ENTREPRENEURSHIP WITHIN

In the US they call it **corporate entrepreneurship**. Researchers call it **entrepreneurial employee activity**.[43] In this book we call it **intrapreneurship** (entrepreneurship *inside* an organisation). Definitions of intrapreneurship have evolved over the last 30 years, particularly in how intrapreneurial businesses differ from other types of businesses.

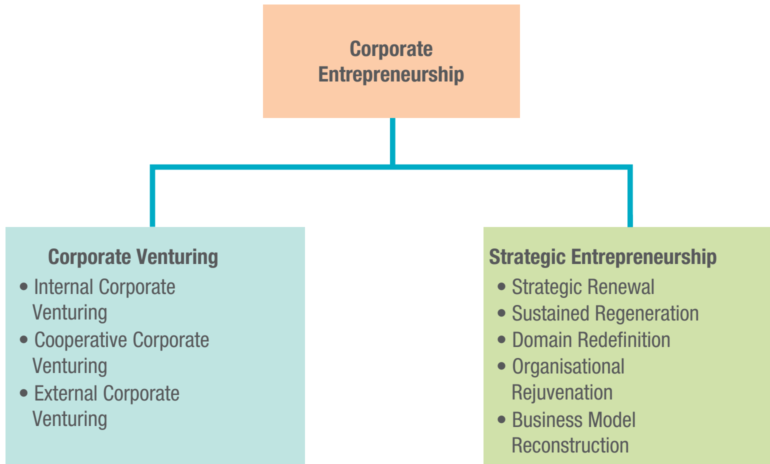
corporate entrepreneurship
The entrepreneurial behaviour of people within large firms and organisations. (Related terms include *intrapreneurship*, *innovation* and *venturing*.)

entrepreneurial employee activity
The activities undertaken by an employee that reflect entrepreneurial behaviours to initiate new-venture formation processes within the context of an existing business

Zahra observed that intrapreneurship includes those 'formal or informal activities aimed at creating new businesses in established companies through product and process innovations and market developments.[44] Guth and Ginsberg stress that intrapreneurship encompasses the two domains of **new-venture development** within existing organisations *and* the transformation of organisations through **strategic renewal**.[45]

Morris and colleagues also spot this dual nature, calling these two areas *corporate venturing* and *strategic entrepreneurship* (see Figure 2.6). **Corporate venturing** commonly involves the adding of new businesses (or portions of new businesses via equity investments) to the company. Strategic entrepreneurship focuses on large-scale, highly consequential innovations that are adopted in the company's pursuit of competitive advantage.[46]

FIGURE 2.6 DEFINING INTRAPRENEURSHIP



Source: Morris, M. H., Kuratko, D. F., & Covin, J. G. (2008). *Corporate entrepreneurship and innovation.* Mason, OH: South-Western/Cengage Learning, 81.

Putting it all together, intrapreneurship is a process whereby an individual (or a group of individuals), in association with an existing organisation, creates a new organisation or instigates renewal or innovation within the organisation. Under this definition, strategic renewal (involving major strategic and/or structural changes), innovation (introducing something new to the marketplace) and corporate venturing (creating new business organisations within the corporate organisation) are all important and legitimate parts of the intrapreneurial process.[47]

Intrapreneurs are a different breed of entrepreneur. Guy Kawasaki once said, 'Entrepreneurs think intrapreneurs have it made: ample capital, infrastructure, salespeople, support people and an umbrella brand. Intrapreneurs do not have it better. At best, they simply have it different. Indeed, they probably have it worse because they are fighting against ingrained, inbred and inept management'.[48] Table 2.2 compares the characteristics and skills of the intrapreneur with those of the traditional manager and the entrepreneur.[49]

Intrapreneurs are not necessarily the inventors of new products or services, but they are the people who can turn ideas or prototypes into profitable realities. They are the people behind a product or service. They are team builders with a commitment and a strong drive to see their ideas become a reality. Most intrapreneurs begin their '**intraprise**' with an idea. This idea typically starts as a vision, often referred to as the 'daydreaming phase'. Here the intrapreneur mentally goes through the process of taking the idea to fruition. Different pathways are thought through and potential obstacles and barriers are mentally examined. Initially, the intrapreneur is the general manager of a new business that does not yet exist. In the beginning, the individual may specialise in one area, such as marketing or research and development, but once the intraprise is started, the intrapreneur quickly begins to learn all the project's facets, seeks **intracapital** and soon becomes a generalist with many skills.

Pinchot famously described intrapreneurs as 'dreamers who do'.[50] They can move quickly to get things done. They are goal oriented, willing to do whatever it takes to achieve their objectives. They are a combination of thinker, doer, planner and worker. They combine vision and action. Dedication to the new idea is paramount. As a result, intrapreneurs often expect the impossible from themselves and consider no setback too great to make their venture successful. They are self-determined goal setters who go beyond the call of duty in achieving their ambitions.

intrapreneurship
Entrepreneurial activities within a company that receive organisational sanction and resource commitments for the purpose of innovative results. It means the infusion of entrepreneurial thinking into large bureaucratic structures, including corporations and governments. Known as 'corporate entrepreneurship' in the US.

new-venture development
The activities during the first or early stage of a new business or project that involves creativity and evaluation in forming the business.

strategic renewal
Transformation of an organisation to put it in a more competitive position and improve financial performance; an important part of intrapreneurship.

corporate venturing
Another word for intrapreneurship or corporate entrepreneurship.

intraprise
A company created by an intrapreneur; a spin-off of a larger company.

TABLE 2.2 WHO IS THE INTRAPRENEUR?

CHARACTERISTIC	TRADITIONAL	ENTREPRENEUR	INTRAPRENEUR
Primary motives	Wants promotion and other traditional business rewards; power-motivated	Wants freedom; goal-oriented, self-reliant and self-motivated	Wants freedom and access to company resources; goal-oriented and self-motivated, but also responds to business rewards and recognition
Tendency to action	Delegates action; supervising and reporting take most energy	Gets hands dirty; may upset employees by suddenly doing their work	Gets hands dirty; may know how to delegate but, when necessary, does what needs to be done
Attitude toward courage and destiny	Sees others being in charge of their destiny; can be forceful and ambitious but may be fearful of others' ability to do them in	Self-confident, optimistic and courageous	Self-confident and courageous; many are cynical about the system but optimistic about their ability to outwit it
Focus of attention	Primarily on events inside the company	Primarily on customers and the marketplace	Both internal and external; sells insiders on needs of venture and marketplace but also focuses on customers
Attitude toward risk	Cautious	Likes moderate risk; invests heavily but expects to succeed	Likes moderate risk; generally not afraid of being fired, so sees little personal risk

Source: From Hegar, Modern Human Relations at Work, 11E. © 2012 Cengage.

intracapital
Special capital set aside for the intrapreneur to use whenever investment money is needed for further research ideas.

When faced with failure or setback, intrapreneurs are optimistic. First, they do not admit they are beaten; they view failure as a temporary setback to be learned from and dealt with. It is not seen as a reason to quit. Second, they view themselves as proprietors of their own destiny. They do not blame their failure on others, but instead focus on learning how they might have done better. By objectively dealing with their own mistakes and failures, intrapreneurs learn to avoid making the same mistakes again and this, in turn, is part of what helps make them successful.

FAMILY SUCCESSORS: DEVELOPING A DYNASTY

entrepreneurial family
A family that provides opportunity for its family members to initiate change, and instils a desire to be innovative.

If you are the son or daughter of an **entrepreneurial family**, even an in-law or more distant relative, chances are you can consider 'succession' as a pathway to your entrepreneurial future. Research shows that many family businesses go out of existence within 10 years. Only three out of 10 survive into a second generation. More significantly, only 16 per cent of all family enterprises make it to a third generation. The average life expectancy for a family business is 24 years, which is also the average tenure for the founders of a business.[51] You can use this to your advantage with proper foresight and planning.

Many private businesses fail to adequately prepare for passing managerial control to the next generation despite its obvious inevitability. If your founding father or mother has not approached you yet, it might be prudent to approach them and ask about their plans for succession.

management succession
The transition of managerial decision making in a business, one of the greatest challenges confronting owners and entrepreneurs, especially in family businesses.

Management succession, which involves the transition of managerial decision making in a business, is more challenging than it may appear. The skills of the business owner may be integral to the business, or they may be unwilling to relinquish their position – even if their health or abilities begin to decline. Sibling rivalry, family members' fear of losing status or a complete denial of death for fear of loss or abandonment can all exacerbate the situation.[52] Table 2.3 provides a list of barriers to succession attributed to the owner and to the family.

TABLE 2.3 BARRIERS TO SUCCESSION PLANNING IN FAMILY BUSINESSES

FOUNDER/OWNER	FAMILY
Death anxiety	Death as taboo
Company as symbol	Discussion is a hostile act
Loss of identity	Fear of loss/abandonment
Concern about legacy	Sibling rivalry
Dilemma of choice	Change of spouse's position
Fiction of equality	
Generational envy	
Loss of power	

Reprinted from Organisational Dynamics, Winter, 61, Kets de Vries, M. F. R., The dynamics of family-controlled firms: The good news and the bad news, Copyright © 1993, with permission from Elsevier.

There are two ways to deal with this – one from the owner's perspective, the other from the successor's perspective.

The owner should develop a **succession plan**, including a decision as to who will be the heir to the business. As a potential successor (for example, you are the only child), you should ask yourself, 'Am I truly interested in taking over?' You might reflect, 'Yes, Dad has always said "there's always a place for you here".' But your inexperience can increase the chances that the business will fail. Are you truly competitive? Have you earned a university degree? Have you gained experience outside the family business? Can you compete for open positions with non-family applicants? Too many companies are led by NextGens who failed in other businesses or spent their 20s (and sometimes their 30s) as aspiring athletes, artists or musicians before signing on to the business as unprepared 40-somethings.[53] However, this may be exactly why you are studying entrepreneurship!

succession plan
Process whereby the firm identifies, recruits and cultivates internal candidates to fill key positions; particularly important in family businesses.

Successors should possess many qualities or characteristics. Depending on the situation, some will be more important than others. In most cases, however, all will have some degree of importance. Some of the most common of these successor qualities are:

- sufficient knowledge of the business or a good position (especially marketing or finance) from which to acquire this knowledge within an acceptable timeframe
- fundamental honesty and capability
- good health
- energy, alertness and perception
- enthusiasm about the enterprise
- personality compatible with the business
- high degree of perseverance
- stability and maturity
- reasonable amount of aggressiveness
- thoroughness and a proper respect for detail
- problem-solving ability
- resourcefulness
- ability to plan and organise
- talent to develop people
- personality of a starter and a finisher
- appropriate agreement with the owner's philosophy about the business.[54]

SUMMARY

We started this chapter by looking at the foundations of entrepreneurial behaviour and particularly how context matters by examining different countries around the Pacific. The wealth of a country, social norms, attitudes to entrepreneurship, perception of capabilities and industry structures all have some bearing on how entrepreneurship manifests in different countries. While individual-level indicators of behaviour are not entirely reliable predictors of entrepreneurship at the country level, they do show why the individual entrepreneurial mind is highly relevant to understanding national entrepreneurial behaviour.

We extended the discussion on the motivations that guide entrepreneurs into an entrepreneurial journey with an aggregated view of entrepreneurial capabilities. These capabilities vary across time as the venture develops from an idea into the survival stage of a young business and then onward into a growth-oriented venture. In attempting to explain the entrepreneurial mindset within individuals, we then presented the cognitive view of entrepreneurship and outlined the most common characteristics exhibited by successful entrepreneurs.

Several studies have been conducted to determine the personal characteristics of successful entrepreneurs. Some of these were discussed in this chapter: commitment, determination and perseverance; drive to achieve; opportunity orientation; initiative and responsibility; persistent problem solving; seeking feedback; internal locus of control; tolerance for ambiguity; calculated risk taking; integrity and reliability; tolerance for failure; high energy level; creativity and innovativeness; vision; independence; self-confidence and optimism; and team-building skill. Next, a review of the dark side of entrepreneurship revealed the hazards of different types of risk, stress and ego that may have negative influences on the entrepreneur.

Entrepreneurship is a career that has many pathways beyond just the traditional start-your-own business type of entrepreneur. We introduced the intrapreneur and the family successor as two major alternative pathways and discussed some of the entrepreneurial characteristics that fit with these particular forms of entrepreneurship. Later in Part 1 we will examine more deeply these major pathway opportunities and explore some other pathways to building an entrepreneurial career, before getting into the process perspective of new venturing in Part 2.

KEY TERMS & CONCEPTS

CourseMateExpress

Review key terms with interactive flashcards.

bankruptcy
calculated risk taking
career risk
cognition
corporate entrepreneurship
corporate venturing
dark side of entrepreneurship
drive to achieve
entrepreneurial behaviour
entrepreneurial capabilities
entrepreneurial career
entrepreneurial characteristics
entrepreneurial cognition
entrepreneurial ego
entrepreneurial employee activity
entrepreneurial family
entrepreneurial leadership
entrepreneurial motivation
entrepreneurial persistence
entrepreneurial stress
entrepreneurial team
external optimism
family and social risk
financial risk
goal orientation
internal locus of control
intracapital
intrapreneurship
intraprise
management succession
mental models
necessity-driven
need to achieve
need to control
new-venture development
opportunity-driven
opportunity orientation
opportunity propensity
psychic risk
risk propensity
self-efficacy
social cognition theory
strategic renewal
succession plan
tolerance for ambiguity
tolerance for failure
Type A behaviour
vision

REVIEW & DISCUSSION QUESTIONS

1 How is the motivation for entrepreneurship influenced by the context of a person's country?
2 According to research, what characteristics of entrepreneurs specifically support the development of a venture at the nascent, survival and growth stages?
3 Many people believe that entrepreneurs think differently to non-entrepreneurs. How can this be explained in terms of entrepreneurial cognition?
4 Why is it that entrepreneurs perceive risk differently to most people in deciding upon undertaking a new venture?
5 Identify two high-profile entrepreneurs from your country and research their backgrounds. Using the characteristics of entrepreneurs outlined in this chapter as a reference, construct a character profile of each. How does your own profile compare to these?
6 How do the following traits relate to entrepreneurs: desire to achieve, opportunity orientation, initiative and responsibility?
7 Explain why entrepreneurs are not gamblers.
8 Is it true that most successful entrepreneurs have failed at some point in their business careers? Explain.
9 Explain why an entrepreneurial team is important for an entrepreneur.
10 In what way is vision important to an entrepreneur? How may it positively and negatively influence new venturing?
11 Entrepreneurship has a dark side. What is meant by this statement?
12 What are the four specific areas of risk that entrepreneurs face? Describe each.
13 What are four causes of stress among entrepreneurs? How can an entrepreneur deal with each of them?
14 Describe the factors associated with the entrepreneurial ego. How might you guard against the negative effects of ego?
15 Aside from starting a for-profit business, what other pathways are there for an entrepreneurial career? Explain how these pathways and the person-career fit for these pathways differ.

EXPERIENCING ENTREPRENEURSHIP

Interviewing an entrepreneur

Tips on how to conduct the interview: You will conduct a formal interview with an entrepreneur. Find someone who is currently (in the past three years) starting a business, who owns at least 51 per cent of the business and who has paid wages to someone other than him/herself. Be sure to get the person to commit to at least 45 minutes. Record the date and place of the interview and the person's name. What is this person's position and your relationship to him/her? The final section of the write-up should address how the findings of the interview apply or are meaningful to you. What did you learn or discover that has meaning for your own plans and future?

The interview must be approached rigorously, not casually. You should be prepared with the questions in advance. Rehearse them with a friend in a mock interview. Develop an efficient means of taking notes or capturing the key points of the interview. Establish a personal rapport (take the entrepreneur out to lunch!). Do not just deal with the superficial questions and answers. The key is to probe, to ask why, to delve beneath the surface. Try to cut through the propaganda. Be sure to examine the total effect of the venture on the person's life. Here are some possible questions.

The entrepreneur before starting the venture

- What is your education background?
- What is your previous work experience (before starting the venture)?
- Did you have any role models when growing up?
- Did you do entrepreneurial things as a youth?
- When did you know you wanted to be an entrepreneur?
- Did you have parents who were entrepreneurial?

The entrepreneur at the time he/she started the venture

- What was your primary motivation for starting a business? What were the factors that led you to start the venture?
- What were your goals at the time you started the venture?
- What sort of beliefs did you have (for example, about employees, partners, debt, etc.)?
- Did you seek to establish a 'lifestyle' business, a 'rapid growth' business or something else? Did your growth orientation change over time?
- What sort of resources (not just financial) did you have when you started the venture? What sort of network did you have? Were there any especially creative things you did to come up with the needed resources?
- How concerned were you with control when starting the venture? (Explore the entrepreneur's need for control – of the venture, of people, of decision making.)
- What was your risk orientation when you started the venture?
- Did you write a business plan?
- Did you feel prepared to start the venture at the time you started it?
- How long was a typical work day and work week when you first started your venture?

The entrepreneur as she/he grew the venture

- How have your goals and values changed since starting the venture?
- Did your risk orientation change as the venture grew?
- Did your need for control change as the venture grew?
- Did the typical work week change as the venture grew (in terms of how much time the venture required and how you allocated your time)?
- Did you make assumptions when you first started out that subsequently proved to be wrong? What sorts of insights were gained?
- What key mistakes did you make along the way? What were some of the key lessons learned? What was your greatest moment and your worst moment?
- Were there some critical points in the development of the venture when the venture almost failed, or when you found yourself at a critical crossroads in terms of some vital decision or issue that had to be addressed in a certain way or the venture would have failed?

The entrepreneur today and tomorrow

- What would you do differently if you had it all to do over again?
- What key personal characteristics do you see in yourself that were especially critical for achieving success with this particular venture?
- What are your plans for the future of the venture?
- What is your exit strategy, or do you not have one?
- What advice, based on your own experience, do you have for a student interested in starting a venture today?
- Note: depending on your university or education provider, you may need to seek ethics approval before conducting interviews.

CASE STUDIES

CASE 2.1

PAUL'S DILEMMA

Paul Medwick runs an all-purpose business incubator in the Sutherland Shire of New South Wales, Australia. In the past month, he has received tenancy applications from three entrepreneurs. All three have fledgling businesses with seemingly strong potential; however, Paul has only one suitable office space available at this time. Paul believes it is important to look at more than just the business itself; the individual also needs close scrutiny. The three entrepreneurs are: (1) Robyn Wood, the principal partner in a small management consultancy specialising in the water resource sector; (2) Richard Wilson, developer of a language 'app' to assist new immigrants; and (3) Phil Booker, owner of a self-publishing advisory service with a number of self-help tools in development. Paul has had the incubator's outside consultant, Professor Diane Jackson, interview each of the three entrepreneurs. Diane has done a lot of work with entrepreneurs and after a couple of hours of discussion can usually evaluate a person's entrepreneurial qualities. In the past, Diane has recommended 37 people for tenancy agreements, and only two of these ventures have failed to integrate, grow and graduate to full commercial tenancies elsewhere in the district. This success rate is much higher than that for other business incubators running similar business models. Following is Diane's evaluation of the three people she interviewed.

CHARACTERISTIC	ROBYN WOOD	RICHARD WILSON	PHIL BOOKER
Perseverance	H	M	M
Drive to achieve	M	H	M
Initiative	M	H	M
Persistent problem solving	M	M	H
Tolerance for ambiguity	L	M	H
Integrity and reliability	H	M	H
Tolerance for failure	H	H	H
Creativity and innovativeness	M	H	M
Team building and teamwork	L	H	M
Self-confidence	H	H	H
Independence	H	H	H

H = High; M = Medium; L = Low.

QUESTIONS

1 Which of the three applicants do you think has the weakest entrepreneurial psychological profile? Explain your reasoning and why you think this profile could be unsuitable for Paul's business incubator.

2 To which applicant would you recommend that Paul make the tenancy offer? Defend your answer.

3 Given the profile of your recommended applicant, what other support might you suggest that the applicant would benefit from to strengthen their capabilities and likelihood of success?

CASE 2.2

THE CASHEW CASE: ARE YOU NUTS?

Mrs Rosario Villaviray is a cashew grower and community leader in the village of Duale, Limay in the Philippines. Mrs Villaviray owns a 3.5-hectare orchard of cashew trees intercropped with other fruit trees such as mango, guava, santol and jackfruit.

In Limay, the cashew growing area is about 71 hectares, producing a total of 84 tonnes of cashew nuts annually. Cashew farmers in the area individually sell the raw nuts to local traders who visit their villages. They are generally price-takers; traders usually dictate the price of the cashew nuts. During peak harvest season, there is an oversupply of cashew nuts in other major supply areas such as the province of Palawan, so much so that the traders don't need to travel to Bataan during this period to buy the farmers' produce. As a consequence, cashew farmers experience difficulty in marketing their produce. For lack of market, some farmers out of desperation have even started cutting down their cashew trees.

Meanwhile, there is something also growing on the tree with value the farmers don't well understand. It's the cashew apple, the tree's 'fruit', which can be processed into a sweet drink or distilled into liqueur. Farmers don't understand its potential economic value and just leave the apples in the field to rot, while some collect and use them as feed for cattle and pigs.

Mrs Villaviray did some homework to find out the full extent to which she could utilise the cashew tree to produce an economic return. She found out that the cashew tree is mostly cultivated for its nut, but the cashew apple also could be valuable. Both the nut and the apple have economic value as food and for industrial use.

The cashew nut consists of the kernel and the shell. The kernel is roasted whole or split and consumed not only as a health food but also as a luxury dessert food. Local food manufacturers use the dried or roasted cashew kernels as ingredients in the manufacture of ice cream and confectioneries, and as a hardener for chocolates and pastries. She also discovered the amazing fact that the cashew nut's shell contains a natural resin known as cashew nut shell liquid (CNSL), which is used as a raw material for industrial manufacture, such as in brake linings, industrial rubber, varnishes, paints, adhesives, anti-corrosives and electrical insulations.

With a strong entrepreneurial spirit, Mrs Villaviray saw the vast income potential of value-adding to her farming business by further processing the cashew nut and the cashew apple. She approached the Bureau of Postharvest Research and Extension (BPRE) for technical assistance to develop a small-scale cashew fruit processing enterprise. As project co-operator, her stake or equity in the project could include the processing space and shed, labour, working capital and management of the enterprise. BPRE, as development facilitator, agreed to provide the processing equipment and facilities. The approach by Mrs Villaviray to the BPRE was timely because BPRE was about to embark on a participatory pilot project on a small-scale cashew fruit processing enterprise.

Source: *Linking farmers to market: Some success stories from Asia-Pacific region* (2008, May). Asia-Pacific Association of Agricultural Research Institutions, FAO Regional Office for Asia and the Pacific, Bangkok, Thailand. Copyright 2008 by APAARI.

QUESTIONS

1 What aspects of this case demonstrate the entrepreneurial mind and behaviour of Mrs Villaviray?
2 What aspects of entrepreneurial mind and behaviour would make Mrs Villaviray think to approach the BPRE and not the bank first for assistance and what is it about Mrs Villaviray that would give the BPRE confidence to agree to assist and back Mrs Villaviray's project?
3 Should Mrs Villaviray have found out more information before approaching the BPRE and does she know enough to enter into this venture? How does this behaviour match with the characteristics of an entrepreneur?

ONLINE STUDY RESOURCES

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CHAPTER 3

ETHICAL, SOCIAL AND SUSTAINABLE ENTREPRENEURSHIP

Orville Wright did not have a pilot's license: Don't be afraid to bend or break the rules.

Richard Tait,
Cranium Inc.

There is a fine line between the delinquent mind of an entrepreneur and that of a crazy person.

Anita Roddick,
Founder, The Body Shop

We haven't inherited the Earth from our ancestors. We have borrowed it from our children and grandchildren.

Traditional saying

What is the business case for eliminating life on Earth?

Ray Anderson,
CEO, Interface

CHAPTER OBJECTIVES

1. To examine the concepts of the social entrepreneur and the social business; and explore the mindset of social entrepreneurs
2. To define the term ethics and examine the implications for entrepreneurs, as well as cross-cultural concepts of ethics and corruption
3. To examine the ethics of criminal entrepreneurs and their similarities to other entrepreneurs
4. To focus on the challenges that face disadvantaged entrepreneurs, including those entrepreneurs who are differently abled
5. To understand the particular dynamics of Indigenous entrepreneurship within Australia and New Zealand
6. To appreciate a third kind of entrepreneurship beyond business and social entrepreneurship, and to introduce the concept of ecopreneurship

This chapter has a wide remit. First we look at social entrepreneurship and examine entrepreneurial ethics cross-culturally. We next examine the important topic of disadvantaged and migrant entrepreneurs. We then turn to environmental entrepreneurship, or ecopreneurship.

As management topics go, these are all comparatively new concepts. What unites them? There is a Chinese proverb that says, 'When the wind changes direction, there are those who build walls and those who build windmills.' To deal with issues of social, ethical, and environmental entrepreneurship in the twenty-first century, we must build windmills in every shape, size and colour; use them ourselves; and export them to others.

SOCIAL ENTREPRENEURSHIP

The field of social entrepreneurship is an exploding area for research and teaching.[1] Many countries have a long history of social entrepreneurship, ranging from credit unions and cooperatives to a whole host of new, innovative programs with goals ranging from fighting poverty and urban decay to sourcing funding for the arts and adapting to climate change. While the field may be relatively new, individuals who adopt entrepreneurial strategies to tackle social issues go way back in history. Social entrepreneurship has been around for as long as humans have lived in communities.

WHO ARE SOCIAL ENTREPRENEURS?

There has been a lively debate in simply defining social entrepreneurship. One problem is that the term **social business** can cover everything from not-for-profits, through to charities and foundations, to cooperative and mutual societies, and all the way to hybrid for-profit businesses. Organisations as diverse as the Muslim Brotherhood and the Catholic Church run social businesses. It is probably best to go beyond a business definition, because social entrepreneurs act as change agents in the social sector. They identify a social problem and use their entrepreneurial skills for both social and environmental goals. They innovate and act according to their desire to create and sustain social value for others. They consider themselves to be accountable to the constituencies they serve. Their assets and wealth are used to create community benefit. They use (at least in part) trading activities to achieve this. Profits and surpluses are reinvested in the business and community rather than distributed to shareholders. There is either a double or **triple bottom line** paradigm that balances economic, social and possibly environmental returns.[2] Sources of social revenue are equally diverse. Not all social entrepreneurs have 'cash sales' (even from grants).

social business
A venture that addresses a social problem, where profits are reinvested in the business itself with the aim of increasing social impact. The community, rather than the owners, receives the dividends.

triple bottom line
An accounting method that captures the values and criteria for measuring organisational (and societal) success: economic, ecological and social.

Tyson defined the social entrepreneur as a person 'driven by a social mission, with a desire to find innovative ways to solve social problems that are not being or cannot be addressed by either the market or the public sector'.[3] Are social entrepreneurs different from business entrepreneurs? Drayton points out the social entrepreneur's differences this way: 'The professional succeeds when she solves a client's problem. The manager calls it quits when he has enabled his organisation to succeed. Social entrepreneurs go beyond the immediate problem to fundamentally change the system, spreading the solution and ultimately persuading entire societies to take new leaps.'[4]

Social entrepreneurs are sometimes called 'public entrepreneurs', 'civic entrepreneurs' or 'social innovators'. Wherever they are, they play the role of change agents by:

1. Adopting a mission to create and sustain social value (not just private value)
2. Recognising and relentlessly pursuing new opportunities to serve that mission
3. Engaging in a process of continuous innovation, adaptation and learning
4. Acting boldly without being limited by resources currently in hand, and
5. Exhibiting heightened accountability to the constituencies served and for the outcomes created.[5]

Drayton famously commented that 'social entrepreneurs are not content just to give a fish or teach how to fish. They will not rest until they have revolutionised the fishing industry'.[6] Like business entrepreneurs, social entrepreneurs are creative thinkers continuously striving for innovation, which can involve new technologies, supply sources, distribution outlets or methods of production. Innovation may also mean starting new organisations or offering new products or services. Innovative ideas can be completely new inventions or creative adaptations of existing ones.

Here's what we know about social entrepreneurship:

- The rate of social entrepreneurship activity (SEA) is lower than the rate of business entrepreneurship. It ranges up to about 4 per cent of the adult population in the UAE, Argentina, Iceland and the USA. Latin American countries such as Venezuela, Peru, Jamaica and Colombia come in second rank at about 3.5 per cent.
- Among the 89 countries sampled in a GEM study, it seems that entrepreneurs in richer countries, having satisfied their own basic needs, may be more likely to turn to the needs of others. On the other hand, social and environmental problems are often more prevalent in developing countries.
- Social entrepreneurs in developing countries focus on more pressing needs such as basic health care provision, access to water and sanitation, and agricultural activities in rural areas.
- Social entrepreneurs in richer countries are particularly active in launching culture-related organisations, providing services for disabled people, focusing on waste recycling and nature protection, and offering open-source activities such as online social networking.
- In contrast to business entrepreneurs, where older age groups predominate, young people have a relatively higher chance of becoming social entrepreneurs.
- While social enterprises are more likely to be started by men than by women, the 'gender gap' is not as high as in business entrepreneurship.
- Education is a good predictor of becoming a social entrepreneur. Students are more likely to be engaged with social entrepreneurial activity than other groups.
- Interestingly, non-white ethnic groups are more likely to be active as social entrepreneurs. Low income and deprivation do not appear to be good predictors of social entrepreneurial activity.[7]

WHAT IS A SOCIAL BUSINESS?

The three traditional sectors – public (government), private (business) and social (non-profit) – have blurred in the new millennium as social and environmental objectives increasingly blend together with business approaches (hybrids). This can be seen everywhere, from civic and municipal enterprises to community development financial institutions, faith-based enterprises, blended value organisations, social economy enterprises, social venturing, sustainable businesses and social enterprises. Whatever we call them, they are dedicating more resources to delivering social and environmental benefits, while public and social sector organisations are attempting to operate in a more businesslike manner.

Figure 3.1 shows where social businesses and enterprises fit within two criteria: where they receive their revenue from; and how they distribute their profits. In one direction we categorise organisations by their 'bottom line'. Do they seek to maximise the financial benefits to owners, or do they seek to maximise the social benefit to the community as a whole? In the other direction, we categorise them by their source of income. Does their income come primarily from earned sources (market exchange of value/sales) or does it originate from some contributed source such as charity, grants, taxes or subsidies?

bottom line
The major priority of the organisation in terms of its measure of value created. Typically it is economic but increasingly social and environmental value is being included. (See also *triple bottom line*.)

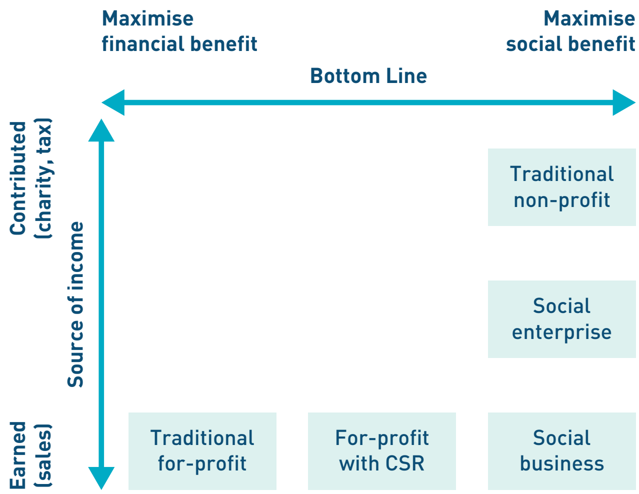


FIGURE 3.1 DEFINING SOCIAL BUSINESSES AND ENTERPRISES

Using these criteria, we can distinguish between traditional for-profits, for-profits with **corporate social responsibility** (CSR) goals and social businesses. At the other end of the spectrum is the traditional non-profit and its subsidiary, a **social enterprise** that seeks direct earned income on behalf of the non-profit. Finally, there is the true social business pursuing social and environmental aims through the use of business methods.

corporate social responsibility A business process that guides a company's activities in the protection and promotion of international human rights, labour and environmental standards by minimising their environmental impact, adhering to international labour standards, contributing to their communities and managing towards a more economically sustainable world.

social enterprise A business that fulfils social aims.

Drilling down a bit further, we see that social entrepreneurs differ widely in the type of organisations launched and the kinds of social or environmental problems they try to solve, such as education, health, culture, economic development and the environment. Of the thousands of social businesses measured:

- Traditional NGOs (7 per cent of the total) rely on donations and are non-profit;
- Not-for-profit social enterprises (28 per cent) are non-profits and rely on donations, but are highly innovative;
- Hybrid social enterprises (28 per cent) combine earned income and donation strategies;
- For-profit social enterprises (12 per cent) rely on earned income, and may have lower levels of social/environmental goals;
- Social committed for-profits (19 per cent) also rely on earned income, and may have lower levels of social/environmental goals.
- Unclassified businesses make up 8 per cent.[8]

Is social or environmental innovation compatible with large organisations? The answer, of course, is yes, it is! Even large governmental corporations can be social enterprises. We call this 'social intrapreneurship'.[9] Social intrapreneurs demonstrate that business and social values can be aligned. Nowhere is this so true as in the field of environmental sustainability.[10] A **social intrapreneur** is a person working in a large business or social organisation who is developing and promoting practical solutions to social or environmental challenges where progress is currently stalled by market failures.[11] A social intrapreneur is an employee of a large organisation who uses entrepreneurial principles to address social and environmental challenges. In contrast with social entrepreneurs in

social intrapreneur A person working in a large business or social organisation developing and promoting solutions or products that add value both to the company's bottom line as well as to society and the planet. Also called corporate social entrepreneur. (See also *intrapreneur*.)

small organisations, social intrapreneurs can leverage organisational capabilities to deliver social value on a large scale by delivering solutions or products that add value to the company's bottom line as well as to society and the planet. Far-sighted companies are increasingly identifying individuals who look beyond conventional business practices and who can foster economic, environmental and social value.

THE MINDSET OF SOCIAL ENTREPRENEURS

Continuing the discussion on mindsets from Chapter 2, do social entrepreneurs have a different mindset from business entrepreneurs? It is true that social entrepreneurs do the same things as business entrepreneurs and have the same skills and temperament.[12] But there are differences. Social entrepreneurs are not as overtly positive and confident as mainstream entrepreneurs. They are more likely to fear failure than their business counterparts and are more likely to say that lack of finance will stop them.[13] Drayton describes the biggest difference thus:

> Scholars and artists come to rest when they've expressed an idea. Managers, when they solve a problem for their company, complete their goal … None of that satisfies a social entrepreneur. The entrepreneur simply knows in a very deep way that, 'I have got to change the whole society'.[14]

Yes, both business and social entrepreneurs have a mission and values. But for social entrepreneurs, the social mission is central. For business entrepreneurs, return on investment and profit are central. Both wish to create superior value, but that value is very different.[15] Social enterprises are fundamentally different from commercial ones. They sometimes have a spiritual or virtue dimension, something very often missing from commercial enterprises.

In an interesting study, Kalish discusses interesting differences between social entrepreneurs and business entrepreneurs, arguing that they have psychologically distinct orientations to spotting a **market gap** and filling it.[16]

market gap
An identifiable market segment that addresses customer needs not being addressed by competitors; also called niche market or market niche.

- *Business entrepreneurs* find 'structural holes' between similar groups of people. For example, they spot market gaps between connected categories of people, such as between suppliers and customers. Business entrepreneurs position themselves in the middle ('entre') to plug the structural hole.
- *Social entrepreneurs* also want to plug structural holes. The difference is that they do this between competing, conflicting or even warring groups of people. Compared with business entrepreneurs, social entrepreneurs view themselves as 'embedded in the larger context and may, therefore, be more similar to the non-partisan and the mediator.'[17] They value the unity of the whole of society and attempt to link others to the benefit of society.

Environmentally focused **sustainability entrepreneurs**, or 'ecopreneurs', may also have a unique mindset. They seek to combine the environmental, economic and social components of sustainability in a holistic manner. They are said to have a different organising logic from more conventional entrepreneurs. Market creation is more difficult for them because the broader community (especially finance markets and governments) has sometimes not progressed far enough to understand their innovations. They also face confusion in the marketplace because they may operate their businesses in ways that run counter to popular perceptions of entrepreneurial behaviour (for example, donations to

sustainability entrepreneur
An entrepreneur who recognises, develops and exploits opportunities that create economic, ecological and social value.

environmental causes, employee-friendly working conditions, a greater interest in wider social issues than in bottom-line profits and a concern for the longer-term implications of their business activities).[18]

ENTREPRENEURIAL EDGE

HOW UNREASONABLE ARE YOU?

Successful social entrepreneurs change the world by being 'unreasonable' – refusing to accept the status quo. Here's how to become one of these pioneers:

- Shrug off the constraints of hierarchy, tradition and bureaucracy. Never do something just because that's the way it's always been done.
- Focus on social value creation. In that spirit, be willing to share your innovations and insights so others can replicate them.
- Apply practical solutions to social problems, combining innovation, resourcefulness and opportunity.
- Innovate by finding a new product, service or approach to a social problem.
- Have an unwavering belief in everyone's innate capacity to contribute meaningfully to economic and social development.
- Show a dogged determination that pushes you to take risks that others wouldn't dare.
- Balance your passion for change with a zeal to measure and monitor your impact.
- Collaborate with change makers in other sectors.
- Display a healthy impatience. Understand that it's sometimes necessary to jump into change before all your ducks are in a row. If it's clear to you that it's time to act, don't hesitate.

Source: Society for Non-Profit Organisations (2012). How unreasonable are you? *Non-Profit World*, March/April. https://www.snpo.org/readarticle.php?id=1888. Adapted from Elkington, J., & Hartigan, P. (2008). The power of unreasonable people: How social entrepreneurs create markets that change the world. *Harvard Business Review*, 5. Published by Harvard Business Publishing, copyright 2008.

THE ETHICAL ENTREPRENEUR

Social entrepreneurs are not the only ones who face choices. Perhaps now is a good time to turn to the field of **ethics**, because it concerns all entrepreneurs. What is ethics all about? Here's a quick ethics check:

ethics
A set of principles prescribing a behavioural code that explains what is good and right, or bad and wrong.

- If you are invited by a business contact for dinner in China, is it a gift or a bribe to take a bottle of wine and a box of chocolates?
- Is it ethical to put pictures of young children in underwear in your advertising?
- Is it ethical to pad your expense account, conceal cash receipts from the tax office, pay your employees under the table or copy a protected computer program?
- Is it ethical to put your business' rubbish into a personal rubbish bin before you put it out on the street for collection if personal collection is free and business collection is taxed?

Ethics have figured prominently in philosophical thought at least since Socrates, Plato and Aristotle. Derived from the Greek word *ethos*, meaning custom or mode of conduct, ethics have challenged philosophers for centuries to determine what exactly represents right or wrong conduct. About 560 BCE, the Greek thinker Chilon offered the opinion that a merchant does better to take an honest loss than to make a dishonest profit. His reasoning was that a loss may be painful for a while, but dishonesty hurts forever – and that advice is just as relevant today.[19]

Many entrepreneurs, especially social entrepreneurs, are highly ethical people, but some entrepreneurs are not. Why is that? Is it because they have a strong 'action bias' that prevents them from considering ethical issues? Is it because they are more focused on personal financial gain even at the expense of others? Are teenagers who love rule-breaking and who are non-conformists more likely to become entrepreneurs? Why is it that male teenagers who engage in 'modest rule breaking' in adolescence (e.g. delinquency and family/school offences) are more likely to become entrepreneurs than corporate managers? Can the lack of resources (or their short-term availability) make an entrepreneur rely on corruption and bribery? Could an entrepreneur introduce a morally questionable innovation that could actually lead to 'destructive innovation'?

Yes, say Anderson and Smith, who describe the case of 'Dodgy Dave', a criminal entrepreneur who provides a collection service for debts irrecoverable by conventional means. His 'service', which was apparently very effective, used only the threat of violence. Even social entrepreneurs must come under scrutiny, because at their core they too look for the most effective methods of achieving their missions, which might require shady dealings.[20]

productive entrepreneur An entrepreneur who captures rents ethically through innovation and also furthers growth. (See also *unproductive entrepreneur*, *destructive entrepreneur*, *annihilative entrepreneur*.)

Baumol helps us understand the ethics in his discussion of differences between productive, unproductive and destructive forms of entrepreneurship, to which we could in the present era of biosphere entrepreneurship add 'annihilative entrepreneurship' (see Table 3.1).[21] **Productive entrepreneurs** are ethical

TABLE 3.1 ALLOCATION OF PRODUCTIVE, NON-PRODUCTIVE, DESTRUCTIVE AND ANNIHILATIVE ENTREPRENEURSHIP

TYPE OF ENTREPRENEURIAL ACTIVITY	PRODUCTIVE ENTREPRENEURSHIP	UNPRODUCTIVE ENTREPRENEURSHIP	DESTRUCTIVE ENTREPRENEURSHIP	ANNIHILATIVE ENTREPRENEURSHIP
Stereotype	**Value-creating hero**	**Robber of value**	**Exploiter of value**	**Plunderer of value**
How does the entrepreneur treat rent seeking?*	Rent-creating Pursues opportunity within prevailing rules. Contributes to net value or to the capacity to produce additional value.	Rent-seeking Adds little value to economy. Sidesteps regulation, evades taxes, lobbies for influence, acquires monopoly rights, establishes protective guilds, executes legal but hostile takeovers.	Rent-destroying Destroys value but recovery is possible. Employs fraud, corruption, bribery, IP piracy, litigation, theft, criminal entrepreneurs, drug dealing, prostitution, racketeering, blackmailing.	Rent-annihilating Recovery is impossible; damage is irreversible. Irreparable value destruction through toxic waste, destruction of ecosystem services, ecocide of species,
Does the entrepreneur capture rents?	Yes, while not limiting the ability of others to do the same.	Appropriates and seizes rents so that others cannot.	Destroys rents but recovery is possible.	Destroys rents but damage is irreparable and recovery impossible.
Value creation	Positive	Unaffected; redistributed	Negative; value lowered.	Toxic; negative value creation
Effect on the biosphere	Adds value to labour, capital and natural resources; respects and adds to the commons	Redistributes land, labour and capital to favoured actors	Diminishes land, labour and capital; extracts natural resources without replenishing	Annihilates land, labour and capital; makes natural resources unusable; sets off runaway processes
Example: Fishing	Farm fishing, hatchery, tuna ranching	Ocean fishing treaties; factory ships	Dynamite fishing	Drag-net, bottom trawl, dredge
Example: Tree harvesting	Cut and replant forestry	Contract forestry	Clear-cut harvesting	Burning of the rainforest to plant cash crops

*Rent-seeking is defined as increasing one's share of existing wealth without creating new wealth for others. Source: Frederick, H. (2018). The emergence of biosphere entrepreneurship: Are social and business entrepreneurship obsolete? *International Journal of Entrepreneurship and Small Business*, 34(3), 381–419. https://doi.org/10.1504/IJESB.2018.092785.

in that they capture rents to the benefit of further growth. **Unproductive entrepreneurs** (think fraudsters) unethically appropriate rents without adding to collective value. **Destructive entrepreneurs** (think criminals) unethically destroy rents but recovery from this calamity is still possible. **Annihilative entrepreneurs** (think ivory hunters) unethically destroy rents, and the damage is catastrophic and irrecoverable.

Notorious scandals of the 1980s and 1990s, when some famous entrepreneurs were involved in wanton plunder and greed, contributed greatly to the present century's economic and climatic crises. This was reinforced during the global financial crisis (GFC) of 2007–2009 by such rapacious entrepreneurs as Allen Stanford (who orchestrated a massive Ponzi scheme) and Bernie Madoff (who was involved in the largest financial fraud in US history). This 'avarice at any cost' is well expressed by Gordon Gekko (played by Michael Douglas) in the 1987 film *Wall Street* (copyright 1987, 20th Century Fox):

> The point is, ladies and gentleman, that greed – for lack of a better word – is good. Greed is right. Greed works. Greed clarifies, cuts through and captures the essence of the evolutionary spirit. Greed, in all of its forms – greed for life, for money, for love, knowledge – has marked the upward surge of mankind. And greed – you mark my words – will not only save Teldar Paper, but that other malfunctioning corporation called the USA (https://youtu.be/6Da1tDKFfno).

Just like racehorses, the problem is that entrepreneurs sometimes have blinders that restrict their vision. They see what works as what is right. As a result, they do not always adhere to conventional morality.

Ethics provide the rules for how society conducts any activity in an 'acceptable' manner. Ethics prescribe a behavioural code about what is good and right or what is bad and wrong at any given time. Morals are values held by an individual (or a moral community) and define what constitutes a good life. The planet is operating in an ever more dynamic and changing environment, so a moral consensus does not exist.[22] Entrepreneurs are confronted by shareholders, customers, managers, the community, government, employees, private interest groups, unions, peers and so on. Values, mores and societal norms all constantly fluctuate. A definition of ethics in such a rapidly changing environment must be based more on a process than on a static code.

Figure 3.2 illustrates a conceptual framework for viewing this process. As one ethicist states, 'Deciding what is good or right or bad and wrong in such a dynamic environment is necessarily "situational". Therefore, instead of relying on a set of fixed ethical principles, we must now develop an ethical process.'[23]

The quadrants depicted in Figure 3.2 demonstrate the age-old dilemma between law and ethics. Moving from the ideal ethical and legal position (quadrant I) to an unethical and illegal position (quadrant IV), one can see the continuum of activities within an ethical process. Yet legality provides societal standards but not definitive answers to ethical questions. At the end of this chapter you will find 'Experiencing entrepreneurship' exercises to test and debate the application of ethics in entrepreneurial ventures.

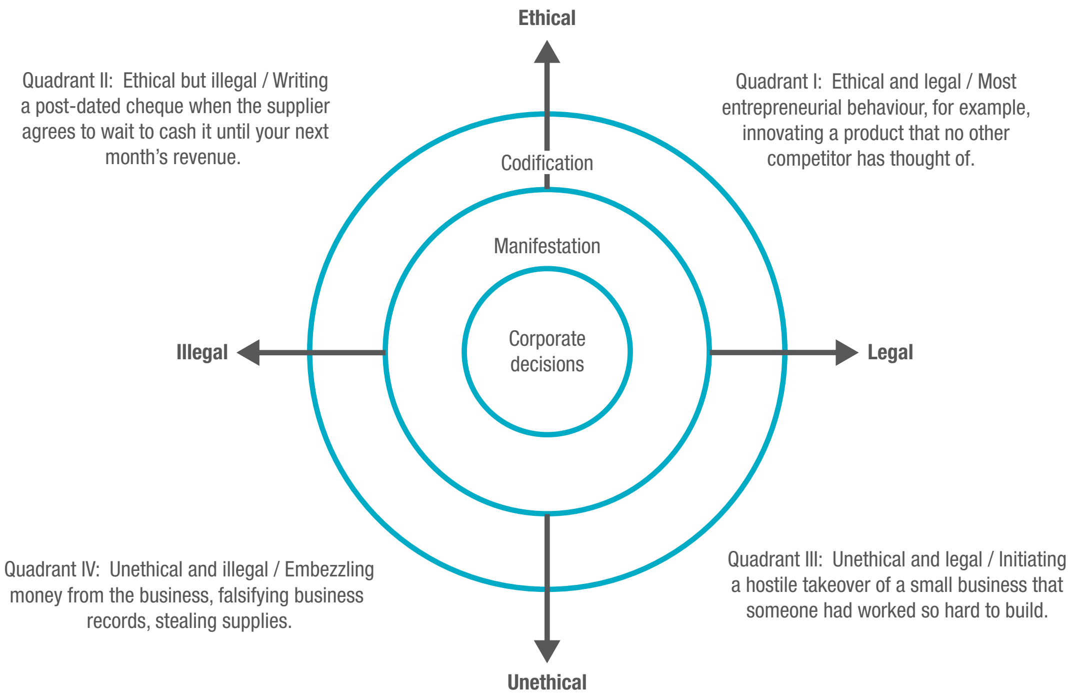
Criminals aside, we are also concerned with real-life business entrepreneurs who sometimes face ethical dilemmas. Just how far down the road toward illegality would you be willing to go to establish a new venture? Survival of the business is the strongest motivation for entrepreneurs. Laws provide the boundaries of legality, but they do not supply answers for ethical dilemmas.

unproductive entrepreneur
An entrepreneur who unethically appropriates rents without adding to collective value through devious use of the legal system or through organised crime. They divert rents through payoffs, litigation, takeovers and tax evasion. See also *productive entrepreneur*, *destructive entrepreneur*, *annihilative entrepreneur*.)

destructive entrepreneur
An entrepreneur who unethically destroy rents but whose destruction may be recoverable. (See also *productive entrepreneur*, *unproductive entrepreneur*, *annihilative entrepreneur*.)

annihilative entrepreneur
An entrepreneur who unethically destroys rents, resulting in catastrophic and irrecoverable damage. See also *productive entrepreneur*, *unproductive entrepreneur*, *destructive entrepreneur*.

FIGURE 3.2 CLASSIFYING DECISIONS USING A CONCEPTUAL FRAMEWORK



Source: Adapted from Henderson, V. E. (1982). The ethical side of enterprise. *Sloan Management Review*, 23(3), 37–48. Copyright 1982 *MIT Sloan Management Review*/Massachusetts Institute of Technology.

ETHICS IN THE CROSS-CULTURAL BUSINESS WORLD

relativist ethics
The belief that moral propositions do not reflect absolute and universal moral truths, but instead make claims relative to social, cultural, historical or personal references. Moral relativists hold that no universal standard exists by which to assess an ethical proposition's truth.

One of the most vexing issues is the conflict in perspectives on how to conduct business across cultures. The two extreme positions are **relativist ethics** or **absolutist ethics**. The relativist says, 'when in Rome, do as the Romans do.' The absolutist argues that the home country's values must be applied everywhere as they are at home.

A well-worn World Bank bribery formula calculates corruption as:

$$\textbf{Corruption} = \textbf{Monopoly} + \textbf{Discretion} - \textbf{Accountability}$$

Corruption exists when a person (or organisation) has *monopoly power* over a good or service, has the *discretion* to decide who will receive it and how much that person will get, and is not *accountable*.[24] The fine line between a gift and a bribe could be determined by using a 'test of disclosure with comfort'. If the business manager or the public official can unhesitatingly acknowledge and justify the giving and receiving of a gift and its size and nature in a public forum without any adverse impact on the company's work and reputation, then and only then is it a gift within the culture of the host country.

absolutist ethics
The belief that there are absolute standards against which moral questions can be judged, and that certain actions are right or wrong, irrespective of context.

Of course, it is difficult to ask the question, 'How much did you receive or pay last year in bribes?' But the Global Corruption Report annually evaluates the perception of corruption around the world using a proxy. The Corruption Perceptions Index relates to perceptions of the degree of corruption as seen by businesspeople, academics and risk analysts and ranges between 100 (highly clean) and 0 (highly corrupt). The scores for Asia-Pacific countries are shown in Table 3.2.

TABLE 3.2 ASIA-PACIFIC CORRUPTION PERCEPTIONS INDEX 2016

WORLD RANK OF 176 COUNTRIES	COUNTRY	2016 CORRUPTION PERCEPTIONS INDEX
2	New Zealand	90
7	Singapore	84
13	Australia	79
16	United States	75
20	Japan	72
52	South Korea	53
55	Malaysia	49
79	India	40
79	China	40
90	Indonesia	37
95	Sri Lanka	36
101	Philippines	35
101	Thailand	35
113	Vietnam	33
136	Myanmar	28
145	Bangladesh	26
156	Cambodia	21
174	North Korea	12

Source: Transparency International (2017). *Corruption Perceptions Index 2016*. Berlin, Germany: Transparency International. Available at https://www.transparency.org/news/feature/corruption_perceptions_index_2016.

Clearly, the globally oriented entrepreneur is going to face a myriad of business environments ranging from relatively clean New Zealand and Singapore through to appalling business corruption in such countries as the Philippines, not to mention Myanmar and North Korea. Even doing business in South Korea (rank 52) can mean running the gauntlet of petty officers and bribes, while huge markets such as China (rank 40) can require a whole new orientation to dealing with corruption.

An example is **bribery**, which we can define as an offer or receipt of any gift, loan, fee, reward or other advantage to or from any person as an inducement to do something which is dishonest, illegal or a breach of trust in the conduct of the enterprise's business.[25] There is growing awareness of the risks posed by bribery, particularly in light of recent scandals, and the public is expecting greater accountability from the business sector. Yet you may have to build a line item in your business plan for 'compliance commissions'.

bribery
A corrupt activity in which a person offers goods, money, services, etc. to sway another person's opinion, action or decision.

China is now a centre for criminal entrepreneurship. This includes bribery, embezzlement, identity theft, pirating of intellectual property, bid rigging, price fixing, violation of consumer rights, diversion of foreign exchange, computer crimes and smuggling. The absence of an effective investigating authority, independent courts and a free media have also made it easier for these crimes to go undetected and unpunished both inside and outside the government. There is a trend in collective corruption whereby private companies, entrepreneurs and organised crime groups now play an important role in initiating and coordinating networks of criminal activity.[26]

ENTREPRENEURSHIP AND ORGANISED CRIME

While discussing the dark side of entrepreneurship we might make mention of actual criminal entrepreneurs and how entrepreneurship on the wrong side of the law has similarities to legitimate and ethical entrepreneurship. Imagine having to run a criminal start-up and growth enterprise in an enduringly hostile landscape! Morselli wrote about 'human resource management in the Cosa Nostra'. Bolton and Thompson (2004) have a fascinating chapter on entrepreneurial criminals such as Al Capone. A study of drug entrepreneurs shows they are shaped by shifting opportunity structures. The range of criminal entrepreneurship is diverse, from bootlegging cigarettes, through hydroponic cannabis growers, to pimping, people smuggling, illegal dumping, people and species smuggling and prostitution.[27]

These criminals share certain things in common with regular entrepreneurs. They have to be excellent risk managers and information managers. For them, 'know-who' is as important as know-how. They are future-oriented organisation builders. Like business entrepreneurs, they are continually working the edge or the margin. They have to weigh up factors such as legal, social and economic risk to determine potential profit and loss. They seek 'niche advantage' and may change the types of crime they perpetrate. They satisfy consumer demand that legitimate markets ignore. The low levels of risk detection and the high profits available are conducive to criminal enterprise. Whether they are engaged in **petty crime entrepreneurship**,[28] like illegal cigarette importers or drug dealers; large-scale embezzlement, like Ferdinand Marcos (former Philippines president) or Mohamed Suharto (former Indonesian president); **Ponzi schemes**; motorcycle gangs; or crime families: criminal entrepreneurs all share one characteristic – they steal from innocent people. This can often mean from other entrepreneurs.

petty crime entrepreneurship
Lower forms of social enterprises, ranging from quasi-legal street peddling, which is an easy way to enter the market, to more criminal activities such as DVD pirating and money laundering.

Ponzi scheme
A scam in which high returns are promised and new investors must continue to be drawn in to pay off earlier investors.

environmental crime
Illegal acts that harm the environment, such as illegal wildlife trade in endangered species, waste smuggling and dumping, and illegal fishing.

Certainly, the most morally questionable acts by entrepreneurs are **environmental crime** enterprises. These entrepreneurial syndicates carry out illegal fishing, illegal trade in wildlife and timber, smuggling of ozone-depleting substances, illegal disposal of asbestos, shipment of animal parts for health remedies, illegal trade in charcoal or trade in hazardous waste, to name a few – all to benefit the criminal entrepreneur and their syndicate.

International criminal gangs and militant groups profit from the plunder of natural resources, and these illegal profits are soaring. Terrorism and even civil wars are consequences of environmental crime. According to UNEP and Interpol, in June 2016 the value of environmental crime was 26 per cent larger than previous estimates, at USD$91–258 billion, compared to USD$70–213 billion in 2014, outstripping illegal trade in small arms.[29] More than half of this amount can be attributed to illegal logging and deforestation.

Environmental crime is perpetuated by everyone from the largest corporations down to naive start-up enterprises. As governments ramp up their regulatory regimes, businesses find new ways to violate laws put in place to protect the environment. The consequences of activities such as illegal logging and timber smuggling, wildlife smuggling, the black market in ozone-depleting substances and dumping of hazardous wastes and chemicals fit the profile applied to other forms of transnational crime.[30] These businesses are polluting the air, water and land. They are pushing many wildlife species, including some that are commercially valuable, closer to extinction, and they are significantly impacting the biological integrity of the planet. Correctly disposing of waste requires time and money. Some companies try to beat the system by illegally disposing of theirs. Pollution crime not only damages the environment, but also results in significant profits for criminals. The illegal disposal of waste into waterways, the air and the ground can significantly damage a community's livelihood, destroy jobs and lower property values. The illegal actions of one company can have far-reaching consequences.

ENTREPRENEURSHIP AND DISADVANTAGED GROUPS

Yet another way to look at ethical entrepreneurship is to focus on those entrepreneurs who launch their start-up ventures out of hardship or suffering, or difficulty fitting into the market due to discrimination or economic handicaps. Without mainstream advantages, they can still overcome the odds to be successful. A truly **disadvantaged entrepreneur** faces external disadvantages such as ethnic disrespect, lack of language skills, poor access to finance and urban poverty, and is usually at the bottom of the social ladder. However, it is important to recognise that not all 'entrepreneurs at the margins' are disadvantaged.

disadvantaged entrepreneur
An entrepreneur from a background of hardship or suffering.

Disadvantaged entrepreneurs have difficulty integrating into the marketplace and typically are located outside the mainstream of social and institutional support for entrepreneurship.[31] This would include minority entrepreneurs but also Indigenous entrepreneurs, women entrepreneurs, disabled entrepreneurs,[32] migrant or refugee entrepreneurs[33] and others. One thought-provoking hypothesis is that *being disadvantaged may actually make one become more entrepreneurial.* Sombart as early as 1911 noticed in references to the Jewish community that creativity and the ability to break through social norms is more frequent among marginal and minority groups. Non-acceptance enables individuals to avoid traditional values and norms that regulate economic behaviour.[34]

Shapero addressed the issue of the entrepreneur as a displaced person.[35] Scase and Goffee suggest that 'entrepreneurs may be more likely to emerge from those groups in society which are deprived or marginal; that is, groups which are discriminated against, persecuted, looked down upon or exceptionally exploited'.[36] This is what we call **social marginality theory**: that the *incongruity between an individual's perceived 'prodigious' personal attributes and the 'low' position that person holds in society might propel them to be entrepreneurial*.[37] Such people seek to overcome disappointing comparisons with their own past or with social reference groups. Hagen suggests that where the behaviour of a group is not accepted or where a group is discriminated against, then **psychological disequilibrium** might drive this person into enterprising behaviour to compensate for this imbalance.[38] One also sees the relevance of the **social exclusion theory** of entrepreneurship, which proposes that entrepreneurs step forward in response to being excluded from employment, education and finance and being denied social legitimacy, social status and civil rights.[39]

social marginality theory
Theory that the perceived incongruity between an individual's (self-perceived) prodigious personal attributes and the position they hold in society might propel them to be entrepreneurial.

psychological disequilibrium
An imbalance between beliefs and reality resulting from incidents or life experiences that demand adjustment or highlight discrimination; according to Hagen's social marginality theory, may drive a person into enterprising behaviour to compensate.

social exclusion theory
Theory that people who suffer from social exclusion – for example, relating to housing, education, property ownership or voting – are more likely to become entrepreneurs.

Of course, these theories do not account for all entrepreneurs, but it is interesting to think that disadvantaged people would be more likely to start a new venture than other people. Below are a few examples.

- *Ethnic entrepreneurs*: By this term, we generally refer to immigrants and newcomers to a particular region or country. This usually means *new settlement*, especially with the social capital that is brought to the area by new immigrants. Ethnic entrepreneurs are more focused on individual and family enrichment than community benefit. They often benefit from governmental assistance because they are viewed as a bedrock of prosperity and as promoters of domestic entrepreneurship. These groups have been widely studied wherever immigrant communities are able to improve their socioeconomic position through entrepreneurship.[40]
- *Refugee entrepreneurs*: Refugee entrepreneurs, whose residency status is often involuntary due to persecution, may have a less extensive social network than immigrants. Refugees' status is precarious and they are unable to return home to acquire funds, capital or labour for their business. Because of their unexpected flight, they often leave valuable things behind, such as financial capital and certificates of education. Worse still, refugee entrepreneurs suffer from trauma and psychological problems, which hamper their self-reliance.[41]

survivalist entrepreneur An entrepreneur who starts a business because it is the only choice or a survival strategy.

Indigenous people Cultural groups that have a historical continuity with a region before its colonisation and who have lived largely independent or isolated from the influence of the larger nation state. These people have maintained at least in part their distinct linguistic, cultural and social/organisational characteristics. Characteristics common across many Indigenous groups include reliance upon subsistence-based production and a predominantly non-urbanised society.

- *Survivalist entrepreneurs*: There is a fascinating literature on **survivalist entrepreneurs**, those who run precarious, vulnerable and insecure enterprises at the fringes of society, who struggle to cross the line into being small businesses. These involuntary entrepreneurs maximise security by avoiding calamities that would jeopardise the family's security and survival. This contrasts with the growth logic of most entrepreneurs. Some call them constrained gazelles (see p. 22), who earn high marginal returns to capital (underscoring their potential to become top performers) but who suffer from survivalist logic.[42]
- *Disabled entrepreneurs*: Where Paralympians are profiled and praised, disabled entrepreneurs get less attention, even though people with disabilities are more likely to be self-employed than the general population. People with disabilities can and do run microenterprises, especially utilising field-levelling technology, but some results show that start-up efforts by nascent entrepreneurs with disabilities are less likely to result in the emergence of a viable organisation, indicating that nascent entrepreneurs with disabilities face particular challenges.[43]
- *Indigenous entrepreneurs*: '**Indigenous people**' encompass cultural groups who have a historical continuity with a region before its colonisation and who maintain at least in part their distinct linguistic, cultural and social/organisational characteristics. Stimulating a new sense of self-determination through Indigenous entrepreneurship has been a positive step for some groups, but it is not the answer for all Indigenous people.[44]
- *LGBTQI:* LGBTQI communities thrive around innovation and entrepreneurial hubs and most likely have a high-tech industry concentration.[45] The fact that they are often the subject of rejection, ostracism and discrimination may have propelled a corresponding emphasis on persistence, tenacity and achievement. Schindehutte and colleagues have identified two types of LGBTQI entrepreneurs. 'Identifiers' are connected to the LGBTQI community, and they start businesses because they desire to support this community and help other people. 'Independents' view sexual orientation as a non-issue in entrepreneurship.[46]
- *Women*: For the sake of completeness, we include women entrepreneurs. We cannot say that women belong to the category of 'disadvantaged' or 'differently abled' entrepreneurs. There is no question that women play a pivotal role in economic development. Women make up 40 per cent of the workforce globally, and the benefits of women starting and owning businesses are well documented.[47] Women's rate of total entrepreneurial activity (TEA) ranges from 3 per cent in Germany, Jordan, Italy and France, to 37 per cent in Senegal, to equal or higher levels than men in Indonesia, Philippines, Vietnam, Mexico and Brazil. This is in contrast to developed economies, where on average women start up at a 60 per cent rate of men. Although the gender gap is narrowing, women entrepreneurs face challenges, including greater likelihood of necessity motivation, lower growth expectations, higher rates of discontinuance and less access to financing.

Some otherwise disadvantaged entrepreneurs may possess a certain magic sauce in terms of personal and functional entrepreneurial competencies.[48] Dyslexia is a case in point. Some might believe that dyslexics do not develop their entrepreneurial potential and instead drift into a life of delinquency; others think that dyslexics often overcome the odds to becoming entrepreneurs. The history of entrepreneurship is awash with examples of illiterate and dyslexic entrepreneurs who have succeeded despite (or because of) this 'gift' (e.g. Henry Ford, Steve Jobs, Walt Disney and Richard Branson). Their gift includes learning from pictures, reliance upon memory, preference for talking, avoidance of the written word and refusal to work from a script. They seem to be more resilient and decisive.[49] The same may be true for those who are blind and deaf, not to mention people with learning disabilities.

What this demonstrates is that some entrepreneurs with different capacities can overcome and even surpass competitors using these positive characteristics. **Differently-abled entrepreneurs** may show that the label of disability is not their defining characteristic as an entrepreneur.[50]

differently-abled entrepreneur
An entrepreneur with a mental or physical condition that entails unique abilities. For example, a blind entrepreneur might excel at running a sound studio.

Senior entrepreneurs (seniorpreneurs) are certainly differently-abled. They are likely to be financially stable and able to invest in themselves. They have had time to develop their skills and knowledge through education as well as through work experience, building confidence in their own abilities. Within the developed countries, for the first time in human history, five generations are in the workplace. Both over-65 generations include many entrepreneurs. The Traditionalists (pre-1946) are wells of knowledge; they are hard-working and perfect mentors for new employees. But the biggest segment of senior entrepreneurs are the Baby Boomers (1946–1964), who coined the term 'workaholic'. They are competitive, often sacrificing home life for their career goals.[51]

Another minority group with special interests of entrepreneurs are *war veterans*. War veterans are nearly twice as likely to be self-employed as non-veterans, regardless of level of combat or military branch. The '**vetpreneur**' is characterised by openness, extroversion, optimism and achievement orientation. One possible explanation is that military service imparts useful training, education or intangible psychological qualities (e.g. self-discipline and leadership).[52] Recently, the FARC guerrillas of Colombia have re-entered society, and many are becoming entrepreneurs.[53]

vetpreneur
A military veteran who becomes an entrepreneur after service.

INDIGENOUS ENTREPRENEURS: AT HOME AND ACROSS THE TASMAN

Now we turn to the rate of entrepreneurial activity among Indigenous populations in Australia and across the Tasman in New Zealand.

ABORIGINAL ENTREPRENEURSHIP

At the last census in 2016 there were 669 900 Indigenous Australians, better called First Australians, comprising 3 per cent of Australia's population.[54] Aboriginal and Torres Strait Islander peoples live right across Australia, and one in three lives in a capital city. Despite living in one of the world's wealthiest nations, a large proportion of Aboriginal and Torres Strait Islander Australians continue to experience endemic poverty and consequently suffer from poor health, low literacy and numeracy, low workforce participation, poor employment prospects and unacceptably poor standards of living.

Archaeological evidence suggests that Aboriginal people have lived in Australia for at least 50 000 years and, prior to invasion and colonial contact, they engaged in wide-ranging intellectual, trade and entrepreneurial pursuits. Trade routes traversed the Australian coast prior to European settlement in 1788.[55] Goods such as pearl, shell, flints and axe heads, oysters and turtles, knives, fishing lines,

Indigenous entrepreneur
An Indigenous person who creates, manages and develops new ventures by and for Indigenous people. The organisations thus created can pertain to the private, public or non-profit sectors.

CourseMateExpress

Go to CourseMate Express and read about how The Body Shop uses economics to change the world and help Indigenous culture.

blankets, rice, steel and tobacco were traded and sold over vast distances, including trade with Macassan traders from what is now known as Indonesia.[56] Another example of **Indigenous entrepreneurship** is that of the Gunditjmara people of what is now Lake Condah in south-western Victoria, who conducted an enterprise that involved an 8000-year-old aquaculture industry.[57] Their main product was smoked eel. This was not a subsistence or hunter-and-gatherer existence, as the Gunditjmara lived in stone homes in permanent to semi-permanent settlements. They constructed extensive dams and water channels to enable them to manage water flows from the local river and rainfall, optimising eel and fish production in a series of man-made lakes. Upon harvesting, they added value to their product by smoking it, extending its durability (or shelf life) and enabling the product to be traded or sold over a vast area.[58]

Today, Aboriginal and Torres Strait Islander peoples are in the main an urban people who suffer high welfare dependency, low work experience and a very low economic base.[59] In 2014 the Overcoming Indigenous Disadvantage report by the Australian government concluded that Aboriginal and Torres Strait Islander peoples are 'over-represented among Australians facing disadvantage, and this disadvantage appears more persistent over time and across generations'.[60] Indigenous people are often caught in a spiral of discrimination that is scarcely conducive to authentic entrepreneurial activity. They experience discrimination and prejudice in the workplace. They have low levels of employment (47.5 per cent).[61] They often lack marketable skills and have an almost non-existent capital base. Many suffer cultural deprivation and a social hopelessness fuelled by an indifferent welfare system. Building an enterprising spirit in these circumstances is far from easy.

Despite wide discussion, there are only a few carefully focused research studies on Indigenous entrepreneurship in Australia.[62] Levels of entrepreneurial activity among Indigenous people are well below those among the general Australian population however, there are examples of indigenous entrepreneurs succeeding despite their disadvantage (see the Entrepreneurship in Practice box below).

MĀORI ENTREPRENEURS

By contrast, the Indigenous people of New Zealand, the Māori, have high rates of entrepreneurial activity. Polynesian settlers arrived in Aotearoa ('Land of the Long White Cloud' in *te reo Māori* language) around the tenth century. Aotearoa was visited briefly by Dutch navigator Abel Tasman in 1642. However, it was not until 1769 that British naval captain James Cook and his crew became the first Europeans to explore New Zealand's coastline thoroughly.

Māori have a history of enterprise upon which to draw. The Māori Wars of the 1860s were fuelled not only by the settlers' hunger for land but also because Māori had become such successful entrepreneurs because they controlled a large share of the country's commerce. Māori were involved with export of produce to Australia[63] and even to England. To some degree Māori entrepreneurial abilities were the subject of envy by Pākeha (white New Zealanders). New Zealand's most distinguished anthropologist, Sir Raymond Firth, in his early work on Māori economics, confirmed that Māori had an entrepreneurial streak. They returned cunning with respect, he said, as this may increase one's *mana* (spirit or respect). Māori dignify labour and reprove idleness. As Firth noted,

> The deep interest taken in work, the commendation of it in proverb and in song, as well as by public opinion, the close attention paid to quality, the administration of skill, the wide fame accorded to acknowledged experts and the preservation of their names in tribal memory – all this comprises a definite social attitude in favour of industry.[64]

When last measured, the rate of Māori entrepreneurship was the highest entrepreneurship rate in the OECD, at 17.7 per cent of the adult population.[65] Nonetheless, Māori entrepreneurs face a number of challenges. Many do not speak their own language *(te reo Māori)* well, which opens up a rift with their elders. Tribal elders may exercise power on the *marae* (a traditional setting), but they generally feel powerless in today's world of technology and change. Equally, outside of traditional contexts, members of the younger generation may have little respect for their elders *(kaumātua* and *kuia)* because they perceive them to be ill-equipped to lead in the modern world. There is a tension between traditional models of leadership, in which status is derived from age and descent, and the models of leadership that apply to the business world, based on the concept of merit. Young Māori resent the wasted and lost opportunities that arise from a mismatch between leadership capability and the nature of the opportunity. Māori entrepreneurs fight battles on several fronts. They have all the usual problems in getting their business off the ground. They may have to wrestle with the wider family group (*hapu*) to be culturally accepted. Finally, Māori entrepreneurs have a hard time being accepted as successful in a business world dominated by European New Zealanders.

With these foundations, a vigorous literature on Māori entrepreneurship has emerged that is helping to understand how ancestral precedents affect Māori enterprise today. Petrie's *Chiefs of Industry* explored entrepreneurial activity of Māori in the early colonial period, showing how quickly and effectively Māori society developed capital-intensive investments, tribal ownership and market understanding. One study reveals four personalities within a Māori entrepreneurial team: (1) *rangatira*, an individual who has oversight and vision in service to a kin community; (2) *kaumatua*, the cultural custodians who support the rangatira; *pōtiki*, the individuals who have authority (*mana*) to speak up; and (4) *tohunga*, the technical specialist, whose role is to provide expertise.[66] Interesting analyses of Māori entrepreneurs in the screen industry have been published.[67] Ngāti Whātua, perhaps New Zealand's most enterprising tribe, suffered a complete land loss over a 120-year period. Their resilience as a community in the face of this loss was fundamental in guiding the kind of entrepreneurial outcomes that they sought (see the Entrepreneurial Edge box below).[68]

ENTREPRENEURIAL EDGE

DREAM TIME, BOOM TIME

Some Aboriginal entrepreneurs have joined the mining boom, building companies, creating jobs and making millions. Neville Stewart recalls the moment his company's fortunes turned during yet another confrontation with a senior mining executive. Did he want to be an Indigenous activist or a contractor, the exasperated executive asked.

''For Christ sake,'' I was saying, ''we are a capable company, give us an opportunity to show what we can do''. I was not being an activist. I wanted one of them to open a door to my company, and eventually they did.'

Stewart began his working life at the wheel of a borrowed grader, levelling red dirt roads in the heat-soaked Pilbara – Australia's quarry to the world. Today he co-heads Australian Indigenous Enterprises (AIE), which is valued at $140 million.

And that is just the beginning. Stewart and his team want to build AIE into a powerhouse of Indigenous enterprise. They have plans for a regional airline, solar power networks and a mobile health service for remote communities, as well as being the nation's biggest employer of Indigenous labour.

For Stewart, 55, it has been a tough slog from cadging his first grader to fulfil a tender he did not expect to get, to owning a grader, to becoming a 'top tier' contractor to the big miners.

Not so long ago, Stewart suffered the ignominy of having to sit through a speech by a cabinet minister on the value of hard work. While he brushes off the incident (there was apparently barely suppressed laughter from Indigenous attendees far wiser, wealthier and hard-working than the minister), Stewart is derisive of government schemes to provide pathways for Aboriginal advancement. 'Aboriginal people are the most trained people in Australia, but there is never a job at the end of it, just more training. You walk into any government office anywhere and you hardly ever see a black face.'

Source: Skelton, R. (2013, March 6). Dreamtime, boomtime. *Sydney Morning Herald*. http://www.smh.com.au/national/dreamtime-boomtime-20130305-2fiup.html. Copyright 2013 by Fairfax Media. Used by permission.

ENTREPRENEURIAL EDGE

COMMERCIALISING THE HAKA

Turning to New Zealand, a desire to turn a passion for *kapa haka* (Māori performing arts) into a profitable business has seen Rotorua-based entrepreneur Wetini Mitai-Ngatai push through setbacks to forge a successful tourism venture, the Mitai Māori Village (http://mitai.co.nz/). Mitai is a traditional Māori village offering a guided bush walk and cultural performances.

Founded in 2003, the village had humble beginnings – its first visitors consisted of just two German tourists. The village has captured a lucrative part of Rotorua's thriving cultural tourism sector in its 10 years of operation, offering an authentic experience complete with *hangi* (a traditional type of earth oven), cultural performances and a bush walk, and has hosted nearly 600 000 people.

Mitai-Ngatai is also an award-winning kapa haka performer and is currently starring in a Māori television reality show that follows the build-up to the national kapa haka championships.

'I had always wanted to work for myself. When I was 23 I had two fish and chip shops. Later, I moved into starting my own kapa haka roopu, Te Matarae i Orehu (which performed at Te Matatini in February). I thought, I love kapa haka and I'm going to do this as a business. Why not do something for myself and my family? My business was a way to provide employment for my family and the wider community, through a unique Māori cultural tourism experience that now employs more than 100 people as well as 13 full-time staff.'

Source: Passion for kapa haka sparks idea (2013, 30 March). *Stuff*. http://www.stuff.co.nz/business/small-business/8484876/Passion-for-kapa-haka-sparks-idea.

SUSTAINABILITY ENTREPRENEURSHIP

The old definition of sustainability used to be simply surviving or maintaining a business' viability against its competitors. Nowadays the term sustainability means a real commitment to the environment and climate change mitigation/adaptation, as well as a revamping of the entire business model right down to its core. In the past, some entrepreneurs simply tried to deny the planet's problems. At worst, they exploited and plundered scarce resources so that they could get their 'fair share' before their competitors did. Fortunately, in the twenty-first century a growing cohort of business and social entrepreneurs, NGOs, impact investors and philanthropists have realised that an environmentally friendly approach does not necessarily translate into a decreased bottom line. In fact, it can even lead to gains in profitability. Given the substantial changes in climate that are forecast there has been substantial interest in understanding the economic consequences of climate change.

On balance, entrepreneurs have undervalued biodiversity, ecosystems and the means of survival that nature provides, including resources such as energy, water, free space and materials. They have sometimes not valued nature as a living ecosystem and have devalued it as a source of natural capital. Rather than adding value to the Earth, entrepreneurs have sometimes aimed only to reduce the quantity of waste that is returned to the planet.

ecopreneurship
The study and practice of nascent and new business owners who innovate, upcycle and offer environmentally friendly services, goods and technology.

ecopreneur
An entrepreneur who combines the unrelenting drive and imagination of the entrepreneur with the stewardship of a conservator.

There is a strong link between entrepreneurship and environmentalism. The term **ecopreneurship** is a combination of two words: 'ecological' and 'entrepreneurship'. An entrepreneur sometimes strives for success by exploiting market opportunities regardless of the consequences. This may be seen as inconsistent with the need to conserve the planet and prevent environmental damage caused by market forces. But an **ecopreneur** combines the unrelenting drive and imagination of the entrepreneur with the stewardship of a conservator rather than the devastation of an exploiter.

Ecopreneurship has been a concept in business research since the early 1990s. Elkington and Burke, in their book *The Green Capitalists*, argued that environmentalism is in entrepreneurs' best long-term interests, as resource depletion and transportation congestion reduce profits. Important to the 'green capitalist' argument is that: (1) businesses can adjust their behaviour; and (2) consumers can make environmentally friendly purchase decisions. Steven Bennett's *Ecopreneuring* focused on opportunities for innovative entrepreneurs to create growth-oriented eco-businesses such as waste recycling, reducing air pollution, 'atmospheric businesses', fuel for the planet, waterworks, safe foods, enviro-investment and education on environment. They, together with Berle and Blue, began to use terms like 'environmental entrepreneur', 'green entrepreneur', 'eco-entrepreneur' and 'ecopreneur'. Anderson and Leal's 1998 book *Enviro-Capitalists* investigated what it takes to be a successful entrepreneur in the environmental arena.[69]

Throughout history, we can see three types of entrepreneurs: *Entrepreneur mercatorius* seeks to add value to the private purse. *Entrepreneur socialis* adds value to the community and society. *Entrepreneur biosphaeris* adds value to the biosphere and ecosystem services. We call this person the **biosphere entrepreneur**. Table 3.3 summarises the main characteristics of biosphere entrepreneurs.

biosphere entrepreneur
An entrepreneur who adds value to natural ecosystems, akin to a business entrepreneur adding value to his private pocket or to shareholders, or a social entrepreneur adding value to the community.

TABLE 3.3 CHARACTERISTICS OF BIOSPHERE ENTREPRENEURS

Add value to the biosphere rather than irreplaceably extracting resources from it
Improve human wellbeing while safeguarding natural ecosystems
Utilise ecosystem services and return them to nature with neutral effect
Upcycle products and waste, producing in the supply chain a product of higher value than the original
Balance the relationship between humans and nature
Promote resilience (ability of the planet to recover)
Solve problems related to the biosphere and to sustainability dimensions (ecological, social and economic)
Are capable of learning to work with natural uncertainty
Use nature's patterns to identify opportunities
Put profits into generation/regeneration of ecosystem services.

A theoretical model of biosphere entrepreneurship shows how Earth, people and the entrepreneurial economy are connected, and how energy and materials flow from and are returned to the biosphere. Unsustainable (or negative) entrepreneurs have extracted and plundered resources, thus depleting Earth's natural capital and decreasing its resilience. Normally entrepreneurs return these resources to the biosphere as waste in devalued form. Sustainable (or positive) entrepreneurship means returning resources in value-added form. In the end, we seek to produce a cohort of positive entrepreneurship who can generate positive impacts through adding value and eliminating designed waste, duplication, disposability, planned obsolescence and wasteful end purposes. In so doing, they can create net positive-impact loop systems and innovations that create levers for biophysical improvements and social transformation.[70]

Consider Figure 3.3. Turning to the left-hand side of entrepreneurial actions, from a material point of view, we can see objects (O) passing from the waste-free **biosphere**, through the **sociosphere**, into the realm of entrepreneurial opportunity within the **econosphere** through the process of resource extraction and production. Next, after entrepreneurs are done with these resources, they pass them out of the econosphere as waste. Their value usually becomes negative (–), in other words, damaging to the environment and resulting in a net biosphere deficit. Throughout the history of entrepreneurship, there has been an uneven, negative exchange to the biosphere resulting in a net deficit to the planet. This is ultimately unsustainable, or what we call '**negative entrepreneurship**'.

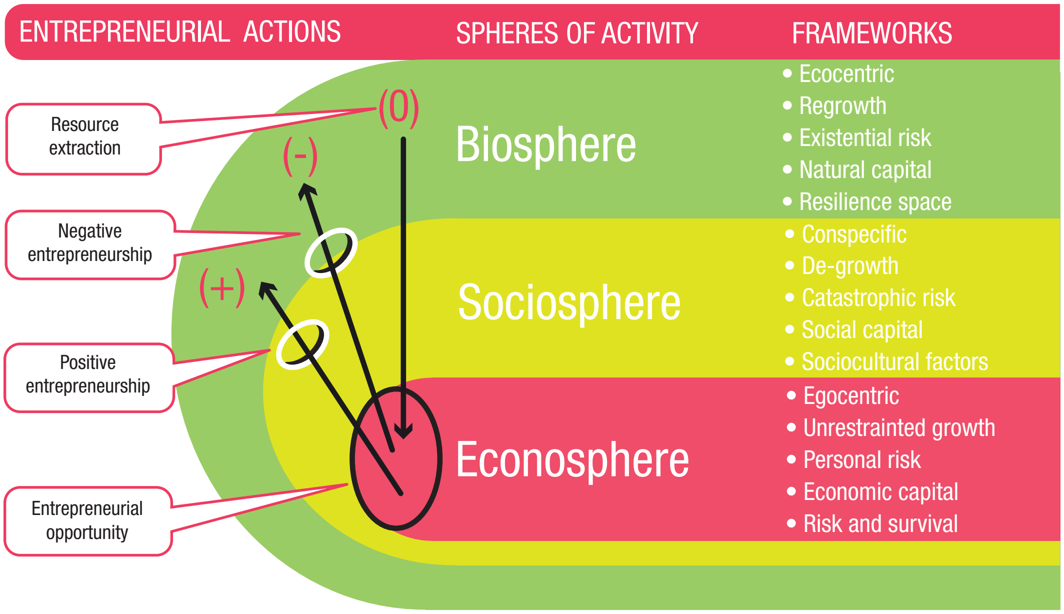
biosphere
All ecosystems on Earth, as well as the Earth's crust, waters and atmosphere, on and in which organisms exist; also, the sum of all living matter on Earth.

sociosphere
All the people in a social system, all the roles they occupy, all their patterns of behaviour, all their inputs and outputs relevant to other human beings, and all the organisations and groups they belong to.

econosphere
Total capital stock; that is, the set of all objects, people, organisations and so on that are interesting from the point of view of the system of exchange.

negative entrepreneurship
Entrepreneurship characterised by an undervaluation of biodiversity and natural resources. Rather than adding value to living materials, negative entrepreneurs only aim to reduce (e.g. through recycling) the quantity of dead resources. (See also *positive entrepreneurship*.)

FIGURE 3.3 INTEGRATED THEORY OF BIOSPHERE ENTREPRENEURSHIP



ENTREPRENEURSHIP IN PRACTICE

EXAMPLE OF POSITIVE ENTREPRENEURSHIP

Recycling usually means separating materials for disposal, but here we make the distinction between downcycling and upcycling. Downcycling transforms waste materials and goods into lower uses. While it may address post-consumer waste, this is a small fraction of the waste entailed in extraction and processing. The obvious example is the recycling of plastics, which turns them into lower-grade plastics without regard to the huge energy losses that were incurred in their production. With upcycling, waste materials are advanced into new, higher-value products. This is the practice of taking something that is disposable and repurposing it into a product of higher quality. An example would be reconstructing old mattresses; repairing and reusing carpet squares; turning wooden pallets into designer furniture; converting waste into art; producing edible chopsticks and compostable shoes; making fashion & homewares from PET bottles and fire hoses; and returning and repairing camping gear when it is worn out.

positive entrepreneurship Entrepreneurship characterised by a commitment to making positive impacts by creating added value through eliminating designed waste, duplication, disposability, planned obsolescence and wasteful end purposes. (See also *negative entrepreneurship*.)

It doesn't have to be this way. **Positive entrepreneurship** (+) can generate positive impacts through adding value and eliminating designed waste, duplication, disposability, planned obsolescence and wasteful end purposes. Positive entrepreneurs can create net positive-impact loop systems and innovations that create levers for biophysical improvements and social transformation. Entrepreneurs can trigger 'impact loops' of two types: They can amplify degradation, or they can add to restoration in the biosphere. They create net positive impacts (not less-negative or even neutral ones) in order to restore the biosphere toward pre-anthropogenic degradation and to lessen the ecological footprint of human beings. With upcycling, waste materials are advanced into new, higher-value products. Table 3.4 compares positive and negative forms of entrepreneurship.

Table 3.5 lists useful resources in the areas of social, ethical and sustainable entrepreneurship.

TABLE 3.4 NEGATIVE AND POSITIVE FORMS OF ENTREPRENEURSHIP

NEGATIVE ENTREPRENEURSHIP	POSITIVE ENTREPRENEURSHIP
Egocentric, individualistic, commercial	Socially connected, environmentally oriented
Pursues opportunity with impunity	Responsible, ethical, sustainable consumption
Plunders and exploits the biosphere	Takes advantage of climate change opportunities
Inconsistent with the need to preserve the planet	Improves environment while achieving growth
Undervalues biodiversity and natural resources	Creates growth through eco-businesses
Destroys value	Value-creating, restorative
Exploits resources with no thought of returning them	Reduces waste, recycling or upcycling it
Subtracts value from ecosystem services	Generates value for ecosystem services
Ignores existential risk to humanity and planet	Considers catastrophic and existential risks
Contributes to the man–nature imbalance	Maintains balance between humans and nature
Irreplaceably extracts resources	Preserves the integrity of the biotic community
Expels used capital with zero or negative value	Adds value to the biosphere
Exploits natural capital, sees capital as only money	Uses social and natural capital, conserves natural capital
Uses shareholder value performance measures	Uses sustainable performance measures
Unproductive, destructive, annihilative	Productive

TABLE 3.5 USEFUL RESOURCES FOR SOCIAL, ETHICAL AND SUSTAINABLE ENTREPRENEURSHIP

SOCIAL ENTREPRENEURSHIP	
Center for the Advancement of Social Entrepreneurship	https://centers.fuqua.duke.edu/case/
Teaching social entrepreneurship: Tips and resources for educators	https://impactentrepreneurs.wordpress.com/2013/03/13/teaching-social-entrepreneurship-tips-and-resources-for-educators/
The Schwab Foundation	http://www.schwabfound.org
BUSINESS ETHICS	
Business for Social Responsibility (United States)	https://www.bsr.org/en/
Bentley University Center for Business Ethics (United States)	https://www.bentley.edu/centers/center-for-business-ethics
Hong Kong Independent Commission Against Corruption (Hong Kong)	http://www.icac.org.hk/en/home/index.html
International Business Ethics Institute (United States)	http://www.business-ethics.org
Transparency International	http://www.transparency.org
HUMAN RIGHTS AND BUSINESS	
Business and Human Rights Resource Centre	http://www.business-humanrights.org
Global Reporting Initiative	http://www.globalreporting.org
The Equator Principles	http://www.equator-principles.com
United Nations Global Compact	http://www.unglobalcompact.org

SUMMARY

This chapter began by showing that social entrepreneurs have a great many of the same characteristics as business entrepreneurs, but their underlying motivations are different. Social entrepreneurs are interested in meeting a social mission. 'Social enterprise' is the term used for a market-based venture addressing social aims. There are a variety of business models that social entrepreneurs can adopt. Social businesses and enterprises are differentiated from traditional businesses by source of revenue and distribution of profit.

The mindset of social entrepreneurs is a bit different as well, particularly in relation to mission and gap filling. Sustainability entrepreneurs are different again in their focus on the environment and social justice.

The global economic and climate crises make it essential to consider the role of ethics for entrepreneurs. Entrepreneurs around the world are some of the planet's best hopes to solve the big problems. Corporate responsibility has now evolved to include protecting a sustainable environment. Fortunately, entrepreneurs can achieve both growth and a better climate.

Ethics are a set of principles prescribing a behavioural code that explains right and wrong; it also may outline moral duty and obligations. Entrepreneurs face many ethical decisions, especially during the early stages of their new ventures. Some arrive at the 'greed is good' conclusion, while others consider the ethical consequences of their behaviours. The opportunity for entrepreneurs to exert ethical influence on their ventures creates a unique challenge of ethical leadership for all entrepreneurs. Despite the ever-present lack of clarity and direction in ethics, it will continue to be a major issue for entrepreneurs during the twenty-first century.

Decisions may be legal without being ethical and vice versa. As a result, entrepreneurs can make four types of decisions: legal and ethical, legal and unethical, illegal and ethical, and illegal and unethical. When making decisions that border on the unethical, entrepreneurs commonly rationalise their choices.

Entrepreneurs frequently have to confront corruption and bribery in many countries. In the Asia-Pacific region, including New Zealand, Australia, Japan and Singapore, the level of corruption is very low, while countries such as Indonesia suffer from high levels of corruption. One challenge that entrepreneurs face in many countries is bribery. China is particularly difficult to work in for this reason.

Entrepreneurship can also be found on the wrong side of the law. It can be observed that criminal entrepreneurs face some of the same start-up and growth dilemmas as legitimate and ethical entrepreneurs. They face risk, are always working at the margin, weigh up 'regulatory' factors and constantly seek niche advantage. One of the greatest ethical threats to the planet today is environmental crime.

The chapter then examined the concepts of differently-abled and disadvantaged entrepreneurs. Is it possible that disadvantaged people might actually become entrepreneurs more frequently than other people? Disadvantages range from cultural and social to geographic and physical. Disadvantaged entrepreneurs may be of many different ethnicities, genders and cultures.

In all nations with significant Indigenous populations, the slow growth of entrepreneurship and self-employment has been cause for concern.

The chapter then looked more deeply at entrepreneurial ecology. Research suggests that opportunities are inherent even in times of crisis, market failure and environmental decline. Yet from the nineteenth century, industrial entrepreneurship carried out the mass extraction of scarce resources without regard for the consequences. Entrepreneurs greatly undervalued biodiversity and ecosystems.

Sustainable entrepreneurship takes into account the living dimension of products and services. Entrepreneurs must seek net positive entrepreneurial impact loops with the biosphere. Positive entrepreneurship eliminates designed waste, duplication, disposability, planned obsolescence and wasteful end purposes. Positive entrepreneurs create net positive impact loop systems and innovations that create levers for biophysical improvements and social transformation.

KEY TERMS & CONCEPTS

absolutist ethics
annihilative entrepreneurs
biosphere entrepreneur
biosphere
bottom line
bribery
corporate social responsibility
destructive entrepreneurs
differently-abled entrepreneurs
disadvantaged entrepreneur
econosphere
ecopreneur
ecopreneurship
environmental crime
ethics
geo-engineering
Indigenous entrepreneurship
Indigenous people
market gap
negative entrepreneurship
petty crime entrepreneurship
ponzi schemes
positive entrepreneurship
productive entrepreneurs
psychological disequilibrium
relativist ethics
social business
social enterprise
social entrepreneurs
social exclusion theory
social intrapreneur
social marginality theory
sociosphere
survivalist entrepreneurs
sustainability entrepreneurs
triple bottom line
unproductive entrepreneurs
vetpreneur

REVIEW & DISCUSSION QUESTIONS

1 Can you identify some social entrepreneurs in your community?
2 Name some social businesses that have no donated income from charity, taxes, grants or subsidies (see Figure 3.1).
3 Name three dimensions that distinguish the mindset of social entrepreneurs from that of business entrepreneurs.
4 Using your own words and experiences, what do you mean when you use the term 'ethics'?
5 A small security company has developed an anti-home invasion app. Although the product has been tested for five years, the technical director points out that the app is susceptible to WiFi hacking. The cash-strapped entrepreneur wants to release the product and use revenue to fix the flaw. Would you say it's ready to go?
6 Why does doing business in certain Asian countries raise ethical considerations for the entrepreneur?
7 As an Australian or a New Zealander, would you pay bribes while doing business in China?
8 What are your opinions on the issues of greed and entrepreneurial crime?
9 Do you have experience in dealing with an entrepreneurial criminal?
10 What is social marginality theory?
11 Is it possible that disadvantaged people can actually become more entrepreneurial than other people?
12 What are some of the advantages that differently-abled entrepreneurs might have?
13 What are the barriers and restraints that disadvantaged entrepreneurs face?
14 What are the elements of a definition of Indigenous peoples?
15 Describe ecopreneurship and think of three real-life examples.

EXPERIENCING ENTREPRENEURSHIP

Exercises in entrepreneurial ethics

Ask the class to form small groups of about eight people to work on ideas for ethical decision-making. Provide each group with information about a business to use for the activity. This could be a local business, a business idea of your choice or theirs, or a business plan sample that they have been working with in the class. Ask each group to do the following:

- Identify problems the entrepreneur might encounter in running this business in an ethical manner.
- Develop a 10-point code of ethics for the business.
- Discuss policies and procedures appropriate for this business that would support the code of ethics.
- List as many ethical problems as possible that might be faced by employees during a normal work day. Discuss possible solutions for the problems. Consider how a procedure guide might help employees to make the best decisions.
- Members of the group should then role-play the process of handling an ethical issue with a customer, with a supplier, with a competitor and with the son of the owner. Discuss the results of the role-playing exercise. If necessary you may want to modify your code of ethics at this time.
- Each group should present their code of ethics to the class and discuss major outcomes of their discussion.

Source: Adapted from PACE, available from the Center on Education and Training for Employment, The Ohio State University, Columbus, OH. http://www.entre-ed.org/teacher-classroom-resources/ethical-behavior-good-business/.

Knowing the difference

Most entrepreneurial actions are ethical and legal. Sometimes, however, they are unethical and/or illegal. Here are the four categories of ethical/legal actions – (1) to (4) – and a list of examples of each category – (a) to (h). Match them up by placing the number of the category next to appropriate examples from the list (two are given for each category). Answers are provided.

1 Ethical and legal
2 Unethical and legal
3 Ethical and illegal
4 Unethical and illegal

- a Giving a gift of $50 000 to a foreign minister to secure a business contract with his country (a customary practice in his country) and then writing off the gift as a tax-deductible item.
- b Knowing that 1 per cent of all tyres have production defects but shipping them anyway and giving kilometre allowances to anyone whose tyres wear out prematurely.
- c Manufacturing a new fuel additive that will increase fuel consumption by 10 per cent.
- d Offering a member of the city council $100 000 to vote to give the entrepreneur the local cable television franchise.
- e Publishing a newspaper story that wrongly implies but does not openly state that the Minister for Education (a political opponent of the newspaper) is deliberately withholding funds for education because of the newspaper's effort to win nomination support for its candidate from the teachers' union.
- f Obtaining inside information from another brokerage that results in the entrepreneur netting more than $2 million.
- g Producing a vaccine that will retard the growth of bone cancer.
- h Producing and selling a drug that will reduce heart attacks, but failing to complete all of the paperwork that must be filed with the government prior to selling the product.

Answers

a 3; **b** 2; **c** 1; **d** 4; **e** 2; **f** 4; **g** 1; **h** 3

CASE STUDIES

CASE 3.1

RUSS GEORGE: SAVE THE WORLD AND MAKE A LITTLE MONEY ON THE SIDE

While politicians at climate change summits debate how much to reduce carbon emissions, one pioneering entrepreneur saw huge opportunities to 'just do it'. Geo-engineering entrepreneur Russ George decided to take the planet's rescue into his own hands. He is best known for his San Francisco-based start-up business Planktos Inc., which claims to 'restore ecosystems and slow climate change [by] removing CO_2 from our oceans and atmosphere by healing the seas, growing new climate forests, and erasing carbon footprints'. His mantra: 'Save the world and make a little money on the side'.

To understand Russ's great entrepreneurial opportunity, first a bit of background.

WHAT IS A GEO-ENGINEERING ENTREPRENEUR?

Scientists and entrepreneurs have been developing what are known as **geo-engineering** technologies that could mitigate climate change. As a carrot, Richard Branson offers geo-engineering entrepreneurs the still-unawarded 'Virgin Earth Challenge', a $25 million award to commercialisers who can remove significant amounts of greenhouse gases from the atmosphere. (Note: it has not yet been awarded.)

geo-engineering Deliberate large-scale manipulation of environmental processes so as to change the Earth's climate, in an attempt to counteract the effects of global warming, e.g. reflective aerosols or (atmospheric) dust, cloud seeding, reforestation and space sunshade.

Geo-engineering is defined as the 'deliberate large-scale intervention in the Earth's natural systems to counteract climate change'.[71] The two broadest areas of geo-engineering remediation focus on solar radiation and carbon dioxide removal. Here are some of the methods that entrepreneurs could use to geo-engineer the planet:

Managing and reducing solar radiation

- *Changing the Earth's reflectivity*: Using space-based or ground-based reflectors, or changing the clouds or the land's surface, so that more of the sun's heat is reflected back into space
- *Stratospheric aerosols*: Introducing small, reflective particles into the atmosphere to reflect sunlight back into space, mimicking the natural cooling effect of volcanic clouds that cooled the Earth during the age of dinosaurs

Removing carbon dioxide

- *Afforestation*: Global-scale tree-planting efforts or using artificial 'trees' with artificial resin to absorb CO_2.
- *Biochar*: Burning biomass (plant material) and burying it so that its carbon is locked up in the soil.
- *Ambient air capture*: Building machines that can remove CO_2 directly from the air and store it elsewhere.
- *Enhanced weathering*: Exposing larger quantities of minerals that react with CO_2 and storing the resulting compounds in the oceans or soil.

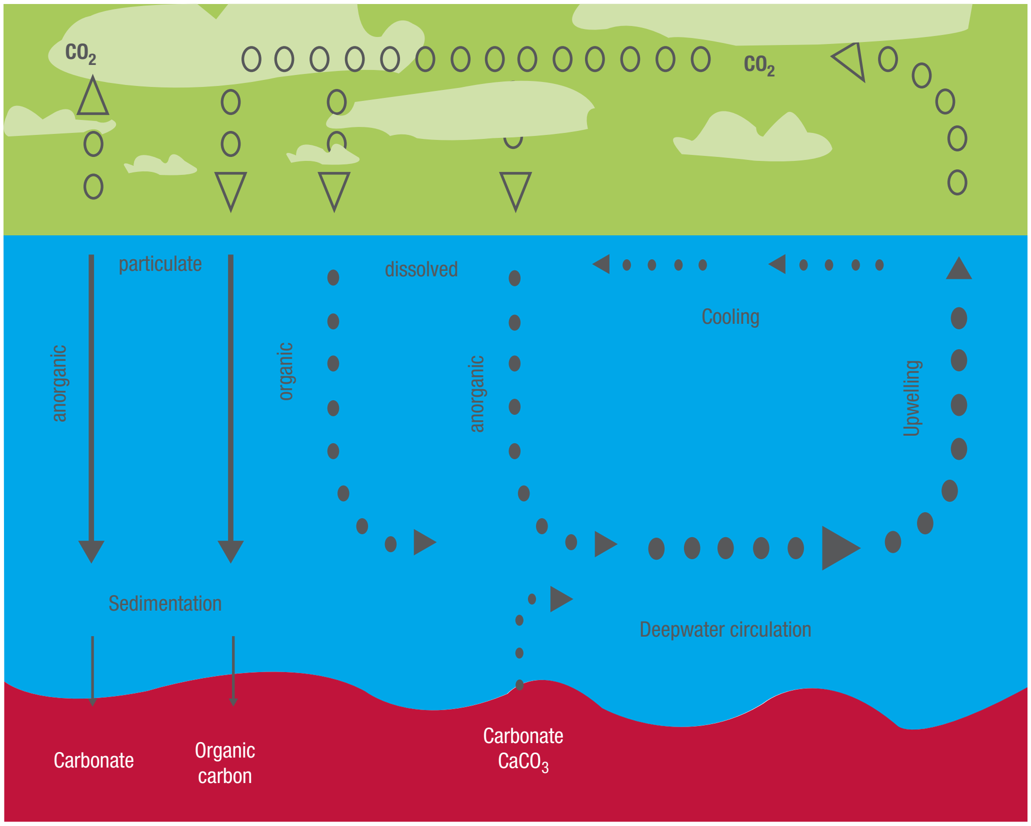
RUSS GEORGE'S BIG IDEA

The technique that most interested Russ George and his team at Planktos Inc. was one of the carbon removal ideas known as ocean fertilisation. This means adding iron – the sort used to improve lawns – to the ocean in order to increase the activity of phytoplankton, the microscopic plants that form the foundation of the marine food chain. The idea is to increase photosynthesis, thereby drawing CO_2 from the atmosphere, eventually sequestering carbon, and sinking it to the bottom of the ocean (see Figure 3.4). Russ' business model was to sell commercial carbon offsets to other polluters for each tonne of sequestered carbon that Planktos achieved. By purchasing carbon offset certificates, companies can compensate for their emissions.

First failed trial

In March 2007, Russ George announced plans to dump tens of thousands of kilograms of tiny iron particles near the Galapagos Islands. In efforts to stop Planktos, lobbying groups filed a formal request to the US Environmental Protection Agency (EPA) to investigate their activities and regulate them under the US Ocean Dumping Act. In addition, public interest organisations asked the Securities Exchange Commission (SEC) to investigate Planktos'

FIGURE 3.4 SINKING CO_2 TO THE BOTTOM OF THE OCEAN



Source: Hannes Grobe, Alfred Wegener Institute for Polar and Marine Research, Bremerhaven, Germany. Copyright 2006.

misleading statements to potential investors regarding the legality and purported environmental benefits of their actions.

Hit with negative publicity, Planktos announced in February 2008 it was postponing its plans in the Galapagos because of a 'highly effective disinformation campaign waged by anti-offset crusaders'. The EPA warned Russ that flying a US flag for his Galapagos project would violate US laws. Planktos announced bankruptcy, sold its vessel and dismissed its employees.

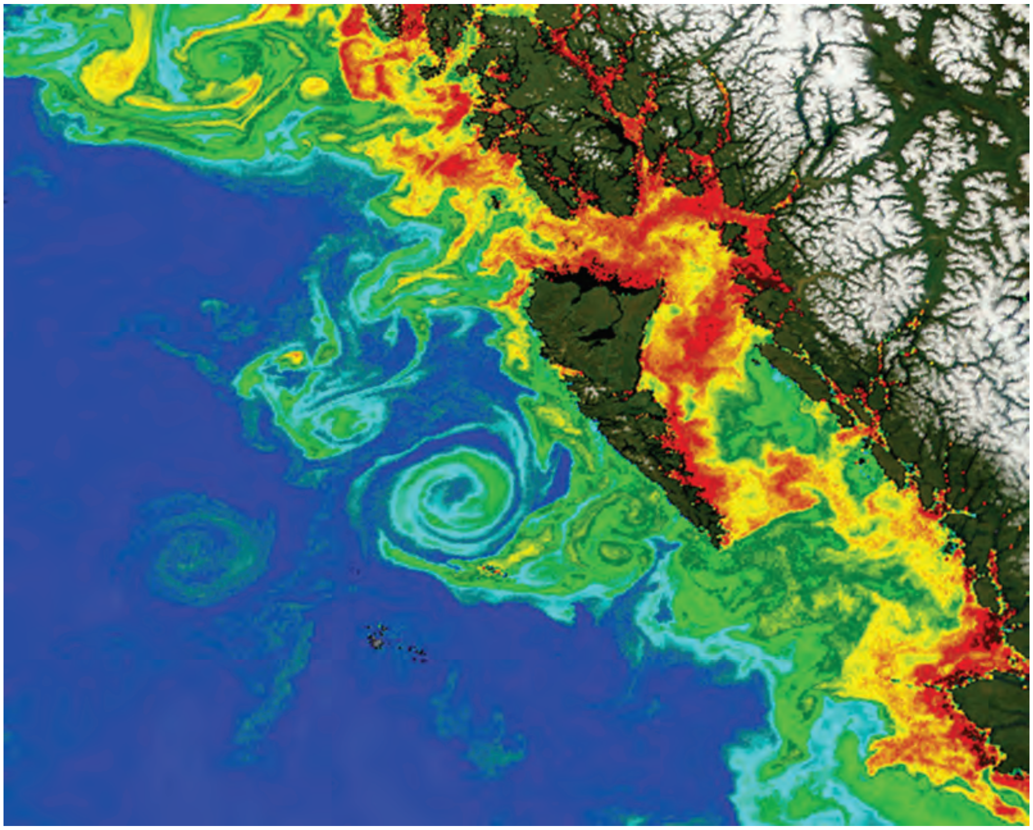
Successful geo-engineering experiment

Undeterred, Russ left Planktos (although he is apparently still a shareholder) and in 2012 he launched the Haida Salmon Restoration Corporation (HSRC). He convinced the Haida indigenous Canadians, for whom salmon harvesting was a traditional way of life, to invest $2.5 million of their own savings. The investors hoped this geo-engineering business would stimulate plankton and thus replenish the fish population while at the same time securing millions of dollars' worth of carbon offsets that could be sold on the international market.

Russ based his project on some solid scientific research. Williamson and colleagues had estimated that widespread ocean fertilisation over the course of a century could remove 10 per cent of the carbon that humans are expected to produce.[72] Smetacek and colleagues found that a man-made algal bloom near Antarctica did successfully sequester carbon on the ocean floor.[73]

Based on this evidence, Russ and his team set sail and poured 120 tonnes of iron-rich dirt into the migration routes of pink and sockeye salmon off the coasts of Alaska and British Columbia over a period of 30 days. The

FIGURE 3.5 THE HAIDA EDDIES OFF THE COAST OF BRITISH COLUMBIA



Source: SeaWiFS image courtesy of the SeaWiFS Project, NASA/Goddard Space Flight Center, and ORBIMAGE.

project resulted in a 35 000 km^2 plankton bloom bigger than the entire island of Jamaica that lasted for several months, turning the waters cloudy red, thereby adding nutrients to stimulate the bloom of plankton on which fish feed.

The resulting 2013 run of pink salmon in Canadian and Alaskan rivers was enormous. Within a few months of the ocean-fertilising operation, NASA satellite images showed a powerful growth of phytoplankton in the waters that received the Haida's iron. Reportedly, fin, sperm and sei whales, rarely seen in the region, appeared in large numbers, along with killer whales, dolphins, schools of albacore tuna and armies of night-feeding squid. By 2014, the catch had quadrupled. In his blog, Russ reported in 2013:

> This is wonderful news for the planet. It means that by working with Mother Nature to undo the terrible wrong we have done … we can re-purpose millions of tonnes of that deadly CO_2 into becoming life itself…. hundreds of millions of salmon, each and every one swimming home to us with their carefully recorded lab journals, their very bodies, all reporting that in their world, their ocean pastures have come back to life.

Russ was astounded to see that this ocean seeding resulted in a huge firestorm from the media and politicians. The Canadian government sent a squad of gun-toting Environment Canada agents to raid the headquarters of the offices of the HSRC. In October 2012, *The Guardian* of London said Russ' business 'contravened UN conventions'.

Scientific American labelled George a 'rogue geo-engineer'. Others have called him the entrepreneurial equivalent of an 'eco-terrorist'.

Russ's big business idea underscored how easy it is for entrepreneurs to manipulate ocean ecosystems. The science and the entrepreneurial business models still need to be worked out. It is true that there is a great deal of uncertainty and concern about the possible downstream negative impacts of geo-engineering. Aerosols in the atmosphere could cause droughts. Cloud reflectors could affect precipitation and temperatures. Ocean fertilisation could have adverse effects on other ecosystems. However, according to Australian scientist Pete Strutton, in the Haida Eddies 'no deleterious impacts have been observed'.[74]

Whether Russ George and the Haida Salmon Restoration Corporation will face legal troubles in the aftermath of the iron dump remains to be seen, but the international rules against such projects are mostly toothless. In any event, the Haida tribe announced it was terminating Russ George in 2013, but a spokesman said, 'While we are confident in the technology, process and buy-in are key'.

QUESTIONS

1. Would you agree with Michael Specter of the *The New Yorker* magazine that Russ George is a geo-vigilante? Or do you believe that humans do much worse than this every day and so doing something positive is ethical?
2. Would you support sending a rocket into space, spreading a few million tonnes of sulphur dioxide particles, and cooling the Earth that way?
3. Which statement do you agree with:
   a. Entrepreneurs are destroyers, so it follows that the business activities of entrepreneurs must be severely regulated and that someone must be empowered to do the constraining.
   b. Entrepreneurs are a creative force – we invent resources and improve the world — so we have to defend our liberty to repair the planet.

Source: Planktos Ecosystems. http://www.planktos.com/; BBC (2014). Tackling climate change with technology: Engineering. http://news.bbc.co.uk/2/hi/technology/8338853.stm; Biello, D. (2012, 24 October). Pacific Ocean hacker speaks out: Is Russ George a "rogue geoengineer," salmon savior or something else? *Scientific American*. http://www.scientificamerican.com/article/questions-and-answers-with-rogue-geoengineer-carbon-entrepreneur-russ-george; CNW (2013, 23 May). Haida announce termination of Russ George. http://www.newswire.ca/en/story/1170825/haida-announce-termination-of-russ-george; Falconer, B. (2014, 5 May). Can anyone stop the man who will try just about anything to put an end to climate change? *Pacific Standard*; Forgey, P. (2013, 10 October). Booming southeast pink returns fuel Alaska's biggest salmon harvest ever. *Alaska Dispatch News*. http://www.adn.com/article/20131010/booming-southeast-pink-returns-fuel-alaskas-biggest-salmon-harvest-ever; Fountain, H. (2012, 18 October). A rogue climate experiment outrages scientists. *New York Times*. http://www.nytimes.com/2012/10/19/science/earth/iron-dumping-experiment-in-pacific-alarms-marine-experts.html?emc=eta1&_r=2&; George, R. (2013, 4 April). Save the world make a little money on the side – my mantra; George, R. (2013). Join me to bring back the fish & ocean life everywhere. http://russgeorge.net; Gramling, C. (2010). Is it time to invest in entrepreneurial geoengineering? *Earth: The Science behind the Headlines*. https://www.earthmagazine.org/article/it-time-invest-entrepreneurial-geoengineering; Keith Johnson, W. et al. (2005). Iron transport by mesoscale Haida eddies in the Gulf of Alaska. *Deep Sea Research Part II: Topical Studies in Oceanography*, 52(7–8), 933–53; Kreiner, T. (2014), Social entrepreneurship and global warming. https://nextbillion.net/social-entrepreneurship-and-global-warming/; Lukacs, M. (2012, 15 October). World's biggest geo-engineering experiment "violates" UN rules. *The Guardian*. http://www.theguardian.com/environment/2012/oct/15/pacific-iron-fertilisation-geoengineering; National Research Council, Committee on Geoengineering Climate; Board on Atmospheric Sciences and Climate; Ocean Studies Board; Division on Earth and Life Studies (2015). *Climate intervention: Carbon dioxide removal and reliable sequestration*. ISBN: 978-0-309-30529-7; National Research Council, Committee on Geoengineering Climate; Board on Atmospheric Sciences and Climate; Ocean Studies Board; Division on Earth and Life Studies (2015). *Climate intervention: Reflecting sunlight to cool Earth*. ISBN 978-0-309-31482-4; Ocean Carbon and Biogeochemistry (OCB). Ocean fertilization. http://www.whoi.edu/ocb-fert/page.do?pid=38315; Oxford Geoengineering Programme (n.d.). What is geoengineering? http://www.geoengineering.ox.ac.uk/what-is-geoengineering/what-is-geoengineering; Pappas, S. (2012, 19 October). Iron dumping in the Pacific Ocean stirs controversy over geoengineering. *Huffington Post*. http://www.huffingtonpost.com/2012/10/19/pacific-ocean-iron-dumping-geoengineering_n_1986517.html; Parry, W. (2012, 18 July). Could fertilizing the oceans reduce global warming? *Livescience*. http://www.livescience.com/21684-geoengineering-iron-fertilization-climate.html; Shukman, D. (2014, 26 November). Geo-engineering: Climate fixes could harm billions. *BBC*. http://www.bbc.com/news/science-environment-30197085; Smetacek, V., et al. (2012). Deep carbon export from a Southern Ocean iron-fertilized diatom bloom. *Nature*, 487(7407), 313–19; Specter, M. (2012, 18 October). The first geo-vigilante. *The New Yorker*. http://www.newyorker.com/news/news-desk/the-first-geo-vigilante; Sustainable Agriculture and Food Systems Funders (2010). Geoengineering briefing paper. http://www.safsf.org/documentsold/Beyond_GE_briefing_papers_final.pdf; Wikipedia. List of proposed geoengineering schemes. http://en.wikipedia.org/wiki/List_of_proposed_geoengineering_schemes; Zubrin, R. (2014, 22 April). Geoengineering could turn our long-barren oceans into a bounty. *National Review*. http://www.nationalreview.com/article/376258/pacifics-salmon-are-back-thank-human-ingenuity-robert-zubrin.

CASE 3.2

AUSTRALIAN BUCCANEER ENTREPRENEUR EATEN BY CANNIBALS

Source: State Library of Victoria/Herald & Weekly Times Limited portrait collection.

This is the colourful story of Benjamin Boyd, the nineteenth-century originator of the Australian get-rich-quick scheme, though he was certainly not the first in a long list of opportunists and criminal entrepreneurs. Australia's history is strewn with unethical rugged individualists, ranging from petty entrepreneurs who had simply stolen cloth in East London to start a tailor shop – before ending up in a Van Diemen's Land prison – to landed gentlemen who loaded their boats to make a living in the New World off other people's backs. It is a history of half-baked dreams that achieved fabulous success, and of well-planned businesses that came to nought.

We now tell the story of the latter. The story combines grand visions and ethical dilemmas in the limitless vistas of colonial Australia. It merges the most unlikely storylines of land development and gold rush fever with slave trade and cannibalism, and even inter-species communication! All these plots are connected to a beautiful sheltered harbour called Twofold Bay just north of Australia's south-east 'corner'. What connects these most unlikely dots of killer whales and South Seas head-hunters? It's the great Victorian-age 'bucca-preneur' Benjamin Boyd.

Already a wealthy stock and insurance broker at age 23 at the beginning of the 1840s, Scotsman Benjamin Boyd of the London Stock Exchange was a self-made man without a drop of aristocratic blood. With a passion for adventure and profit, his grand scheme was to risk the £200 000 he had accumulated in London to achieve even greater profits in Australia and the islands of the Pacific.

Using that almost extrasensory perception that entrepreneurs have to see over the horizon, Boyd set his sights on whaling, sheep farming and passenger steamships, not to mention creating his own Pacific republic. He spent a big chunk of his wealth on a glorious schooner named *The Wanderer*, which gave him immediate entry into Sydney's Royal Yacht Squadron, where he could associate with the landed classes. But he dreamed of becoming his own aristocrat. The story goes that one day in Scotland, as a globe spun under his fingers, he paused it at a bay north of Cape Howe. 'This is Twofold Bay,' he told his lady, 'and there I will found my own town, Boyd Town.'

Twofold Bay was already a well-known whaling centre due to its proximity to the whales' annual migration route to and from Antarctica. Incredibly, it is also famous as the place where human beings and killer whales (orcas) collaborated in hunting the much larger baleen whales for their tasty meat and their valuable oil and bones. A pack of orcas would locate the baleens, corral them into Twofold Bay, and then, by breaching and tail-slapping the surface, alert the human whalers onshore, who would quickly pour into their boats. The orca pack then divided into three groups, one underneath to prevent the baleen from diving, one repeatedly putting its snout into the blowhole to weaken the beast, and the third progressively ripping away at the flesh. The orcas would help kill their larger cousins and turn over the carcasses to the whalers – as long as the orcas got the baleen tongues and lips, which they adored.[75]

Boyd's Whale Tower

Source: 'Ben Boyd's tower' by Bluedawe, Wikimedia Commons, 2006.

Whale products were to the nineteenth century what petroleum is to the world today. Whale oil greased the cogs of the Industrial Revolution and illuminated factories and homes. Whale bone was that century's plastic. Entrepreneurially ambitious men would include whaling in their portfolios in the same way that modern entrepreneurs would invest in information technology today. Needless to say, these men had no regard for biodiversity: breeding females and calves were slaughtered freely, with no regard for their biological importance.

A man of quick action and copious resources, and persuasive to his predominantly Scottish investors, Boyd dispatched a steamer to the far coast to set up a passenger service. Undeterred by the lukewarm reception from the colonial authorities to his ideas, he dispatched a second and third steamer to Australia, and launched the 'Royal Bank of Australia' (he was anything but royal!) with his own capital as well as that of others who were lured into the scheme by the prospects of handsome returns. He gathered a band of gentleman entrepreneurs and set sail 'buccaneer-style' in 1841 on his spectacular yacht, with cannon and long guns.

Upon arrival, Boyd first set up his steamship activities, connecting Sydney with Tasmania and Port Phillip (Melbourne). But disaster came early when one of his steamers, the *Seahorse*, struck rocks. The insurance company claimed captain's negligence and Boyd was saddled with the entire loss of £25 000. Unperturbed, he started buying up land for cattle and sheep, becoming the largest landholder after the Crown at the time, with 2 million acres of land in the Riverina and on the Monaro plateau.

The capital city of Boyd's empire was called Boyd Town and it had a hotel, a store, rendering facilities, a jetty and a large whaling watch tower. Taking advantage of the orca feast, by 1844, he had three dozen whale boats for pursuit of any leviathan that might venture near his port. The Sydney newspaper observed: 'Perhaps there is no individual who has done so much for the colony and in so short a time'.[76]

On land, Boyd spent vast sums of money and employed hundreds of workers. To avoid cash flow problems, he even issued his own currency based upon wool, cattle, whale oil, tallow and hides. Workers spent these notes in the company stores.

Many problems confronted this fearless entrepreneur. There was dishonesty among his managers, exorbitant commissions by suppliers, misrepresentations by his bookkeepers and extortion. Even worse than that, Boyd was covering up huge losses to his English shareholders in expectation of short- to medium-term revenues. His Royal Bank of Australia had raised money by issuing (unsecured) debentures. Boyd insisted its directors should maintain utmost secrecy, thus setting the scene for a massive fraud against the debenture holders. The bank, with its proper-sounding name, was really just a front designed for Boyd's own personal use.[77]

Boyd's whaling and vast land holdings required huge numbers of workers. He advertised everywhere and had no shortage of volunteers to accept free passage to Twofold Bay, but the offer of an extra pound of wages from a rival sheep rancher always induced them to break their engagement. Boyd ultimately resorted to employing convicts who had served their time, and learned to prefer them. But there were never enough workers.

So this ever-innovative entrepreneur seized upon one of the most loathsome and unethical practices of the time: blackbirding. A cross between slavery and indentured servitude, blackbirding meant coercing people through trickery and kidnapping to work as labourers. By 1847, Boyd ordered his ship *Velocity* to travel to present-day Guadalcanal (Solomon Islands) to capture workers and send them back to his sheep-raising districts. Typically, they

Source: State Library of Victoria.

would lay anchor in a harbour and then beg the local island leader for 50 able-bodied men to clean the vessel. In another locale they might invite some dozens aboard to trade tobacco, knives, files, matches and seamen's clothing. Once the men were aboard, the sailors would weigh anchor and kidnap the unsuspecting South Sea Islanders. But even this venture proved a failure, as many of the islanders perished in Australia; very few managed to find a friendly vessel to return home.

Having barely missed success due to the steamship insurance debacle and the late 1840s depression, by 1849, in just seven short years, Boyd's operations at Twofold Bay had ground to a halt. What was worse, another of his ships was wrecked, bringing back a crew of South Sea Islanders – and the ship was uninsured. Shipwrecks, dishonest managers, unfit labourers – not to mention his own swindler instinct – did Boyd in before he could ever quite achieve success.

Ever the irrepressible optimist, he slipped quietly away from Sydney (and from his creditors) to start a new escapade when he heard about the California Gold Rush in 1849. He set off for San Francisco with a brigade of followers on the glorious *Wanderer*. Stopping in New Zealand, they loaded the ship with flour and Māori *kumara* (potatoes), which they sold at prodigious prices in the Golden Gate. Little is known of Boyd's activities after San Francisco, but all his labours in the California foothills came to nought. His heart was not in panning for gold (fortunately he had a crew of South Sea Island sailors who did the digging for him) but he still had his glorious schooner and a sizeable amount of funds and investments.

Boyd's buccaneer-preneurial spirit came to the fore and he launched yet another grand scheme, this time seeking to create a his own island republic in the Pacific. Stopping first in Hawaii, Boyd convinced legendary King Kamehameha to become regent of a Pacific empire ranging from Hawaii and the Marquesas to Samoa and Tonga, but his real plan was to loot them of their presumed resources. He reconnoitred various South Seas islands and finally settled on San Cristobal (now Makira) and Guadalcanal in the Solomons.

Arriving from Hawaii, and presumably not knowing that Makira, Solomon Islands, was the very harbour whence his ship *Velocity* had previously kidnapped so many South Sea Islanders, Boyd lay at anchor for several days while he inspected ashore. On 15 October 1851, Boyd paddled off for a little pigeon-shooting before breakfast and never came back. The rest of the story is certainly embellished in the retelling.

Rapid gunfire was heard and a search party was launched. When they arrived, all they saw were great numbers of footprints, evidence of a struggle and Boyd's deserted paddle boat. Boyd was nowhere to be seen, but they did recover his belt. Was entrepreneur Benjamin Boyd stripped, killed and eaten by the cannibal families of victims of his blackbirding expedition in Guadalcanal? The evidence points to that. The irony that the man who first brought indentured labour to Australia should finally be eaten by those same islanders was not lost on his countrymen. As one historian quips, 'Australia's penchant for cutting down tall poppies was never more dramatically gratified … That he had been eaten merely added titillation to a good story'.[78]

Three years later in 1854, hearing rumours of a 'wild white man' still alive and possibly a prisoner on the island, the cutter *Oberon* and the HMS *Herald* arrived to search for Boyd. They found trees that Boyd had marked, so the searchers announced that they would give 100 tomahawks if Boyd was delivered to them alive. Two enterprising natives assured them Boyd was dead and they presented what they claimed was Benjamin Boyd's skull for 'twenty tomahawks'. (Examining the skull, Australian phrenologists asserted that it was not Caucasian and the bone still resides in the Australian Museum in Sydney with the inscription 'Skull of a Polynesian [sic – it was Melanesian] sent as Captain Boyd's'.) Another Islander told the rescuers the probable truth that Boyd was 'killed by Chief Possakow'. Unconvinced, the rescuers left behind hatchets, spectacles and cards with the inscription 'Seeking you. Advise us. H.M.S. Herald'. Nonetheless, the captain's log concludes Boyd was killed after being captured. The *Sydney Morning Herald* reported that Boyd had been eaten and his skull was hung outside the chief's house.[79] Headhunting was practised at the time in Melanesia, as was anthropophagy (eating human flesh).[80] It is documented that the captain of another blackbirding vessel, the *Minolta*, was beheaded during a labour 'recruiting' drive.[81]

The ultimate irony was that Boyd was a man ahead of his times in the sense of *just a few years ahead of his times*. He was so close to success in Twofold Bay. Done in primarily by his insurance company failing to pay, he almost pulled off a brilliant con on his investors. Having lost huge land value in the depression of the late 1840s and finding no gold in California, it is poignant that just after his death gold was discovered in his beloved Australia and land values throughout the colony soared. Historian Tom Mead agrees, 'Ben Boyd was a man before his time.' Mead also adds that Boyd would have felt in good company with the 'corporate cowboys' of Australia's 1980s and 1990s.[82]

The last enduring irony was that Boyd's flagship *Wanderer*, returning to Sydney, struck the bar on Port Jackson and was completely wrecked, ending her days after a most eventful career in both Australia and the South Seas.

Source: Adapted from the historical record. Sources in addition to the endnotes: Walsh, G. P. (1966). Boyd, Benjamin (Ben) (1801–1851). *Australian Dictionary of Biography*. http://adb.anu.edu.au/biography/boyd-benjamin-ben-1815/text2075; Wellings, H.P.M (1940); *Benjamin Boyd in Australia (1842–1849) Shipping magnate; merchant; banker; pastoralist and station owner; Member of the Legislative Council; town planner; whaler*. Sydney: DS Ford. http://handle.slv.vic.gov.au/10381/152332; Lawson, W. (1939). *In Ben Boyd's Day*. Sydney: New Century Press; Diamond, M. (1988). *The Sea Horse and the Wanderer*. Melbourne: Melbourne University Press.

QUESTIONS

1. How would you describe or define the opportunity that attracted the entrepreneur Benjamin Boyd to venture to Australia? Was the idea well grounded?
2. Consider such things as natural resources, labour, money and social pressures and discuss the points that undermined the sustainability of Boyd's various ventures.
3. Given the mores of the time, was Boyd an ethical entrepreneur?
4. Referring to the discussion of traits in Chapter 2, was Boyd's irrepressible optimism actually just bloody-minded ignorance?
5. Should history judge Boyd as a failed entrepreneur? If so, was failure due to his own devices or was he a victim of circumstances?
6. What lessons could be drawn from this case for pioneering entrepreneurs today? What would be the moral to this story?
7. What are the physical places or technology fields in the twenty-first century that may parallel setting sail to a distant land in the nineteenth century? Using the story as an analogy, what hazards may face the pioneering entrepreneur?

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CHAPTER 4

PATHWAYS TO ENTREPRENEURIAL VENTURES

Every large and successful company was once a start-up struggling to survive. Some of these successful companies were conceived in a flash of inspiration and planned on the back of a napkin in a coffee shop. Others took shape painstakingly over time in a basement or a garage. Some start-ups were created and then flourished overnight, while others achieved success only through a long series of painful fits and starts. The point is, every company that exists today began rather small.

Joel Kurtzman,
Startups That Work[1]

CHAPTER OBJECTIVES

1. To describe the major career pathways that lead to entrepreneurial venturing
2. To discover bootstrapping and minipreneurship as fast lanes to gaining entrepreneurial venture experience
3. To detail the classic start-up model for new-venture activity
4. To identify and discuss what is involved in acquiring an established venture that already has some entrepreneurial momentum
5. To contextualise family business succession as a pathway to entrepreneurship
6. To outline how intrapreneurship is equally an entrepreneurial pathway
7. To examine re-engineering organisations for entrepreneurial behaviour as a pathway opportunity

WALKING ENTREPRENEURSHIP'S PATHWAYS

Every prospective entrepreneur, by definition, will at some stage be involved in launching and/or owning a new venture. There certainly are a variety of different pathways to experiencing entrepreneurship, including starting, purchasing or inheriting a business, but increasingly, social and other forms of ventures offer opportunities for an entrepreneurial experience. In this chapter, we first examine three common new-venture launch pathways: bootstrapping and minipreneurship, and the conventional **new-new** and **new-old approaches** for business start-up and social ventures. We then consider three pathways that involve transitions and/or integrating new venturing with established businesses; namely **family succession**, the acquisition of an existing venture and intrapreneurial ventures. Lastly, we consider a pathway less about being the entrepreneur and more about working to make entrepreneurship happen for others. This we call the **re-engineering organisations** pathway, which is important not just for private sector businesses but also for the public and non-government sectors. Each pathway has its own compensations and rewards; there are also certain disadvantages and difficulties that have to be considered. It is wise for an entrepreneur to understand the particular form of entry. This chapter is devoted to outlining some of the particular issues related to each entry and experience pathway into entrepreneurship.

new-new approach
A start-up approach to business in which a brand-new concept is introduced to a brand-new marketplace.

new-old approach
A start-up approach to business in which the concept provides a new angle to something that already exists in the marketplace.

family succession
The process of transferring the assets of a family business from one generation to the next.

re-engineering organisations
Organisations engaging in the practice of renovating and re-configuring organisational cultures, management techniques, structures, systems, processes and values, particularly to achieve high levels of innovation and enterprise.

Maybe you don't think you are ready. But you have probably already started down the pathway. There are just so many preparatory actions that set you up for the entrepreneurial journey! Did you know that in the US, 80 per cent of women entrepreneurs once sold Girl Scout cookies?[2] By the time they leave school, a goodly proportion of entrepreneurs, including the authors of this book, have had some experience with trading, making, selling, teaming, negotiating, hustling, bending rules, setting new trends, leading, debating, performing, dedicating oneself to making the world a better place or a myriad of other things that differentiate them from the next person and distinguish them as change makers. Entrepreneurial pathways turn your solo efforts into collective action.

PERSONAL PREFERENCES

Entrepreneurs need to recognise certain personal factors that we described in Chapter 2 when we outlined the entrepreneurial mind. Personal preferences, accordingly, help to target our choices toward different types of ventures. An entrepreneur's background, skills, interests and experience are all important factors in selecting the type of business to start and/or buy, as we discuss below. In addition, personal preferences for location and size of a business should guide the selection process. If you have always desired to own a business in the city or in the country, then that is exactly where the opportunity search should begin.

VARIATIONS ON A THEME

In considering these pathways, at the outset it is worth noting that, no matter how you get into it, in these modern times entrepreneurship is not only about profit making. The three traditional sectors – public (government), private (business) and social (non-profit) – have blurred in the new millennium as social and environmental objectives increasingly blend together with business approaches. This can be seen everywhere, from civic and municipal enterprises to community development financial institutions, faith-based enterprises, blended value organisations, social economy enterprises, **social venturing**, biosphere entrepreneurs and social enterprises. Whatever they are called, they are dedicating more resources to delivering social and environmental benefits, while public and social sector organisations are attempting to operate in a more businesslike manner.

social venturing
A form of entrepreneurship that seeks to resolve or address social issues through the use of economic models and the practice of business-like behaviours.

Glance at Figure 3.1 again. We looked at what defines social businesses and enterprises, considering two main criteria: where they receive their revenue from (earned sources versus contributed sources), and how they distribute their profits (their bottom line: financial benefits versus social/environmental benefits). We used these criteria to distinguish between traditional for-profits; for-profits with corporate social responsibility (CSR) goals; social businesses; and traditional non-profits and the social enterprises that seek income on their behalf. Finally, there is the true social business, pursuing social and environmental aims through the use of business methods. The pathways we will discuss in this chapter can apply to any venture, regardless of where they fall on the profit–social spectrum.

A big part of entrepreneurship, as we will see later, is in the creative effort that entrepreneurs put in to shape and sustain their ideas through to venture creation and subsequent growth. Your challenge is to learn from others while at the same time being in touch with your own passions and experiences, forging your own pathway. Every entrepreneur and every venture takes a unique journey between the conception of an idea and ultimate success.

bootstrapping
A means of starting a new venture through highly creative acquisition and use of (sometimes other people's) resources. (See also *incrementalist approach*.)

cash flow
A measure of the movement of money within a business venture, including all outflows and inflows. Usually measured for a specified period of time either in the past or in the future. The flow of money in must provide timely coverage for any necessary flows of money out of the business venture. Never, even temporarily, run out of cash flow.

BOOTSTRAPPING AND MINIPRENEURSHIP

One common pathway trod by many prospective entrepreneurs is bootstrap entrepreneurship.[3] **Bootstrapping** is a means of starting a new venture through highly creative acquisition and use of (sometimes other people's) resources. Some people say that bootstrapping means starting a new business without financing. Bootstrapping relies greatly on networks, trust, cooperation and wise use of existing resources, rather than going into debt or giving away equity.

Here are some tips that have come from experience: look for the 'low-hanging fruit'; use a copycat idea; find quick, break-even, cash-generating products. Companies that are already making money are able to build credibility in the eyes of investors. Meanwhile, keep growth in check. Too many start-ups fail because they grow beyond their financial means. Focus on cash, not on profits, market share or anything else in the early stages; these will become immensely important though once you are up and running. Because of their financial means, bootstrapped organisations cannot afford to pursue multiple strategic goals – staying alive is the main objective. For example, bootstrapped companies cannot pursue prolonged loss-making strategies to build a market share or a customer base, as cash will be quickly depleted. Having a healthy **cash flow** is critical to survival, so sales strategies must ensure healthy returns (reaching break-even quickly) right from the outset.[4]

ENTREPRENEURSHIP IN PRACTICE

HOW TO BOOTSTRAP A BUSINESS

Bootstrapping options for product development

- Prepaid licences, royalties or advances from customers
- Special deals on access to product hardware
- Development of product at night and on weekends while working elsewhere
- Customer-funded research and development
- Turning a consultant project into a commercial product
- The least useful methods here are research grants and university-based research incubators.

continue

continue

Bootstrapping options for business development

- Forgone, delayed or reduced compensation
- Working from home using personal savings
- Deals with professional service providers at below-competitive rates
- Space at below-market or very low rent
- Personal credit cards and home equity loans

The least useful methods here are severance payments, barter and special terms with customers.

Bootstrapping options to minimise the need for capital

- Buying used equipment instead of new
- Borrowing equipment from other businesses for short-term projects
- Charging interest on overdue payments from customers
- Hiring personnel for shorter periods instead of employing permanently
- Coordinating purchases with other businesses (mutual purchasing of goods)
- Leasing equipment instead of buying
- Ceasing business relations with customers who frequently pay late
- Offering the same conditions to all customers (no preferential treatment)
- Buying on consignment or trade credit from suppliers
- Deliberately choosing customers who pay quickly
- Sharing business premises with others or running the business from home
- Employing relatives or friends at non-market salaries

The least useful methods here are sharing of equipment and employees employed with other local businesses.

Bootstrapping options to meet the need for capital:

- Withholding entrepreneur's salary payment for short or long period of time
- Paying employees with company shares (giving employees some ownership)
- Seeking out best purchasing conditions with suppliers
- Deliberately delaying payment to suppliers
- Using the entrepreneur's private credit card for business expenses
- Obtaining loans from relatives and friends
- Bartering under-used products or services with other companies
- Franchising or licensing the product or business idea to others for a royalty fee

The least useful methods here include raising capital from a factoring company by selling the company's accounts receivable.

Another innovative option is called 'invoice financing'. Under this system, a business outsources its invoices to another company, such as a bank, which pays most of their value immediately and takes on the burden of chasing up payments.[5]

Source: Kotelnikov, V. Bootstrapping: The most common source of initial equity for entrepreneurial firms. http://www.1000ventures.com/venture_financing/bootstrapping_methods_fsw.html. Copyright Vadim Kotelnikov. Used by permission.

Any entrepreneur, but particularly bootstrapping entrepreneurs, should seek out low-cost but quality sources of assistance. Access to business information, training programs, business referrals, government programs, business networks, workshops and seminars, mentoring support and business analysis is vital. Especially important to bootstrap entrepreneurs are business incubators and access to finance. There are many types of free and low-cost programs available to start-up entrepreneurs. One of the most successful entrepreneur creation programs has been in Thailand, the OTOP (One Tambon [village], One Product) program. Rather than providing easy credit, OTOP focuses on creating markets of community entrepreneurs and assisting in exports.[6]

While bootstrapping has plenty of upsides – for instance, less equity dilution, greater control, stronger incentives, measured and focused progress and greater flexibility – there are also potential negatives, such as slower growth; less cash for adequate or timely product development; limited choices in support and staff, which undermines the quality and performance of the venture; and inability to defend against or target disruption to larger, better resourced competitors. The choice about whether to bootstrap or not depends on more than the entrepreneur and may require consideration of market and industry dynamics and the rate of technology change.

Another pathway to launching an entrepreneurial career at the lower risk end of the spectrum is online minipreneurship.[7] Minipreneurs are consumers who do not merely consume but also create, produce and trade goods, services and experiences. Imagine that you could look inside Google on any given day. In Singapore on that day there might be only 10 people on the island looking for edible ink (for cake decorating) or vinyl (record collectors) or sources of funding (for their businesses). Thousands of entrepreneurs start out trading on online auction websites and make interesting businesses selling niche products to gap markets. It is ideal because accounting, promotion and marketing are largely taken care of so that the minipreneur can focus on inventory, fulfilment and, most importantly, new business models. Minipreneurs keep costs down by availing themselves of low-cost online products and services, such as Skype for phone calls or PayPal for accepting credit card payments. Others take advantage of programs such as Google AdSense and other online advertising schemes that allow them to earn additional income streams.

Graduating from that and using their own off-the-shelf e-commerce software, many people are launching their own online businesses. It has never been easier to set up a 'miniprise' to service those niche needs in the **long tail**. Niche is the new mass as consumerism becomes more about standing out and less about conforming to trends. Long-tail businesses aggregate products in niche markets. They only need a few thousand people in the entire world to be interested in what they offer.

long tail
Potential customers that seek goods with unusual characteristics, whose needs can now be met through reduced marketing costs (internet) and distribution costs.

What are the main drivers behind this trend towards minipreneurship? Resources once exclusively available to multinationals, from access to marketplaces to partnering with top talent, are now at the fingertips of experienced, entrepreneurial individuals. Consumers are discovering that they can make a buck by doing their own manufacturing, enterprising, venturing, selling, trading or auctioning. Being one's own boss, even if it is only for a few hours a week, is just too tempting to forgo, as is the extra income. In essence, minipreneurship is chic. Minipreneurs have a highly developed network of intermediaries, tools, resources and processes at their disposal within an elaborate market system of co-dependent entrepreneurs. Minipreneurs have access to hardware and software; information and communications technology and skills; design, production and manufacturing; extensive marketplaces; advertising; talent; finance; payment; and logistics.[8] Minipreneurs get their business up and running instantly, relying on everything from rock-bottom priced laptops, printers and open-source software to broadband connections and free telephony.

Take humble salt, for example. You can go online and scoop up hundreds of gourmet varieties, from sulphurous Indian black salt to flaked pink salt from Australia's Murray River basin, all marketed by enterprising minipreneurs.[9] If you are working online the only limits are your own imagination and a clever new business model. There is really no need for an office. In many cities in Asia, the world's largest established culture of minipreneurship, wireless cafes are full of business owners with their laptops, meeting contacts or managing their inventory. Minipreneurship is already an established career option understood by many of the younger generations.

ENTREPRENEURSHIP IN PRACTICE

THE RISE OF THE MINIPRENEUR

The website http://www.trendwatching.com coined the term 'minipreneurs', embracing small and micro-businesses, freelancers, co-creators, eBay traders, web-driven entrepreneurs, mumpreneurs, solopreneurs, advertising-sponsored bloggers, free agents, weekend entrepreneurs, seniorpreneurs and so on. A minipreneur is a person whose business is based on the expert knowledge or experience they have acquired and how they leverage the internet.

Now entrepreneurship encompasses exciting ventures that can be accessed and marketed through online tools around the world. The top minipreneurial businesses are eBay, blogging, podcasting, online stores, online training, freelance research, copy writing and editing, consultancies and transcription services. Minipreneurs are waking up to the reality that through manufacturing, enterprising, selling and trading, wealth and self-employment are at their fingertips. Having control over one's destiny is an appealing prospect. Despite living in times of greater risk and uncertainty, people seek independence and the chance to develop a portfolio of revenue streams.

One of the main problems with being a minipreneur is isolation. A solution to this is to form a MasterMind group. The basic premise is that more can be accomplished in less time by working together in a small group of supportive colleagues. The collective wisdom of the group – often called 'the third mind' or 'synergy' – moves you beyond your individual perspectives to create ideas and 'Aha!' moments that often leapfrog your business to new heights of success.

With minipreneurship being the trend of future entrepreneurship, a potential gap in the marketplace exists for facilitating such individuals. Like any other business, minipreneurs have administration, production, advertising, insurance, travel, networking, public relations, technological support and web-hosting demands. Although their needs may be scaled down in comparison to larger operations, the need is still present.

In order to profit from the minipreneur movement, business owners and service providers around the country need to be asking one question: How can my business help these minipreneurs succeed? By helping them gain profit through facilitating their administration, technological, production and other needs, businesses can benefit from this emerging market. Instead of thinking about how these new businesses can become customers, start thinking about how to market services to help them succeed.

Source: Westphal, L. (2006). Marketing to minipreneurs. *NZ Marketing Magazine*, 25(1). Published by NZ Marketing Magazine, copyright 2006; Who wants to be a minipreneur? (2011). http://ecubation.com/2011/05/who-wants-to-be-a-minipreneur. Published by eCubation, copyright 2011.

THE CLASSIC PATHWAY: (DISRUPTIVE) NEW-VENTURE CREATION

The next logical step up the pathway to entrepreneurship is the classic **new business start-up**. In Chapter 7 we will look at the lean start-up model for new ventures but suffice to say at this point that entrepreneurs, the ones readily and instantly recognisable, aim to or have disrupted an established market by introducing new products and innovations, such as Uber and Airbnb. In so doing these entrepreneurs drive less-innovative products out of the market and advance the product frontier, or they drive efficiencies in the market by lowering prices, satisfying untapped demand or broadening market penetration for particular groups of products or services. We can see this happening by looking at the novelty (or unfamiliarity) of their products or services relative to customers' current experience. We can also see it by looking at the degree of competition faced by the new entrepreneurial business (whether other businesses offer similar products or services); disruptive ventures tend to have few direct competitors. This type of start-up has the distinguishing feature of requiring some form of modest to high capital raising, depending on the business model they launch.

new business start-up A business that is newly originated by an entrepreneur in response to some form of recognised opportunity to provide products and/or services to satisfy a perceived market demand.

Actually, there are two ways to approach this. The first is an approach whereby a new business start-up creates a unique product or service – one that is not being offered today but would be in great demand if it were. The second is to adapt something that is currently on the market or extend the offering into an area in which it is not presently available. The first approach is often referred to as *new-new,* the second as *new-old.*

CourseMateExpress

Biomimicry at Dyesol Australia: Is this new-new or old-old? Go to CourseMate Express to read about solar power cells that you paint on.

NEW-NEW APPROACH

New products or services frequently enter the market. Typical examples include smartphones, music and movie streaming services, plasma televisions and global positioning systems (GPS). All of these products and more have been introduced as a result of research and development (R&D) efforts by major corporations and research institutions that ultimately enable new ways to service consumer demands. What we must realise, however, is that unique ideas are not produced only by large organisations. Moreover, the rate at which new products enter the market has caused the public to expect many of their household goods to improve continually.

How does one discover or invent new products? One of the easiest ways is to make a list of annoying experiences or hazards encountered with various products or services during a given period of time. Common examples include objects that too easily fall out of one's hand, household chores that are difficult to do and items that are hard to store. These are **PITA products**, or 'pain in the arse' products. Can certain innovations alleviate these problems? This is how some people get ideas for new products. For example, an engineer once observed the mechanism for recording the revolutions of a ship's propeller. As he watched the device tally the propeller's revolutions, he realised that the idea could be adapted to the recording of sales transactions – a problem he had been trying to solve for some time. The result led eventually to development of the traditional cash register. Of course, now these mechanical machines are digital and internet-connected, which in turn provides opportunities for improving the original idea.

PITA product
A product or service that solves the customer's 'Pain In The Arse'. (See also *pain*.)

Entrepreneurs may arrive at creative ideas through either adaption or innovation. Table 4.1 contrasts the two problem-solving approaches of adaptors and innovators.[10]

TABLE 4.1 TWO APPROACHES TO CREATIVE PROBLEM SOLVING

ADAPTOR	INNOVATOR
Employs a disciplined, precise, methodical approach	Approaches tasks from unusual angles
Is concerned with solving, rather than finding, problems	Discovers problems and avenues of solutions
Attempts to refine current practices	Questions basic assumptions related to current practices
Tends to be means oriented	Has little regard for means; is more interested in ends
Is capable of extended, detailed work	Has little tolerance for routine work
Is sensitive to group cohesion and cooperation	Has little or no need for consensus; often is insensitive to others

Sources: Kirton, M. (1976). Adaptors and Innovators: A description and measure. *Journal of Applied Psychology*, October, 623. Copyright 1976 by The American Psychological Association.

One hot area is internet social media, such as Facebook, Snapchat and LinkedIn. From plug-ins to location-based marketing initiatives to higher bandwidth, there's change afoot in the world of social media. Facebook was founded by Mark Zuckerberg, a Harvard University student who was frustrated by the lack of networking facilities on campus. The company was founded in February 2004 and now, with 1.94 billion monthly active users (as at 31 March 2017),[11] it is one of the most trafficked websites on the internet. By mid-2017, Facebook had surpassed a market capitalisation of USD$444 billion.[12] The story of the company's founding at Harvard is so well known as to already be almost mythic. In 2010, the movie *The Social Network* was released, telling the story of Facebook's journey from idea to realised venture. In general though, the main sources of new ideas for both men and women are prior jobs, hobbies or interests and personally identified problems. This new-new approach indicates the importance of people being aware of opportunities encountered in their daily lives (work and free time), as well as of the emergence of new technologies that provide applications to solve problems. Both these avenues can also present opportunities for new business ideas. In Chapter 5 we will delve more deeply into creativity and where innovative ideas come from.

NEW-OLD APPROACH

Most small ventures do not start with a totally unique idea. Instead, an individual piggybacks onto someone else's idea by either improving a product or offering an existing service in an area in which it is not currently available – hence the term new-old approach. Some of the most common examples are setting up restaurants, clothing stores or similar outlets in sprawling suburban areas that do not have an abundance of these services or outlets. Of course, these kinds of operations can be risky because competitors can move in easily. Potential owners considering this kind of enterprise should try to offer a product or service that is difficult to copy. For example, a computerised billing and accounting service for medical doctors can be successful if the business serves a sufficient number of doctors to cover the cost of computer operators and administrative expenses in order to turn an adequate profit. Or perhaps ideas can be merged into another type of enterprise, such as a hand car wash; a bookshop combined with a café; or a gymnasium with childcare facilities. This new-old approach seeks out opportunities that have been overlooked by other would-be entrepreneurs.

Regardless of whether the business is based on a new-new or a new-old idea, the prospective owner should not rely exclusively on gut feeling or intuition to get started; some degree of analysis is advised to provide evidence that intuition is in tune with customer needs. This we address in Part 2 of this book. We further demonstrate in Part 3 that proper planning and analysis are integral to the long-term success of any venture.

ENTREPRENEURSHIP IN PRACTICE

TECHNOLOGY MEETS SOCIAL ENTERPRISE

Across the globe, school computers in the developing world have slow processors and little storage space, which limits the possibilities for learning computer skills and using the internet. Students using these computers in the classroom have never dreamed of owning their own PCs and cannot fathom the world on the other side of an internet connection.

Yet in many of these places, the speed of the internet connection is actually fast enough for mainstream computing purposes and children are eager and excited to learn. So some social-technical entrepreneurs created WiHood, a name coming from 'The World is Your Neighbourhood'. WiHood offered a virtual personal PC that overcame the physical barriers to digital learning by making clever use of Cloud computing and modified USB drives.

The WiHood USB bracelet held open-source software, plugged into any computer, and allowed users to see their very own familiar desktop and access their files stored in the Cloud at WiHood's servers. The portable, personal device bypassed computing and storage bottlenecks, ensuring the safety of personal documents and giving students familiarity with and ownership of their digital learning.

In Kenya, WiHood connected the 465 students at Chelelemunk All Girls Boarding School with their own WiHood PC accounts and worked with aid organisations and NGOs with reach into needy areas. As is sometimes the case in social enterprises, the value of the product is hard to pin down – between the software, the pride in owning something, the power of information, the safety of hosting documents online and the fashion statement, it covers a lot of ground.

continue

continue

By creating an easy and portable solution for anyone without their own PC, WiHood aimed to enable an easier computing experience, thus facilitating computer use and helping to bridge the digital divide by engaging students in learning. WiHood bracelets were available on Amazon.com, its global distributor.

Regrettably, in 2012, the last WiHood bracelet was sold. Since starting the social venture in 2007, the entrepreneur, Thomas F. Anglero, said 'the world's first virtual PC on a USB is now just another integrated service that operates invisibly in the back-end of many online services. Such is the nature of innovative ideas, they all have their time and place and some will survive while others serve their purpose and move on, but they all have an impact.'

Undaunted, Anglero became a serial social entrepreneur and has now moved onto other ventures. Why not visit his blog and check out his latest thoughts and social ventures? Go to http://anglero.blogspot.com.au.

Sources: Adapted from Anglero, T. F. (2012). The last WiHood PC bracelet has been sold. Thomas F. Anglero Blog, copyright 2012; WiHood bracelets make computer education portable (2010). Ashoka Technology and Invention Blog, copyright 2010

ACQUIRING AN ESTABLISHED VENTURE

Another pathway into entrepreneurship might be purchasing an operating business venture rather than entering into your own new start-up enterprise.[13] Purchasing a business venture is a complex transaction and the advice of professionals should always be sought. The key advantages are presented here, tempered by the fact that it is always a case of 'buyer beware!' Later we will explore in more detail the opportunities inherent in established ventures, consider the evaluation of the selected venture and pose the key questions to ask when weighing up a business purchase decision.

Another approach for getting into an established venture, although not discussed in detail here, is to buy a **franchise**. Buying a franchise is buying the right to carry on the business of a centralised business owner, usually in a defined geographic area. Examples include McDonald's, Jim's Mowing, Snap Printing, H&R Block, 7-Eleven and Domino's Pizza, to name a few. The franchisor sells the franchisee a business system of operation, usually including such things as marketing materials and ordering and sales systems, while also managing key supply relationships and assisting with location specification. While franchising provides a growth opportunity for the **franchisor** (discussed in Chapter 9), it is also a possible pathway for a **franchisee** who may be less interested in growing a venture but more inclined to manage one. Either way, purchasing either a business or a franchise has its risks. Is it an opportunity or a financial death trap? For now, let's consider the upside.

franchise
Any arrangement in which the owner of a trademark, trade name or copyright has licensed others to use it to sell goods or services.

franchisor
A company or person that grants franchises.

franchisee
An independent business that sells or markets the products and/or services of a larger firm (the franchisor). The franchisee receives training and marketing support from the franchisor and pays a fee for ongoing support.

liquidation
A legal process to close trading for insolvent business legal entities who are unable to pay debts as they fall due.

INCREASE CONFIDENCE AND REDUCE UNCERTAINTY

If you are less confident in meeting the challenges of seizing entirely new venture opportunities head-on, purchasing a business may be a better option. A new business faces two great dangers: the possibility that it will not find a market for its goods or services, and the chance that it will not be able to control its costs in operation. If either event occurs, the new business likely faces **liquidation**. But buying an existing business can alleviate most of these fears. A successful business has already demonstrated the ability to attract customers, control costs and make a profit. Many of the challenging decisions of a newly formed business are sidestepped, such as questions around location, advertising channels, plant and equipment acquisition, office and/or factory layout, stock planning and inventory management, pricing strategies, and so on. When a new owner buys an ongoing operation, they are often purchasing a known quantity. Of course, it is important to check whether hidden problems exist in the operation, but otherwise the purchase of an existing and successful operating venture can be a wise investment.

GET ON WITH THE JOB

If you are a more strategic and managerial type of entrepreneur, you can skip straight to the business of growing a venture. An ongoing enterprise already has assembled the inventory, equipment, personnel and facilities necessary to run it. In many cases, this has taken the owners a long time to achieve. They have spent countless hours 'working out the bugs' so that the business is as efficient as possible. Likewise, they have probably gone through a fair number of employees before getting the right type of personnel. Except for the top management, the personnel usually stay with the sale. Therefore, as a new owner, if you treat the workers fairly, you should not have to worry about hiring, placing and training personnel. A note of caution: You do need to guard against the top management opening a competing business, and therefore you should ensure that a **legal restraint of trade** applies and a **non-compete clause** is included. Otherwise, roll your sleeves up and get right in there to work magic on the growth opportunity.

legal restraint of trade
A legal document signed by the seller of a business that restricts him or her from operating in the same industry for a reasonable amount of time and within a reasonable geographic jurisdiction.

non-compete clause
An agreement as part of the purchase of an existing venture that the previous owner will refrain from conducting business in the same industry within a reasonable distance for a reasonable period of time. Also known as legal restraint of trade or an agreement to not compete.

SEIZE AN OPPORTUNITY AT A DISCOUNT

Sometimes it is possible to buy an ongoing operating venture at a good price. The owner may want to sell quickly because of a retirement decision or illness. Or the owner may be forced to sell the business to raise money for some emergency that has occurred. Or the owner may seek a greater opportunity in another type of business and therefore be willing to sell at a low price in order to take advantage of the new opportunity. However, it is seldom that a person sells a successful venture at an extraordinarily low price. The owner of a successful small venture built the enterprise through skilful business practices, knows how to deal with people and has a good idea of the operation's fair market value. That person will rarely sell for much below the fair market value without good reason. If that reason is legitimate, then good value can be found. But it is equally or possibly more likely that if it looks like a bargain, then what appears to be an opportunity could be a pathway to a horror business recovery or, worse, financial ruin. To help you avoid this mistake it is wise to seek professional advice.

ENTREPRENEURIAL EDGE

EXAMINING THE OPPORTUNITIES

Entrepreneurs in search of a possible venture to buy need to examine the available opportunities through various sources:

- *Business brokers:* Professionals specialising in business opportunities can often provide leads and assistance in finding a venture for sale. However, the buyer should evaluate the broker's reputation, services and contacts. The entrepreneur should also remember that the broker usually represents – and gets a commission on the sale from – the seller.
- *Newspaper ads/online classifieds:* 'Business opportunity' classified ads are another source. Look online at places like TradeMe, Business Classifieds and even Gumtree.
- *Trade sources:* Suppliers, distributors, manufacturers, trade publications, trade associations and trade schools may have information about businesses for sale.
- *Professional sources:* Professionals such as management consultants, solicitors and accountants often know of businesses available for purchase.

FAMILY VENTURING AND SUCCESSION

Families are actually the dominant business form worldwide. They play a leading role in the social and economic wealth creation of communities and countries. Contrary to misperceptions, family businesses are not limited to small 'mum and dad' operations. Some of the world's biggest and best-known companies are actually family-owned, including Walmart (USA), L'Oréal (France), Benetton (Italy), Siemens (Germany), Ikea (Sweden), Lego (Denmark), Samsung Group (Korea), Tata Group (India), Foxconn (Taiwan) and Kikkoman (Japan). Entrepreneurial families are dynamic, transmitting their company culture through family member interactions. They are focused on entrepreneurial objectives or motives (compared to most family businesses, who simply want a steady income). They are also more resilient, tending to have better survived the 2008–09 **global financial crisis** (GFC) than businesses that did not have family ownership (perhaps because they can better absorb misery!).

global financial crisis (GFC)
Also known as the 'Great Recession', the worst financial crisis since the Great Depression of the 1930s which resulted in the collapse of large financial institutions, the bailout of banks by national governments and downturns in stock markets around the world. In many areas, the housing market also suffered.

As you consider your entrepreneurial future, you might be asking yourself whether you are ready to become a successor in your own family business, or whether you would rather found your own company. Either way, research shows that many entrepreneurs have self-employed parents who act as intimate role models, influencing their children's likelihood of pursuing an entrepreneurial career. Those raised in a family business have been closely exposed to the challenges and opportunities of an entrepreneurial career.

When the next generation takes over the family business it is called **transgenerational entrepreneurship**.[14] We often hear about the role of supportive parents, but parental influence over the occupational choice of children generally lessens as their children grow older; at later ages they are influenced more by factors outside the family environment. Parents have the most influence over their children during early childhood through both parenting and genetic inheritance. Children then become socially conditioned and start to pick up the values of their socioeconomic class. During childhood, children are heavily influenced by fantasy and may develop aspirations for fantasy occupations like astronaut, fireman, oceanographer, pilot, train driver or policeman, rather than wanting to directly mirror their father or mother's occupation. Exposure to entrepreneurship within the family may not be enough for a child to learn the tacit knowledge necessary to succeed in creating and growing business ventures, but it is a good lead-in.

transgenerational entrepreneurship
Entrepreneurship that extends through multiple generations of a family; focuses on the processes that help family firms – the dominant form of business around the world – succeed beyond the first generation.

Figure 4.1 shows the probable influences of parents and family upon their children's career choices.

How are ownership and leadership transferred from one generation to the next? We call this family succession. Let's first recall our previous discussions of how entrepreneurial mindsets (see Chapter 2) are developed across time and generations within the same family.[15] Often, the founding entrepreneur (the patriarch or matriarch) once had an innovation, but his or her successors simply continue to maximise this existing product or service without innovating something new. Other families are **serial entrepreneurs** who create new streams of value across generations. How does the 'founding father' or 'founding mother' transmit their entrepreneurial zeal, spirit, attitudes, values and beliefs about being entrepreneurial to their children? Many things shape the quality of a family business, especially the nature of the marriage, whether family members are disengaged or enmeshed in the business, the distribution of authority between spouses and the relationship with extended family. Entrepreneurs and their spouses are typically driven by a powerful dream that affects the way they bring up their children. It is a rocky road, but when done correctly, the family is perhaps 'the most reliable of all social structures for transmitting cultural values and practices across generations'.[16]

serial entrepreneur
An entrepreneur who starts not one but repeated new business ventures.

Yet it is always a challenge to transition from the individualistic quest of the founders to the team effort of the sibling or offspring partnership. At the core, these businesses enjoy what is

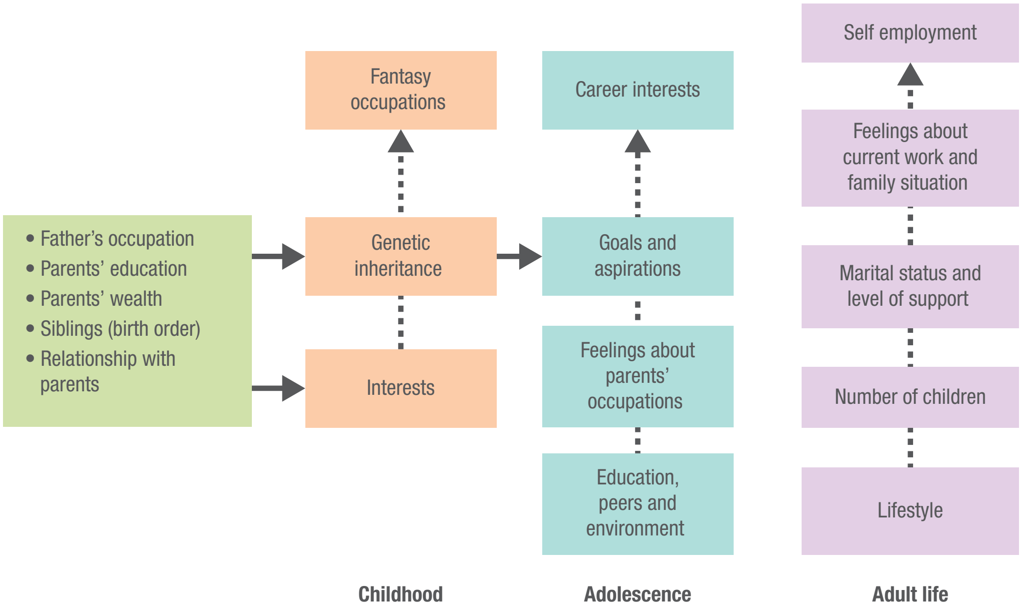


FIGURE 4.1 THE PROBABLE INFLUENCE OF PARENTS AND FAMILY UPON THEIR CHILDREN'S CAREER CHOICES

Source: Hunter, M. (2012). *Opportunity, strategy and entrepreneurship. Introduction, the nature of opportunity, time and space, the vision platform, and making connections* (Vol. 1), Nova Publishers. Copyright Murray Hunter. Used by permission.

called '**familiness**', that distinctive bundle of resources originating from the 'interaction between the family, its individual members and the business' to ensure the company's continuity across generations.[17] Transgenerational entrepreneurship consists of five elements: (1) a focus on the family as the entrepreneurial engine; (2) the entrepreneurial mindset of the family (entrepreneurial orientation); (3) the family's influence on company resources (familiness); (4) contextual factors such as industry, community culture, family life stage and family involvement; and (5) entrepreneurial, financial and social performance (see Figure 4.2).

familiness
Those unique resources that emerge from interactions between the family system as a whole, the individual family members and the family business.

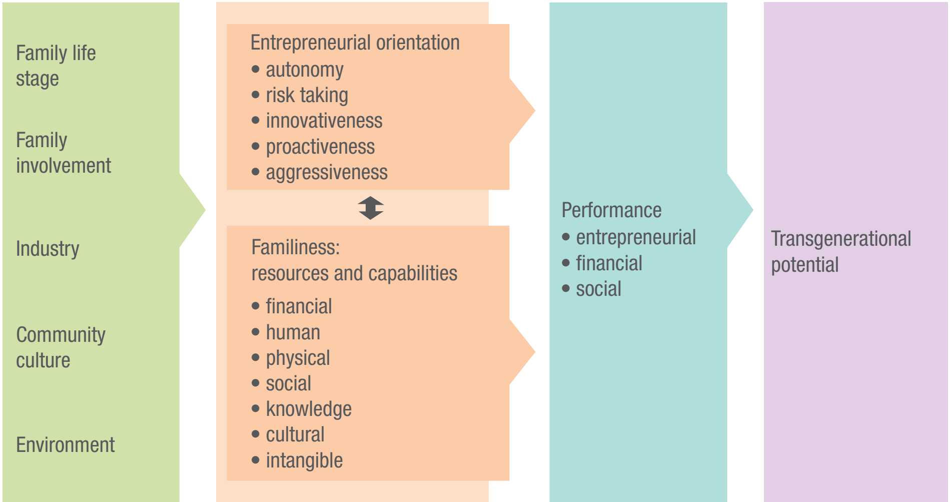


FIGURE 4.2 FAMILY ENTREPRENEURSHIP FRAMEWORK

Source: Sieger, P., Nason, R., Pramodita, S., & Zellweger, T. (2011). *STEP global booklet*. STEP Summit Reports and Resources, Paper 5. Copyright 2011 by Babson College. Used by permission.

ENTREPRENEURIAL EDGE

SUCCESSION SECRETS OF A 1300-YEAR-OLD FAMILY BUSINESS

The Hoshi Ryokan, a traditional Japanese inn, has been managed by the Hoshi family since it was established in AD 718, making it the world's oldest independent family business.

The inn is currently in the hands of the forty-sixth generation of Hoshis. Zengoro Hoshi is currently at the helm, and is preparing to hand over the reins to his grandson, after the unfortunate death of his eldest son. This handover will bring the Hoshi Ryokan into its forty-eighth generation of Hoshi family ownership.

The Hoshi family credit the longevity of the business to clear-cut succession rules with each passing generation, as well as instilling the simple business motto in each new generation of 'study the water running down a small current'. Zengoro explains that this refers to the ideology of being like that small but powerful stream of water, focusing on removing each small obstacle from its path as it moves along to improve the stream in the end.

In order to bypass any conflicts or confusion that could arise from the family growing larger and more diverse with every generation, the Hoshis have instituted the strict rule that the family business is to be passed onto the eldest son of each generation. This ensures that every member knows, long before succession needs to happen, whom the next owner of the inn is to be.

If there is no eldest son, then a son-in-law is chosen to take the helm, who is then adopted into the family so that the family name is still preserved. This practice also allows the family to bring in new, talented blood through arranged marriages.

The succession of the family business is taken very seriously within the Hoshi family, which is why the Hoshi name, along with the family wealth, is only given to the family member inheriting the family business. This practice allows the family to shuffle non-selected children to other family names, as well as easing the adoption process of an heir who has married into the family.

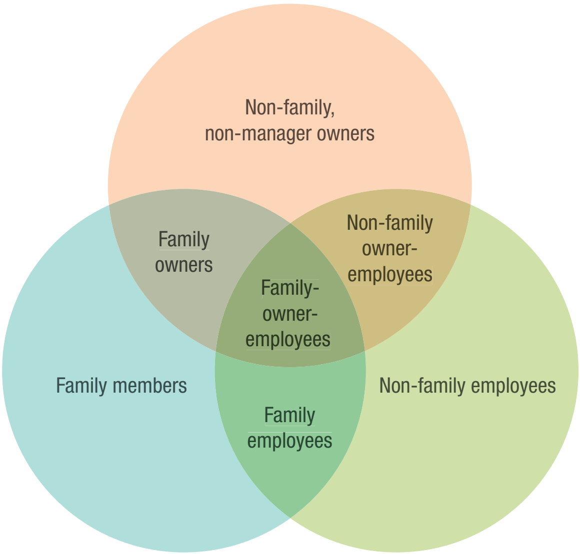
This may seem unfair by modern standards, but this strict protocol has ensured the success of the business for over 1300 years. The strong set of values, as well as the evaluation of the business assets before each succession, has allowed the Hoshi family to achieve what many families cannot. In many family businesses, each new generation tends to come along with their own set of ideas, which can soon crumble the business' very foundation. But the Hoshis have ensured that each heir is fully invested in the success of the business and keeping its legacy going.

Source: Adapted from Bennedsen, M. (2014, March 1). Centuries-old Japanese family-owned inn a model for succession. *South China Morning Post*. http://www.scmp.com/business/companies/article/1436947/centuries-old-japanese-family-owned-inn-model-succession. Published by South China Morning Post Publishers Ltd, copyright 2014.

three-circles model
Describes the three overlapping groups that comprise the family business system: family, business and ownership. Including the overlaps, there are seven interest groups, each with its own legitimate perspectives, goals and dynamics.

Family businesses are by definition three overlapping systems – family, owners and manager-employees – called the **three-circles model** (Figure 4.3). The entire family, with all its generations, inhabits the family circle (bottom left). But there are three types of family members: those who own shares but do not work there; those who work there but do not own shares; and fully vested family owner-employees. Family members are most concerned with reputation, dividends and family unity. Then there is the ownership circle (top). Some may be external investors who are neither family nor employees; others are non-family managers or employees. These owners have different interests; to them, business performance and dividends are what matter. Finally, the management-employee circle (bottom right) includes both owner-employees who are not family members, and family who work in the business but do not own shares. They are most concerned with reputation, career opportunities, bonuses and performance measures. In the very centre are the fully vested family-owner-managers. This includes the founder or a senior family member. They are concerned with any or all of the interests and concerns of the other groups.[18]

FIGURE 4.3 THREE-CIRCLES MODEL OF FAMILY BUSINESS



Source: Tagiuri, R., & Davis, J. (1996). Bivalent attributes of the family firm. *Family Business Review*, 9(2), 199–208. Copyright 1996 by SAGE Publications. Reprinted by permission.

THE ENTREPRENEURIAL ORGANISATION

For some entrepreneurs, working within a larger organisation is a dream come true. They are building a better society and business from the inside out. Ideally, they have resources galore and freedom to innovate, but rarely is life ideal. Nevertheless, intrapreneurship is the career for entrepreneurs and innovators inside large companies, social enterprises, governments and other institutions who initiate new ventures with resources not under their own control[19] but in the control of the organisation that employs them.

Some authors (perhaps tongue-in-cheek) have suggested that entrepreneurship in large organisations is an oxymoron. How can there possibly be innovation in a large corporation or a government bureaucracy? Entrepreneurship is often viewed as a small-business phenomenon, but increasingly it is being applied in the corporate sector. Research and practice have shown that entrepreneurship in large organisations can indeed lead to innovation, new product development, greater wealth creation and economic development.

THE RISE OF INTRAPRENEURS

The interest in entrepreneurial thinking in large organisations started to develop in the mid-1980s. In 1982, in an article in *The Economist* called 'The coming entrepreneurial revolution', Norman Macrae popularised the term 'intrapreneur' when he suggested that job growth would come either from small companies or from those bigger companies that managed to split themselves into smaller and smaller profit centres, which would need to become more and more entrepreneurial.[20] The global economy is creating profound changes for institutions, businesses and industries throughout the world. Companies and enterprises everywhere must re-examine their purposes and strategies carefully to satisfy their multiple stakeholders. In response to rapid, discontinuous and significant changes, many established companies have restructured their operations in fundamental and meaningful ways in order to become more entrepreneurial and responsive to change. In fact, after years of restructuring, some of these companies bear little resemblance to their ancestors in their business scope, culture or competitive approach.[21]

entrepreneurial economy
A new emphasis on entrepreneurial thinking in the global economy that developed in the 1980s and 1990s and is prevalent now in the twenty-first century.

Renowned management expert Peter Drucker described the movement in terms of the **entrepreneurial economy** and highlighted four major developments that explained its emergence.[22] First, the rapid evolution of knowledge and technology promoted the use of high-tech entrepreneurial start-ups. Second, demographic trends such as two-wage-earner families, continuing education of adults and the aging population added fuel to the proliferation of newly developing ventures. Third, the venture capital market became an effective funding mechanism for entrepreneurial ventures. Fourth, awakening in the US and spreading throughout the developed world, industry began to learn how to manage entrepreneurship.[23]

For larger incumbent businesses in an industry, the constant challenge is to keep pace with the winds of change. Major changes that can threaten an industry can occur on two fronts.[24] First, the core assets of the industry can be undermined. For instance, the printing industry has been under sustained pressure from the digital sector as customers are lured away from books (the main asset of the printing industry) and instead attracted to the digital form of print downloaded onto mobile devices. Similar change has occurred in the music industry, with the shift away from vinyl records and compact discs toward digitisation. The second area of industry risk is when the core activities of the incumbent businesses are no longer desirable to consumers. For example, the travel sector is facing major change as consumers increasingly access deals and make direct contacts with suppliers via the internet. The activities of travel agents are becoming less valued by the end user as consumers do it themselves. Similar pressures are felt by DVD movie hire businesses as the value of a short-term hiring service is replaced by the convenience of internet downloads.

Propelled by the changes of the new millennium, entrepreneurship is now a major force in world business and this has led to an increased desire for this type of activity inside large enterprises. Although some researchers have concluded that entrepreneurship and bureaucracies are mutually exclusive and cannot coexist,[25] others have described entrepreneurial ventures within the enterprise framework.[26] Intrapreneurial techniques have been used (with success and with failure) throughout the world. Steven Brandt puts it this way:

> Ideas come from people. Innovation is a capability of the many. That capability is utilised when people give commitment to the mission and life of the enterprise and have the power to do something with their capabilities. Non-commitment is the price of obsolete managing practices, not the lack of talent or desire.
>
> Commitment is most freely given when the members of an enterprise play a part in defining the purposes and plans of the entity. Commitment carries with it a de facto approval of and support for the management. Managing by consent is a useful managing philosophy if more entrepreneurial behaviour is desired.[27]

ENTREPRENEURSHIP IN PRACTICE

DOES INTRAPRENEURSHIP EXIST IN ASIA?

Traditionally, Asian businesses have been viewed as bureaucratically structured public companies, or as family-owned patriarchal organisations – two corporate forms that on the face of it might hinder the growth of an intrapreneurial culture. However, if one looks a little closer, intrapreneurship has in fact been one of the major ways in which Asian companies have been able to develop and grow. In fact, one could observe that much of the national economic development that took place during the 1980s and 1990s within the Asian Tigers (Hong Kong, Singapore, South Korea and Taiwan) was due to corporate intrapreneurship that brought great innovation and diversity to Asian businesses.

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Modern intrapreneurship in Asia probably has its roots in the European colonial trading companies at the beginning of the last century, which controlled the majority of business dealings between manufacturers and distributors. The colonial companies expanded primarily through the creation of new divisions that were set up by a manager with great freedom to exercise discretion, take initiative and promote innovation. Their job was to enter into new markets and industries, and to grow their operations into conglomerates and monopolies. From trading and retail, then local assembly, they eventually became exporters, such as Harpers, Inchcape, Hagemeyer and the Borneo Companies.

Many Chinese business groups grew in a similar manner. Most had humble beginnings as traders, which led to direct investment in industrial activities, and later to vertical integration into downstream activities, real estate and property, and even banking and financial services. In many companies, each division had a different member of the family at the helm. This was the case for the Salim Group (cement, automobiles, flour, food, chemicals, banking, property and insurance) in Indonesia, the Kuok (plantations, flour, shipping, hotels, mining, computer services, retail and film distribution) and Hong Leong (banking, insurance, automobile franchises, construction, hardware and manufacturing) groups in Malaysia, and the Charoen Pokphand (animal feed, poultry, chemicals, automobiles, telecommunications, textiles, property and retail) group in Thailand, for example.

As is the case everywhere, initiating intrapreneurship within any Asian business requires both a bright idea and a champion. The problem is that a conservative business typically controls the scope of acceptable new ideas. Consequently, some businesses will be more open to new ideas than others, and this is why many businesses within the region fail to grow, and actually decline. The chairman/CEO must see ideas as opportunities; whether or not they do so depends to a great extent on their cultural values and where they see their business' role within the environment. Few employees in any Asian business will have the chance to advocate new ideas to the decision makers. Within Chinese business groups, most pioneers of new divisions were either a direct relative, or related by marriage. Only in the last few years have Asian-based businesses selected candidates based on proven entrepreneurial qualities of leadership, creativity and ability to manage a project. The actions of moving resources into new activities of a business may make other employees insecure, perhaps feeling that cooperating with the intrapreneur is contrary to their personal interests. Many businesses that need to transform within the changing global environment find it difficult to break away from the top-down orientation that initially brought success when the founder started and grew the business.

Intrapreneurship in Asia has its dark side. The autonomy that intrapreneurship may bring to an individual or group opens up possibilities of taking advantage of the business, which can lead to abuse of trust and corrupt dealings. Currently many state-owned enterprises face the problem that any new company or division that is formed drains finances and fails because of the conflict between employee and personal interests. Intrapreneurship has also encouraged a *cowboy mentality*, where businesses enter industries that they don't really understand, leading to losses and even bankruptcies. One just has to drive around the region to see all the failed construction projects and closed down factories that had short operational existences.

So the opportunities for intrapreneurship within Asian businesses are paradoxical. Intrapreneurship made many companies what they are today, yet at the same time, opportunities are very limited because of the low level of trust put in employees without family connections and long periods of service within the business.

Nonetheless, more and more businesses in the Asia-Pacific region are realising the importance of nurturing intrapreneurs to help drive growth, as revealed in a 2014 survey of Asia-Pacific senior managers and business owners about how to foster intrapreneurship among employees and workers. What do these owners and managers consider to be the top strategies?

- *Singapore*: Almost half (49 per cent) of business owners and senior managers in Singapore say flexible work conditions are a key to fostering intrapreneurship, followed by mixing selected staff from different functions (40 per cent); skills-updating programs (40 per cent); and access to senior management (39 per cent).
- *Australia*: The most popular tools to foster intrapreneurship are programs to keep workers' skills fresh (51 per cent), co-mingling of staff from different departments (45 per cent) and flexi-work policies (41 per cent). Forty per cent of Australian owner-managers identified the consultancy sector as a high-potential sector for entrepreneurs. A shock result was that just 11 per cent identified an entrepreneurial streak among their female workers.
- *India*: In India, 48 per cent of Indian owner-managers think flexible working is key. More than half want skills-updating programs (55 per cent); 36 per cent believe in mixing staff from different functions; and 32 per cent believe access to senior management is important.
- *Hong Kong*: Flexible work is most important (47 per cent), followed by mixing staff from different functions (46 per cent); skills-updating programs (42 per cent); and formal innovation programs (29 per cent).
- *China*: Forty-six per cent of Chinese respondents report that flexible working is key to fostering innovation. But 37 per cent believe access to senior management is a key innovation driver; and 36 per cent see IT systems/software as the richest intrapreneurial sector.

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- *Taiwan*: Forty-one per cent in Taiwan believe that access to senior management is a key innovation driver (compared with just 28 per cent in Hong Kong).
- *Japan*: Forty-seven per cent of Japanese respondents report that skills-updating programs are key to fostering innovation.
- *India*: Thirty per cent of Indian businesses identify travel and tourism as a high-potential sector for entrepreneurs.

Sources: Regus (2014). Entrepreneurship: Flourishing in tough conditions. https://www.slideshare.net/REGUSmedia/re4393-prs-gbs-10-entrepreneurs-reporta4globalenmar14v4; Hunter, M. (2012). Does intrapreneurship exist in Asia? University Malaysia Perlis. http://www.orbus.be/info/important_news_july_extra_016-2012.htm.

RE-ENGINEERING INTRAPRENEURIAL ORGANISATIONS

The rise of the intrapreneur also increases the demand for making organisations conducive to intrapreneurship. Herein lies a related entrepreneurial pathway. What kind of organisation offers potential for re-engineering? To answer this question, first look to an organisation's management philosophy. Many organisations have outdated ideas about cooperative cultures, management techniques and the values of managers and employees. Unfortunately, doing old tasks more efficiently is not the answer to new challenges; a new culture with new values has to be developed.[28] Bureaucrats and controllers in an organisation must learn to coexist with – or give way to – designers and innovators.

Organisations with an intrapreneurial mindset, whether in the commercial world or in government bureaucracies, provide the freedom and encouragement required for employees to develop their ideas.[29] This is often a problem in larger, corporatised enterprises because many top managers do not believe that entrepreneurial ideas can be nurtured and developed in their environment. They also find it difficult to implement policies that encourage freedom and unstructured activity. But intrapreneurial businesses develop policies that will help innovative people reach their full potential. This is our last pathway discussion – one that enables and develops entrepreneurial and intrapreneurial behaviours in established organisational settings.

Gifford Pinchot, whose 1985 book *Intrapreneuring* became a classic in the field, proposed a test that helps to identify intrapreneurial organisations. He asks questions such as:

- Does the organisation encourage entrepreneurial thinking? Will individuals receive the company's blessing for their self-appointed idea creations? Some companies foolishly try to appoint people to carry out an innovation when, in fact, the ideas must surface on their own.
- Does the organisation provide ways for innovators to stay with their ideas? When the innovation process involves switching the people working on an idea – that is, handing off a developing business or product from a committed innovator to whoever is next in line – that person often is not as committed as the originator of the project.
- Are people in the organisation permitted to do the job in their own way, or are they constantly stopping to explain their actions and ask for permission? Some organisations push decisions up through a multilevel approval process so that the doers and the deciders never even meet.
- Has the organisation evolved quick and informal ways to access the resources to try new ideas? Innovators usually need discretionary resources to explore and develop new ideas. Some companies give employees the freedom to use a percentage of their time on projects of their own choosing and set aside funds to explore new ideas when they occur. Others control resources so tightly that nothing is available for the new and unexpected – the result is nothing new.

- Has the organisation developed ways to manage many small and experimental innovations? Today's business cultures favour a few well-studied, well-planned attempts to hit a home run. In fact, nobody hits a home run every time; it is better to make more frequent attempts, with less careful and expensive preparation for each.
- Is the organisation's system set up to encourage risk taking and to tolerate mistakes? Innovation cannot be achieved without risk and mistakes. Even successful innovation generally begins with blunders and false starts.
- Are people in the organisation more concerned with new ideas or with defending their turf? Because new ideas usually cross the boundaries of existing patterns of organisation, a jealous tendency toward 'turf protection' blocks innovation.
- How easy is it to form functionally complete, autonomous teams in the organisational environment? Small teams with full responsibility for developing an innovation solve many of the basic problems, yet some companies resist their formation.[30]

If these questions can be answered positively, the result suggests an organisational philosophy that supports intrapreneurial behaviour. A number of negative responses suggests the organisation is challenged in rethinking its approach to creating an intrapreneurial environment.

Another way to view whether an organisation is taking an innovative intrapreneurial atmosphere seriously is to consider the cultural tactics it takes. Managers with foresight will use the corporate entrepreneurship tactics in Table 4.2 as a guide for developing the necessary innovative philosophy. When these are followed, they create an environment conducive to and supportive of potential entrepreneurial thinking. The result is a business philosophy that supports innovative behaviour.

TABLE 4.2 CORPORATE INTRAPRENEURSHIP (CI) TACTICS

Use demonstration projects
Uncover specific past CI-related activities that have been successful, easy wins that motivate employees into action. Highlight how they supported the business case for the initiative, the employees involved, the case for CI-related activities and their successful outcomes.
Use cross-functional working groups
Create teams from across the organisation who come together with a shared purpose or problem to resolve. They can be small or large and consist of same- or different-discipline employees of the same or different seniority, depending on the nature of the problem.
Open forums and workshops
Run open forums where employees can discuss initiatives, concerns, ideas and relevant issues. These should be available to middle- to lower-ranking employees, and ensure that no consequences of discussions can backfire on employees.
Tailor the business case
Create a bespoke business case for CI that is specific to your organisation's business plan (same objectives, same long-term targets). Find places to insert your CI objectives into the business plan, with supporting sections for each department that show how the objectives fit into the whole picture.

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Education and skills development

Provide education and skills development packages on CI, including bespoke aspects, for specific employee groups. Also consider training manuals for new starters or promotions, intranet-based communications on latest initiatives, competitions testing employees' knowledge on CI (where pre-reading is needed), offsite and day training sessions on specific aspects of CI, and conference attendance for champions or directors to be educated by peers in the industry.

Individual opportunism

Bring people close to the action. Let them see for themselves (internally or externally) what CI is about through training events, specific activities or campaigns, internal talks, talks from external people, opportunities to volunteer, champions network and so on.

Buddy system

For your network of champions or volunteers, pair a new starter with a member of staff who is more experienced, either in the business or in CI, to act as a mentor for their activities. A buddy gives the new starter support and a sounding board. This alliance can also provide political benefits, such as access to a higher-ranking employee or to a different part of the business.

Mobilise middle managers

Middle managers can be powerful allies or saboteurs, as they can block access or deny permission to junior members of staff to get involved, or open doors for the CI team. It is critical to focus on all levels of employees when engaging them in corporate responsibility.

Create a visible CI team

Make the CI team (core team and directors with responsibilities) visible in the business so that employees understand they are core to the business itself. The team also need to build credibility and show that they can consistently deliver value to the business. A credible and reliable CI team inspires trust in employees.

Reward and recognise

Use the 'total reward package' approach: reward not just on pay but on recognition, skills development, identity enforcement, promotion and so on. Some employees will be motivated by personal reward (political, promotion); for others it will be emotional reward (belonging, belief in the issues being addressed) or business success (solving a business need, enabling a business target).

Create a champions network

Build an informal network of employees across the business (top to bottom and across all departments) who are interested in CI and want to get involved. Ideally, have a tiered approach from the top (the Board) down through all levels of employment. Start with those already engaged and help them network with other employees across the business to build the network. Some companies allow senior managers/directors to nominate employees (usually middle managers) to get involved.

Source: Revised and adapted from: Dougherty Centre for Corporate Responsibility (2011). Engaging employees in corporate responsibility. In N. Exter (Ed.), *How-to guide* (6th edn). Cranfield University School of Management, 27–35. Copyright 2011 by Cranfield University School of Management.

RECOGNISING OBSTACLES TO INTRAPRENEURSHIP

Obstacles to intrapreneurship usually reflect ineffectiveness of traditional management in adapting to new-venture development. Although it is unintentional, the adverse impact of particular old-style techniques can be so destructive that the individuals within an enterprise will tend to avoid intrapreneurial behaviour. The top barriers for intrapreneurs are: management resistance to change in organisations; corporate bureaucracy that slows down project approval; refusal to allocate resources to new ideas; lack of training and support for employees; low rewards for success coupled with high costs of failure; and performance evaluation based solely on job descriptions.[31] Table 4.3 provides a list of traditional management techniques, their adverse effects (when the technique is rigidly enforced) and recommended actions to change or adjust the practice. If you find yourself surrounded by traditional management practices, see what you can do to influence the adoption of corrective actions.

TABLE 4.3 SOURCES OF AND SOLUTIONS TO OBSTACLES TO CORPORATE INTRAPRENEURSHIP

TRADITIONAL MANAGEMENT PRACTICES	ADVERSE EFFECTS	RECOMMENDED ACTIONS
Enforce standard procedures to avoid mistakes	Innovative solutions blocked, funds misspent	Make ground rules specific to each situation
Manage resources for efficiency and ROI	Competitive lead lost, low market penetration	Focus effort on critical issues (e.g. market share)
Control against plan	Facts ignored that should replace assumptions	Change plan to reflect new learning
Plan for the long term	Non-viable goals locked in, high failure costs	Envision a goal, then set interim milestones; reassess after each
Manage functionally	Entrepreneur failure and/or venture failure	Support entrepreneur with managerial and multidisciplinary skills
Avoid moves that risk the base business	Missed opportunities	Take small steps, build out from strengths
Protect the base business at all costs	Venturing dumped when base business is threatened	Make venturing mainstream, take affordable risks
Judge new steps from prior experience	Wrong decisions about competition and markets	Use learning strategies, test assumptions
Compensate uniformly	Low motivation and inefficient operations	Balance risk and reward, employ special compensation
Promote compatible individuals	Loss of innovators	Accommodate 'boat rockers' and 'doers'

Source: Reprinted by permission of Elsevier from Sykes, H. B., & Block, Z. (1989). Corporate venturing obstacles: Sources and solutions. *Journal of Business Venturing*, Winter, 161. Copyright 1989 by Elsevier Science Publishing Co., Inc.

Understanding the obstacles is critical to fostering intrapreneuring because they are the foundation points for all other motivational efforts. To gain support and foster excitement for new-venture development, managers must remove the perceived obstacles and seek alternative management actions.[32]

After recognising the obstacles, managers need to adapt to the principles of successful innovative companies. James Brian Quinn, an expert in the innovation field, found the following common factors in large companies that are successful innovators.

- *Atmosphere and vision*: Innovative companies have a clear-cut vision of, and recognised support for, an innovative atmosphere.
- *Orientation to the market*: Innovative companies tie their visions to the realities of the marketplace.
- *Small, flat organisations*: Most innovative companies keep the total organisation flat and project teams small.
- *Multiple approaches*: Innovative managers encourage several projects to proceed in parallel development.

interactive learning Methods of learning within an innovative environment that cut across traditional, functional lines in the organisation.

skunkworks A highly innovative enterprise that uses groups functioning outside traditional lines of authority. Also known as a gumboot factory.

- **Interactive learning**: Within an innovative environment, learning and investigation of ideas cut across traditional functional lines in the organisation.
- **Skunkworks**: Also known as a 'gumboot factory' in Australia and New Zealand, a skunkworks is a group that operates with autonomy within a large organisation, outside the traditional lines of authority. Every highly innovative enterprise uses these groups, which eliminate bureaucracy, permit rapid turnaround and instil a high level of group identity and loyalty.[33]

As Pinchot says, creativity and innovation are fuelled by the intelligence of people who have the freedom and right to express their ideas.[34] Intrapreneurship relies less on hierarchy and more on shared vision; less on rules and more on choices. Teams can be organised around the mission to design ever-better ways to conduct enterprises and create a stream of exchangeable value.[35] Reduction of organisational hierarchy is also important to promote intrapreneurship. It is necessary to eliminate organisational structures that obscure personal responsibility and homogenise individual actions.[36]

It is clear that the right organisational structure, culture, rewards and norms are pre-requisite if innovative activity is to exist and prosper. Intrapreneurial organisations evolve through a series of emerging constructions of people, corporate goals and existing needs. In short, organisations can encourage innovation by relinquishing controls and changing the traditional bureaucratic structure. Helpful to an intrapreneurial re-engineering pathway are the ten 'intrapreneur's commandments' shown in Table 4.4.

TABLE 4.4 THE INTRAPRENEUR'S COMMANDMENTS

1	Come to work each day willing to give up your job for the innovation.
2	Circumvent any bureaucratic orders aimed at stopping your innovation.
3	Ignore your job description – do any job needed to make your innovation work.
4	Build a spirited innovation team that has the 'fire' to make it happen.
5	Keep your innovation 'underground' until it is ready for demonstration to the corporate management.
6	Find a key upper-level manager who believes in you and your ideas and who will serve as a sponsor to your innovation.
7	Permission is rarely granted in organisations; thus, always seek forgiveness for the 'ignorance' of the rules that you will display.
8	Always be realistic about ways to achieve the innovation goals.
9	Share the glory of your accomplishments with everyone on the team.
10	Convey the innovation's vision through a strong venture plan.

PUBLIC SECTOR ENTREPRENEURSHIP

Citizens and politicians around the world regularly lament the absence of entrepreneurial behaviour in the public sector. The need to be entrepreneurial and innovative also applies to institutions such as governments and other public sector organisations. Drucker once observed that public institutions 'need to be entrepreneurial and innovative fully as much as any business does'.[37] Entrepreneurship, he believed, was as much a public-sector imperative as a private-sector one (see Table 4.5). Throughout the

TABLE 4.5 COMPARISON OF PRIVATE, CORPORATE AND PUBLIC ENTREPRENEURS

	PRIVATE (INDEPENDENT) ENTREPRENEUR	CORPORATE ENTREPRENEUR	PUBLIC SECTOR ENTREPRENEUR
Objectives and characteristics	Freedom to discover and exploit profitable opportunities; independent and goal oriented; high need for achievement	Requires freedom and flexibility to pursue projects without being bogged down in bureaucracy; goal oriented; motivated but influenced by the corporate characteristics	Motivated by power and achievement; undertakes purposeful activity to initiate, maintain or aggrandise one or more public-sector organisations; not constrained by profit
Focus	Strong focus on the external environment, competitive environment and technological advancement	Focus on innovative activities and orientations such as development of new products, services, technologies, administrative techniques, strategies and competitive postures; concentrates on the internal and external environment	Aims to create value for citizens by bringing together unique combinations of public and/or private resources to exploit social opportunities; learns to use external forces to achieve internal change
Innovation	Creates value through innovation and seizing the opportunity without regard to resources (human and capital); produces resources or endows existing resources with enhanced potential for creating wealth	Fosters a system that enables and encourages individuals to use creative processes that allow them to apply and invent technologies that can be planned, deliberate and purposeful in terms of the level of innovative activity desired; instigates renewal and innovation within the organisation	Takes risks with an opportunistic bias toward action and consciously overcomes bureaucratic and political obstacles their innovations face
Opportunity	Pursues an opportunity regardless of the resources they control; relatively unconstrained by situational forces	Pursues opportunities independent of resources they currently control; does new things and departs from the customary to pursue opportunities	Uses every opportunity to distinguish their public enterprise and leadership style from what is in the public sector; understands the business as well as the opportunity for business growth and development
Risk taking	Assumes significant personal and financial risks but attempts to minimise them; risk taking is a prime factor in the entrepreneurial character and function	Moderate risk taker; recognises that risks are career related	Calculated risk taker; takes relatively big organisational risks without taking big personal risks
Character and skills	Self-confident; strong knowledge of business	Self-confident; believes that they can manipulate the system; strong technical or product knowledge; good managerial skills	Self-confident; high tolerance of ambiguity; strong political skills

Source: Kearney, C., Hisrich, R. D., & Roche, F. (2007). A conceptual model of public sector corporate entrepreneurship. *International Entrepreneurship and Management Journal*, 4(3), 295–313. Republished with permission of Springer via Copyright Clearance Center, Inc.

public sector entrepreneurship Entrepreneurship that combines public and private resources in pursuit of social objectives.

governpreneurship Entrepreneurship within the governmental sector.

world, governments and other public institutions have been struggling with how to become more entrepreneurial. It is not an easy task, considering the centuries-long system of entrenched bureaucracies that resist change.

This has led Hisrich and Al-Dabbagh to advocate **public sector entrepreneurship**, defined as 'an individual or group of individuals undertaking activities to initiate change by adapting, innovating and assuming risk, and recognizing that personal goals and objectives are less important than generating results for the organization'. They have coined the term **governpreneurship** to describe this type of activity within governments.[38]

ENTREPRENEURSHIP IN PRACTICE

NEW ZEALAND'S SUCCESS IN COMMERCIALISING GOVERNMENT COMPANIES

Despite its small size, New Zealand has about 500 organisations directly involved in commercialising innovation: science, engineering and technology companies, laboratories, campuses, workshops, studios and factories, as well as 50 major institutions, including universities, research institutes, polytechnics and private-sector companies. During the 1980s, New Zealand government departments with a strong trading function were corporatised or privatised, on the premise that such services could be more efficiently provided by commercially oriented organisations, rather than subject to ministerial control and government interference. This has been a great success and provides an important example of intrapreneurship.

MetService

New Zealand's weather forecasting services began in 1861 as part of the then-government's Marine Department. In 1992 responsibility for weather forecasting was transferred to the newly incorporated SOE 'MetService', whose main business activity involved forecasting and communicating weather-related information. MetService's vision was to be a recognised leader in weather and information presentation services, to be profitable and well managed, to employ enthusiastic and highly skilled staff dedicated to the success of the company, and to achieve worldwide growth through customer appreciation of its valuable and innovative services. With projects such as turbulence forecasting over the Himalayan Mountains for Qantas Airways, low-cost weather systems for isolated areas using mobile phone technology, heat stress and pasture growth indices for New Zealand's agricultural industry and energy forecasts for various power stations in the UK, MetService gained recognition as a successful, innovative and entrepreneurial organisation.

New Zealand Post

NZ Post had provided mail services for more than 160 years, but in 1987 the postal side of the business became a commercial, profit-oriented entity. There was an awareness of the decreasing trend in traditional mail, so the decision was made to diversify business around a central theme of connecting people. With projects such as international consultancy to other postal administrations, electronic systems for the archival and retrieval of customer documents, electronic mapping of customer delivery points and agency services enabling online payment of fees for more than 80 different organisations, NZ Post was increasingly viewed as a successful and proactive organisation. Consistent with this strategy of pursuing entrepreneurial opportunities, NZ Post took the rather bold and controversial step of entering New Zealand's banking industry in 2001 with the establishment of Kiwibank.

Spark New Zealand

Formerly known as Telecom New Zealand, the company was carved out of the government-run New Zealand Post Office in 1987 and privatised in 1990. To further speed privatisation, in 2008 the company was chopped up into three operations to correspond to the 'local loop unbundling' initiatives by government. This resulted in Telecom Retail; Telecom Wholesale; and Chorus (network infrastructure). Finally, the companies became separately listed on the stock exchange, thus ending once and for all any remnants of monopoly. In 2014 Telecom Retail changed its name to Spark New Zealand.

Source: Adapted from Luke, B., & Verreynne, M.-L. (2006). Strategic entrepreneurship in the public sector: Fact or farce? *Regional Frontiers of Entrepreneurship Research 2006, Third AGSE International Entrepreneurship Research Exchange,* 8–10 February, Auckland, New Zealand; Easton, B. (2013). *The commercialisation of New Zealand.* Auckland University Press; Luke, B. (2013). Re-examining the financial returns from New Zealand's SOE sector: Re-examining privatisation. http://eprints.qut.edu.au/72533.

SUMMARY

In this chapter we have explored six pathways to gaining entrepreneurial experience and building an entrepreneurial career. Three of these pathways are more specific to creating your own new venture, and three rely on leveraging existing organisations. At the outset we made it clear that entrepreneurial pathways are subject to personal preferences. Entrepreneurs come in all shapes, sizes and types and so too do their ventures. We also pointed out that entrepreneurs can create the same pathway approaches to ventures regardless of where they fall along the social–commercial or non-profit–profit spectrum. Social ventures use similar planning tools to regular business ventures, but at each step there are different considerations and nuances, and these will be explored further as you advance through your studies.

This chapter first outlined one of the most common pathways: bootstrapping, sometimes defined as simply starting a new business without financing. We also looked at the exciting new area of minipreneurship, which has been made possible by advances in technology and online communication that allow the minipreneur to set up their business with minimal funding.

The chapter then went on to describe a conventional business start-up that raises capital to launch a unique product or service. Sometimes this involves what is called a *new-new approach* – that is, the development of an entirely new idea for a product or service (as was the case with MySpace and Google). In most instances, however, the prospective owner/manager uses a new-old approach by piggybacking on someone else's ideas. This involves either expanding on what the competition is doing or offering a product or service in an area or market segment in which it is not presently available.

Another pathway opportunity is the purchase of an existing successful business, which has a number of advantages. Three of the most important advantages to this pathway are that the business' successful future operation is potentially more likely, the time and effort associated with starting a new enterprise are eliminated and a bargain price may be possible. However, before deciding whether to buy, the prospective owner needs to be aware of the potential pitfalls and shortcomings that may be concealed in the detail of an existing business purchase proposal.

Our second established-venture pathway considered family business succession. Family businesses are a dominant business form across the globe and some rival the size of large public companies. These businesses can come with unique challenges that only arise in family contexts: family and business goals can be in conflict, siblings can be rivalrous, employees can be envious and the owner is unaccountable to any other. At the same time they have virtues and offer opportunities for succession if managed well.

Lastly we covered the intrapreneurial pathway. Some may believe this has the advantages of resource-rich environments and security, but those familiar with the pathway recognise a set of obstacles and challenges that are particular to large and often bureaucratic organisations. The intrapreneurial pathway relies on organisations that allow freedom and experimentation, provide autonomy, limit rules and structures, and generally seek out new ideas, being ready to disband outdated practices to embrace opportunity. Organisations such as these are not so common, but this fact also offers opportunities to transform organisations, including government and public service organisations.

KEY TERMS & CONCEPTS

CourseMateExpress
Review key terms with interactive flashcards.

- bootstrapping
- cash flow
- entrepreneurial economy
- familiness
- family succession
- franchise
- franchisee
- franchisor
- global financial crisis (GFC)
- governpreneurship
- interactive learning
- legal restraint of trade
- liquidation
- long tail
- new business start-up
- new-new approach
- new-old approach
- non-compete clause
- PITA product
- public sector entrepreneurship
- re-engineering organisations
- serial entrepreneur
- skunkworks
- social venturing
- three-circles model
- transgenerational entrepreneurship

REVIEW & DISCUSSION QUESTIONS

1 Discuss how personal preferences may influence the type of entrepreneurial pathway an entrepreneur may choose.
2 What features distinguish a social venture from a conventional business and what would motivate an entrepreneur to take this pathway?
3 What are some examples of bootstrapping that you could use in your business idea?
4 What has given rise to minipreneurs and what kinds of businesses are they engaged in?
5 How does the new-new approach to starting a new venture differ from bootstrapping? Provide examples for your answer.
6 How does a new-old approach differ from the new-new pathway to starting a new venture and what are the advantages of the new-old approach?
7 Not all entrepreneurs start just with an idea and little else. Name three other pathways into entrepreneurship and describe the advantages of each.
8 What are the two major risks that confront a new venture start-up that can be avoided by purchasing an established business?
9 What are the advantages of buying an ongoing business? Explain them.
10 How does purchasing a franchise differ to buying an established business? What limitations does buying a franchise place on an entrepreneur?
11 When buying an established business, what protections can be put into place to keep the staff and to ensure the executive team that leaves does not open a competing business?
12 Family businesses are not all small. Research and list at least five family businesses in your country that are household names. What do they do and what generation of management is currently heading the business?
13 What does the term 'transgenerational entrepreneurship' mean and what are the five elements that influence this phenomenon?
14 Why would some describe entrepreneurship in large organisations as an oxymoron?
15 What is intrapreneurship and why is it becoming increasingly important for large organisations?
16 How does re-engineering an organisation differ to the intrapreneurship pathway?
17 What are five questions that can be applied to test whether an organisation is intrapreneurial?
18 Name and describe at least five tactics an organisation might apply that signal an intrapreneurial philosophy.
19 Describe how private, corporate and public-sector entrepreneurs may differ in at least three common dimensions.

EXPERIENCING ENTREPRENEURSHIP

Do you have what it takes to get on the pathway?

Studies of successful entrepreneurs reveal common characteristics – family backgrounds, experiences, motivations, personality traits, behaviours, values and beliefs. How do you fit these patterns? What is your EQ (entrepreneurial quotient)? A US insurance company, Northwestern Mutual Life, created the following test, now found adapted and abridged, to predict how suited you are to entrepreneurship.[39] This test cannot predict your success – it can only give you an idea whether you will have a head start or a handicap. Entrepreneurial skills can be learned. The test is intended to help you see how you compare with others who have been successful entrepreneurs.

CourseMateExpress
Experience this activity online.

Add or subtract your score as you evaluate yourself:

1 Significantly high numbers of entrepreneurs are children of first-generation immigrants. If your parents immigrated to your country, score one. If not, score minus one.

2 Successful entrepreneurs are not, as a rule, top achievers in school. If you were a top student, subtract four. If not, add four.

3 Entrepreneurs are not especially enthusiastic about participating in group activities in school. If you enjoyed group activities – clubs, team sports, double dates – subtract one. If not, add one.

4 Studies of entrepreneurs show that, as youngsters, they often preferred to be alone. Did you prefer to be alone as a youngster? If so, add one. If not, subtract one.

5 Enterprise can usually be traced to an early age. Did you start an enterprise during childhood – lemonade stands, family newspapers, greeting card sales – or run for elected office at school? If so, add two. If not, subtract two.

6 Stubbornness as a child seems to translate into determination to do things one's own way – a hallmark of proven entrepreneurs. If you were stubborn as a child, add one. If not, subtract one.

7 Caution may involve an unwillingness to take risks, a handicap for those embarking on previously uncharted territory. Were you a cautious youngster? If so, deduct four. If not, add four.

8 Were you daring or adventuresome as a child? If so, add four more.

9 Entrepreneurs often have the faith to pursue different paths despite the opinions of others. Do the opinions of others matter a lot to you? If so, subtract one. If not, add one.

10 Being tired of a daily routine often precipitates an entrepreneur's decision to start an enterprise. Would changing your daily routine be an important motivation for starting your own enterprise? If so, add two. If not, subtract two.

11 Yes, you really enjoy work. But are you willing to work overnight? If yes, add two. If no, subtract two.

12 Are you willing to work as long as it takes with little or no sleep to finish a job? If so, add four more.

13 Entrepreneurs generally enjoy their type of work so much they move from one project to another – non-stop. When you complete a project successfully, do you immediately start another? If yes, add two. If not, subtract two.

14 Successful entrepreneurs are willing to use their savings to finance a project. Are you willing to commit your savings to start a business? If so, add two. If not, subtract two.

15 Would you be willing to borrow from others? If so, add two more. If not, subtract two.

16 If your business should fail, would you immediately start working on another? If so, add four. If no, subtract four.

17 Or would you immediately start looking for a job with a regular pay cheque? If so, subtract one more.

18 Do you believe being an entrepreneur is risky? If so, subtract two. If not, add two.

19 Many entrepreneurs put their long-term and short-term goals in writing. Do you do this? If so, add one. If not, subtract one.

20 Handling cash flow can be critical to entrepreneurial success. Do you believe you have the ability to deal with cash flow in a professional manner? If so, add two. If not, subtract two.

21 Entrepreneurial personalities tend to be easily bored. Are you easily bored? If so, add two. If not, subtract two.

22 Optimism can fuel the drive to press for success in uncharted waters. Are you an optimist? If so, add two. If not, subtract two.

What's your EQ (entrepreneurial quotient)?

If you scored +35 or more, you have everything going for you. You ought to achieve spectacular entrepreneurial success (barring acts of nature or other variables beyond your control).

If you scored +15 to +34, your background, skills and talents give you excellent chances for success in your own business. You should go far.

If you scored 0 to +15, you have a head start of ability and/or experience in running a business and ought to be successful in opening an enterprise of your own if you apply yourself and learn the necessary skills to make it happen.

If you scored 0 to −15, you might be able to make a go of it if you ventured on your own, but you would have to work extra hard to compensate for a lack of built-in advantages and skills that give others a leg up in beginning their own business.

If you scored −15 to −43, your talents probably lie elsewhere. You ought to consider whether building your own business is what you really want to do, because you may find yourself swimming against the tide if you make the attempt. Another work arrangement – working for a company or for someone else, or developing a career in a profession or an area of technical expertise – may be far more congenial to you and allow you to enjoy a lifestyle appropriate to your abilities and interests.

EXPERIENCING ENTREPRENEURSHIP

Your personal entrepreneurial action plan

CourseMateExpress

Experience this activity online.

Before making the final decision about going into business, a prospective entrepreneur needs to ask a number of personal questions. Ten of the most important ones are listed here. As you read, mark the response that best describes you.

Complete the following by checking the box that most closely matches your answer. Follow the instructions at the end to ascertain your score.

1 Are you a self-starter?
- ☐ I can get going without help from others.
- ☐ Once someone gets me going, I am just fine.
- ☐ I take things easy and do not move until I have to.

2 How do you feel about others?
- ☐ I can get along with just about anyone.
- ☐ I do not need anyone else.
- ☐ People irritate me.

3 Can you lead people?
- ☐ I can get most people to go along with me once I start something.
- ☐ I can give the orders if someone tells me what should be done.
- ☐ I let someone else get things done and go along if I like it.

4 Can you take responsibility?
- ☐ I take charge and see things through.
- ☐ I'll take over if necessary but would rather let someone else be responsible.
- ☐ If someone is around who wants to do it, I let him or her.

5 Are you an organiser?
- ☐ I like to have a plan before I begin.
- ☐ I do all right unless things get too confusing, in which case I quit.
- ☐ Whenever I have things all set up, something always comes along to disrupt the plan, so I take things as they come.

6 Are you a hard worker?
- ☐ I can keep going as long as necessary.
- ☐ I work hard for a while, but then that's it.
- ☐ I cannot see that hard work gets you anywhere.

7 Can you make decisions?
- ☐ I can make decisions, and they usually turn out pretty well.
- ☐ I can make decisions if I have plenty of time, but fast decision making upsets me.
- ☐ I do not like to be the one who has to decide things.

8 Can people rely on your word?
- ☐ Yes, I do not say things I do not mean.
- ☐ I try to level with people, but sometimes I say what is easiest.
- ☐ Why bother? The other person does not know the difference.

9 Can you stick with it?
- ☐ When I make up my mind to do something, nothing stops me.
- ☐ I usually finish what I start.
- ☐ If things start to go awry, I usually quit.

10 How good is your health?
- ☐ Excellent.
- ☐ Pretty good.
- ☐ Okay, but it has been better.

Now count the number of checks you have made next to the first responses and multiply this number by 3. Count the checks next to the second responses and multiply by 2. Count the checks next to the third answer. Total these three numbers. Of a possible 30 total points, a potentially successful entrepreneur should have at least 25 points. If not, the prospective entrepreneur should consider bringing in a partner or abandoning the idea of going into business alone. The potential entrepreneur should always keep in mind these personal factors while formulating the action plan.

CASE STUDIES

CASE 4.1

CHECKING IT OUT

When Arlene Ryan inherited $150 000 from her grandfather, she decided to use the money to start her own business. Arlene had been a legal secretary for 14 years and felt she knew quite a lot about business. 'Every day I take depositions and type legal memoranda,' she noted to a friend. 'And I've seen lots of businesses fail because they didn't have adequate capital or proper management. Believe me, when you work for a law firm, you see – and learn – plenty.'

Almost six months passed before Arlene decided on a business to pursue. A franchise ad in a business magazine caught her attention; Arlene called and found out that the franchiser was selling fast-food franchises in her area. 'We are in the process of moving into your section of the country,' the spokesperson told her. 'We have 111 franchisees throughout the nation and want to sell 26 in your state.' Arlene went to a meeting that the franchiser held at a local hotel and, along with a large number of other potential investors, listened to the sales pitch. It all sounded very good. The cost of the franchise was $75 000 plus 4 per cent of gross revenues. The franchiser promised assistance with site location and personnel training and encouraged the prospective franchisees to ask questions and investigate the organisation. 'If you don't feel this is a good deal for you, it's not a good deal for us either; good business is a two-way street,' the spokesperson pointed out. 'We are going to be looking very carefully at all franchise applications and you ought to be giving us the same degree of scrutiny.'

Arlene liked what she heard but felt it would be prudent to do some checking on her own. Before leaving the meeting, she asked the spokesperson for the names and addresses of some current franchisees. 'I don't have a list with me,' he said, 'but I can write down some that I know of, and you can get their numbers from Google'. He then scribbled four names and locations on a piece of paper and handed it to her.

Arlene searched the internet and was only able to get telephone numbers for two of the franchises. The other addresses apparently were wrong. She then placed calls to the two franchisees. The first person said she had owned her franchise for one year and felt it was too early to judge the success of the operation. When she found out Arlene was thinking about buying a franchise, she asked if Arlene would consider buying hers. The price the woman quoted was $5000 less than what the company currently was quoting. The second person told Arlene he simply did not give out information over the phone. He seemed somewhat edgy about talking to her and continually sidestepped Arlene's requests for specific financial information. Finally, he told her, 'Look, if you really want this information, I think you should talk to my lawyer. If he says it's okay to tell you, I will.' He then gave Arlene the lawyer's number. Something didn't feel quite right about this so before she called the lawyer she thought she would think it over during her lunch break. When she returned, she had decided that further investigation was necessary. She felt she needed more information about what a potential franchisee could expect from the franchisor making such an offer. She wondered where she may obtain further information and what specific rights she may have if she would buy into a franchise. What and who should she ask to get the right answers? If she didn't buy this franchise, there would be others.

On arriving back at her desk one of the law firm's partners was waiting for her. 'Hey, Arlene, what are you doing calling this guy?' he asked, holding up the telephone number of the franchisee's lawyer. 'Are you planning to sue someone? That's his specialty, you know'. Arlene smiled. 'As a matter of fact, I am. I'm thinking of suing you guys for back wages.' The lawyer laughed along with her and then walked back into his office.

QUESTIONS

1 Does Arlene's background suggest she is ready for a career transition to run her own business? Describe Arlene's character traits and experience that this case suggests and describe how these would support her transition or otherwise.

2 Should Arlene have been open with her boss and discussed her ideas about a franchise and the merits of considering this particular purchase? What may be the consequences of this conversation?

3 Draw up a list of things that Arlene should consider in making a decision to move into her own business and recommend different strategies that would seem right for her. Describe the strengths and weaknesses of the alternatives.

CASE 4.2

JESSICA'S 'CAREER BLUEPRINT'

Jessica Perry was still at high school when she began her entrepreneurial journey and started her now thriving business Career BluePrint.

Jessica explains it was the school itself that inspired the commencement of her business endeavour. Jessica sought counselling regarding her own career planning, and it was this exposure, she said, coupled with her home environment – both parents were entrepreneurs – that paved the way for an alternative, self-directed career path.

Leaving school was also a preparation for things to come as Jessica took on a school-based apprenticeship and a job at local grocery outlet Foodland. With the educational support of Adelaide Training and Employment Centre (ATEC) and the achievement of a Certificate III in Business, Jessica began to see a future role as a facilitator between employers and work-based apprentices, customising training.

At a public speaking training course Jessica developed techniques that helped her be accepted into the Spark Program, which provided access to a network of mentors and community business leaders to help her launch her business idea. Jessica found herself amid a vibrant community of start-up support assistance programs with eager mentors in a true 'entrepreneurial ecosystem'. One thing led to another and soon she was also accepted into the Chamber of Commerce and Industry South Australia's (Business SA's) SAYES (South Australia Young Entrepreneur Scheme) program, giving her yet another level of support and guidance.

The assistance garnered from Adelaide's entrepreneurial ecosystem resulted in substantial developments for Career BluePrint as Jessica worked to produce a comprehensive business plan and visual portfolio. The programs assisted with defining ambitious yet realisable goals and determined '… that the business was face to face and the core product was workshops … which were to then move online.' The result was the delivery of a scalable business. Jessica explains that she discovered how to build the back end of a business and began to develop a team, including a web development graphics team overseas and a research team of 10 people.

Jessica's mother Wendy, also a successful businessperson, helped Jessica by advising on strategy. Jessica's entrepreneurial father, Scott, assisted as a product development manager, which put Career BluePrint in good hands. With such great familial support, Jessica runs the business completely independently as the sole decision maker.

Through her exposure to a variety of support programs at such a formative stage of Career BluePrint's development, Jessica has been able to build a brand and market presence and focus on achieving a scalable enterprise that can grow. This has been assisted by networking and getting known 'building a personal brand'. Scalability was important to understand '… because you can't sell time all the time' Jessica says.

Jessica reflects on her entrepreneurial journey and its many challenges over the period of Career BluePrint's development and says, 'a lack of money hasn't stopped anything …' and in many ways has informed an attitude of 'what is the solution rather than what is the problem'.

Identifying the real customer as the target was another very important insight gained by Jessica as she embraced the full scope of her entrepreneurial undertaking. Jessica found she had to focus on 'parents and schools, not the young funky and cool.' Stability was a second and equal consideration to factor in, as 'schools needed to know that you'd be there next year'.

With the move to an online offering, Career BluePrint went national, launching a new phase of growth. The next aim was to enter international markets with offerings in the United States of America. Career BluePrint has moved past its tipping point and is set to engage with national partnerships in Victoria and Western Australia, and may soon see similar deals internationally. There has already been the opportunity to co-brand events through existing and developing networks and with involvement in public speaking training, as well as the opportunity to be involved in national and international conferences such as IVETA World TVET, a point of orientation for vocational educators across the globe.

Jessica has been recognised with several awards for her entrepreneurial drive, including recognition as 'Young up-start entrepreneur under 30' at Start-up Adelaide. With investigations into other global markets pending, especially across the Asia-Pacific region, and the seeking of strategic partners, Jessica's move to a greater international ecosystem has set her business on a trajectory that will see her entrepreneurial skills and achievements continue to grow exponentially. The assistance provided by Adelaide's entrepreneurial ecosystem and its associated programs provided foundational opportunities for the development of entrepreneurs like Jessica.

QUESTIONS

1 How would you describe Jessica's entrepreneurship pathway? Bootstrapping, minipreneurship, new-new or new-old, family business, intrapreneurship? Explain your answer.
2 Map out the important points that supported Jessica's entrepreneurial development by considering the different aspects of personal development and business opportunity development. Discuss how these different development aspects were important for shaping Career BluePrint's success.
3 Discuss your views on how much Jessica's entrepreneurial career has been influenced by her own drive, her family context and the various support programs that she engaged with. Is Jessica a born entrepreneur or were her circumstances the major driver of her entrepreneurial pathway?

ONLINE STUDY RESOURCES

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PART ONE

ENTREPRENEURIAL CASE ANALYSIS

AN ENTREPRENEURIAL LENS: SAME PROBLEM, DIFFERENT MINDSET

Dr Tracey Dodd

In her light-filled office, located on the outskirts of the central business district of Adelaide, South Australia, the current CEO of Junction Australia, Ms Maria Palumbo reflects:

> My job, and the job of all 230+ people that work for Junction Australia, is to transform lives. Our capital is the impact that we make to the life trajectory of vulnerable people living in the community. When we have a positive impact, we build capital in the community, and in the form of our social licence to operate. We also enhance credibility with our funders who are mostly government agencies. When we change lives for the better, we also build trust and support from our philanthropic supports and most importantly the community that we serve. That is the power that drives our business model.

It is no easy task to build a social enterprise that is economically viable in the long term. It requires the ability to maintain financial capacity over time (Bowman, 2011). This financial capacity provides the organisation with the ability to seize opportunities and react to unexpected threats while maintaining operations (Guthrie, Ricceri, Dumay, & Nielsen, 2017).

Ms Palumbo continues:

> I am often accused of putting the dollars before the heart. However, if we do not achieve an annual surplus and ensure value for money in our services there will be no heart. The bottom line dictates our impact; it sustains the heart.

In 2017, when Ms Palumbo joined the social enterprise that is Junction Australia, she was determined to show how partnerships between a social enterprise, the private sector and government could simultaneously achieve social and economic outcomes (Junction Australia, 2018).

Ms Palumbo is passionate about providing safe and affordable housing for all, including vulnerable people on low incomes. She joined Junction Australia at a pivotal moment. Established in 1979, Junction Australia has grown to over 230 people who work across South Australia, including 33 local and diverse government areas. Providing housing and community support services throughout the State, Junction Australia's portfolio included:

- 2200 homes accommodating 4000 tenants (of these homes, 1500 are women-led households); and
- 30 support services, including homelessness support and foster care for 4500 people each year.

But Junction Australia was not always this large. A significant enabler of the growth and resulting financial sustainability of the social enterprise came from the transfer of 563 properties from the South Australian Government to Junction Australia as part of the *Renew our Streets and Suburbs* project (ROSAS) in recent years. ROSAS, announced by the State Government in February 2015, aimed to renew 4500 State Government dwellings through the transfer to community housing providers.

The transfer represented both a significant problem and an opportunity. Built prior to 1968, many of the dwellings were in various states of disrepair. Furthermore, the residents in these dwellings were often vulnerable, facing social isolation due to poor physical or mental health, as well as low levels of education attainment and employment. However, with most of the houses located within 10 kilometres of the city, or in highly desirable areas such as the Fleurieu region, ROSAS offered a significant opportunity to unlock the economic value of the properties, as well as transform previously disconnected dwellings into thriving local neighbourhoods.

This opportunity did not originate from within Junction Australia. Instead, it originated from a South Australian Government policy decision, which Ms Palumbo was part of in her then role as an executive with the State Government. The policy decision had five imperatives:

1. To offer more choice and higher quality for those needing social and affordable housing
2. To improve the sustainability of the South Australian social housing system into the future
3. To renew communities by creating great places to live through the redevelopment of existing properties
4. To stimulate economic activity
5. To transition public housing stock management to a net positive financial position.

Under ROSAS, the State Government transferred the management of approximately 4000 properties to eligible community housing providers (such as Junction Australia) under a 20-year concurrent lease. In order to be successful, community housing providers had to demonstrate how they would repair existing dwellings to improve living standards, leverage these assets to enable further development (reaching the target of 500 new properties), as well as work with local residents to enhance their wellbeing. No mean feat indeed.

However, Junction Australia seized this opportunity based on its expertise, strong professional networks and positive communication with key stakeholders. In 2016, it won its bid for the Morphettville and Fleurieu regions of the *ROSAS Public Housing Stock Management Transfer* tender.

When the organisation's previous CEO retired in 2017, Ms Palumbo seized the opportunity to throw her hat into the ring to lead this transformational change. She said:

> For too long community housing providers have maintained a welfare mentality. Instead of seeing problems as an opportunity for transformational change, they maintained existing ways of doing things. Unfortunately, this approach is not working – homelessness is increasing in Australia. I wanted to be a game changer; to bring a commercial lens to the issue of housing affordability and homelessness. The board of Junction Australia were inspired by this vision and here I am.

Not all Junction Australia staff agreed. Some felt that economic and social goals were mutually exclusive rather than reinforcing and supportive. However, through effectively communicating how the financial position of the organisation, and partnerships with new commercial partners, can enable Junction Australia to achieve greater good, Ms Palumbo is changing attitudes and bringing people along with her.

As a social entrepreneur, Ms Palumbo has strong professional networks that enable her to foster an organisational culture that actively draws on best practice from across Australia and around the world. She is also supported by a highly skilled board and an executive team committed to confronting social issues such as homelessness and the shortage of affordable housing in Australia. These internal resources allowed Junction Australia to significantly expand the business in recent years.

Integral to Junction Australia's success was a proactive communication and engagement strategy fostered by Ms Palumbo. This included identifying salient stakeholders, such as tenants, local Members of Parliament, councils, government agencies, and local community service providers. Junction Australia identified key messages and tailored them for each stakeholder group. These key messages were based on:

- What Junction Australia stands for, its 50 years of experience, its value-based approach, and customer satisfaction ratings; and
- Junction Australia's expectation of building strong and mutually beneficial relationships with tenants and striving for continuous improvement in tenancy management.

Drawing on a new mindset based on value creation Ms Palumbo has created an approach within Junction Australia that enables it to take advantage of its assets and craft an innovative vision for both local regions that worked with the private and government sectors to transform the existing housing stock and enhance the local community. Through the ROSAS initiative, Junction Australia plans to build 133 new dwellings, and upgrade 302 more. As at 30 June 2017, Junction Australia's operating equity equalled AU$192.8M. A strong financial base ensures long-term economic viability and a greater capacity to tackle social issues, such as homelessness and the shortage of affordable housing in Australia.

CONCLUSION

By seizing on a local opportunity, and the policy position of the South Australian Government, the CEO of Junction Australia has built a sustainable social enterprise now worth over AU$192M. The organisation was able to achieve significant growth in recent years by framing the social problem as an opportunity, and by working with the State Government and other stakeholders to reshape the social housing landscape. In place of rundown and aging dwellings and socially isolated tenants, Junction Australia is transforming the local areas in which it operates into vibrant communities comprising quality and affordable housing coupled with programs to connect the community to key services and foster social engagement. This 'value added' approach has secured Junction Australia's financial viability and sustainability.

DISCUSSION QUESTIONS

1. The CEO of Junction Australia had a new mindset: '. . . seeing problems as an opportunity'. How did she apply this mindset?
2. Who were the key stakeholders in this case? How and why did the CEO of Junction Australia engage with these stakeholders?
3. Discuss the reasons why collaboration was key to this example of a successful social enterprise?
4. 'The bottom line . . . sustains the heart.' Explain why some Junction Australia staff may disagree with this statement.
5. Is the CEO in this case in any way entrepreneurial or intrapreneurial? Justify your answer.

ENDNOTES

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PART TWO

DESIGNING RESILIENT ENTREPRENEURSHIP: FROM OPPORTUNITY IDENTIFICATION TO BUSINESS MODEL

CHAPTER 5

OPPORTUNITY IDENTIFICATION AND THE CREATIVE PURSUIT OF INNOVATIVE IDEAS

The best way to have a good idea is to have lots of ideas.

Linus Pauling,
Science Educator[1]

Given one hour to save the planet, I would spend fifty-nine minutes understanding the problem and one minute resolving it.[2]

Albert Einstein

Entrepreneurs need to search purposefully for the sources of innovation, the changes and their symptoms that indicate opportunities for successful innovation.

Peter F. Drucker,
Innovation and Entrepreneurship[3]

Everybody has a plan until they get punched in the mouth.

Mike Tyson,
Boxer.[4]

CHAPTER OBJECTIVES

1. To understand how creativity and opportunity are connected to the build-measure-learn model
2. To present ways of developing personal creativity: to recognise relationships, to use lateral thinking, to use your 'brains' and to think outside the box.
3. To identify theories of opportunity recognition
4. To model the process of identifying an opportunity
5. To distinguish between an idea and an opportunity and to examine biases and pitfalls
6. To define and illustrate the sources of opportunity for entrepreneurs
7. To familiarise ourselves with the important concept of the value proposition and discuss sources of value

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USING CREATIVITY TO BUILD-MEASURE-LEARN

As we dive into personal creativity and opportunity recognition, remember: We are focused on your ability to ideate, quickly build a 'minimum viable product' of that idea, measure its effectiveness among your consumers and learn from real-world experiments. Think of the next four chapters as applying the scientific method to your start-up.

- We use creativity in the *build stage*, developing a minimum viable product.
- We use creativity in the *measure stage*, when you generate hypotheses (assumptions) to test (for example, 'Will Australians regularly fly to Asia for cheaper dental treatment?').
- The *learn stage* makes you take a hard look at your results and determine whether a 'pivot' is required. Pivoting away from an unvalidated idea takes courage as well as creativity.

The build-measure-learn loop (see Figure 5.1) is a fast track to product or service development. *Fast and furiously* you use your creativity to identify opportunities, ideate, build a minimum viable product, measure its effectiveness, learn from that experiment and then maybe change course.

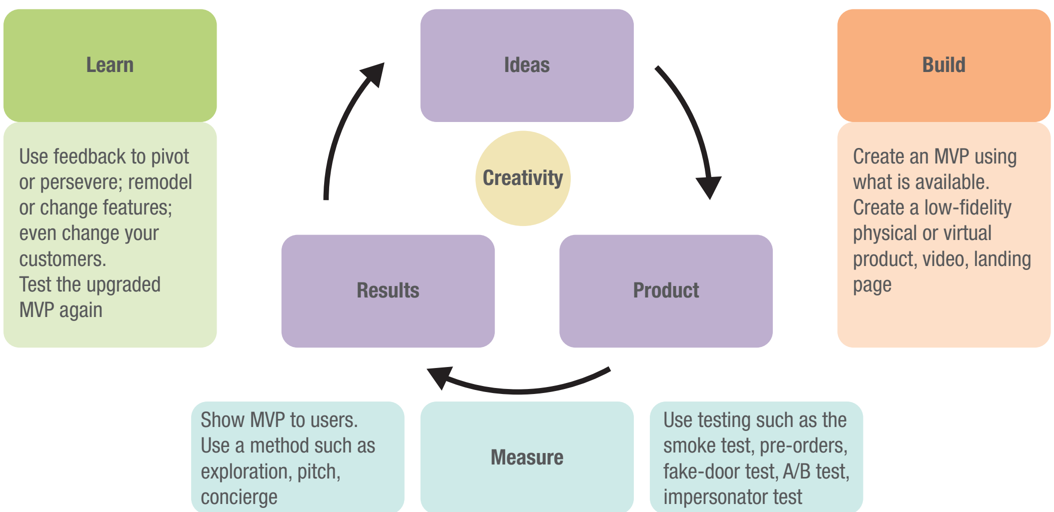

FIGURE 5.1 THE BUILD-MEASURE-LEARN LOOP

ENTREPRENEURIAL IMAGINATION AND CREATIVITY

How do we find and evaluate opportunities? To see opportunities, entrepreneurs blend imaginative and creative thinking with a systematic, logical process ability. This combination is key to successful innovation. In addition, potential entrepreneurs are always looking for unique opportunities to fill needs or wants. They sense economic potential in business problems by continually asking 'What if…?' or 'Why not…?' They develop an ability to see, recognise and create opportunity where others find only problems. The first rule for developing entrepreneurial vision is to recognise that problems are to solutions as demand is to supply. Analysis that blends creative thinking with systematic inquiry such that problems are looked at from every possible angle is a hallmark of the entrepreneurial imagination.[5] What is the problem? Whom does it affect? How does it affect them? What costs are involved? Can it be solved? Would the marketplace pay for a solution? Entrepreneurs continually and imaginatively cycle through these types of questions.

THE ROLE OF CREATIVE THINKING

creativity
The generation of ideas that results in improved efficiency or effectiveness of a system.

Creativity is the generation of ideas that results in the improved efficiency or effectiveness of a system.[6] This combination is the key to successful innovation. In addition, potential entrepreneurs are always looking for unique opportunities to fill needs or wants. They develop an ability to see, recognise and create opportunity where others only find problems. Creativity has become a compelling topic in the popular media. Richard Florida is an academic whose field is regional economic development. He says: 'Human creativity [is] the key factor in our economy and society … we now have an economy powered by human creativity. Creativity … is now the decisive source of competitive advantage'.[7]

THE NATURE OF THE CREATIVE PROCESS

creative process
A process of exploration, selection, combination, refinement and reflection to create a new idea or innovation.

Creativity is a process that can be developed and improved.[8] Everyone is creative to some degree. However, as is the case with many abilities and talents (for example, athletic or artistic), some individuals have a greater aptitude for creativity than others. Some people were raised in an environment that encouraged them to develop their creativity. They have been taught to think and act creatively. For others the process is more difficult because they have not been positively reinforced and, if they are to be creative, they must learn how to formally implement the **creative process**.[9]

Many people incorrectly believe that only a genius can be creative.[10] Most people also assume some people are born creative and others are not, or only the gifted or highly intelligent person is capable of generating creative ideas and insights. Yet the real barriers to creative thinking are sometimes the inadvertent 'killer phrases' we use in our communications. People may not intentionally stop a creative idea, but simple negative phrases such as 'that won't work' or 'we've tried that before' or 'get real!' prohibit people from thinking any further. Figure 5.2 lists 15 top 'idea stoppers' in the English language. Repeated negative phrases prohibit people from thinking any further. Moreover, if you give a task requiring creativity to those ill-equipped with the knowledge or skills; restrict their autonomy; constrain their resources too tightly; create teams that think too much alike; punish failure rather than value the learning opportunity; and generally fail to provide support, creativity will be the casualty every time.[11]

Creativity is not some mysterious and rare talent reserved for a select few. It is a distinct way of looking at the world that is often illogical. The creative process involves seeing relationships among things others have not seen (for example, imagine being the first person to discover the potential for using USB (Universal Serial Bus) sticks to transfer data between computers).[12]

DEVELOPING YOUR CREATIVITY

You can do several things to improve your own creative talents. Becoming aware of some of the habits and mental blocks that stifle your creativity is one of the most helpful.[13] Of course, as with most processes, your development will be more effective if you regularly practise exercises designed to increase your creative abilities. The following section will help you to improve your awareness of some of the thought habits that limit your creativity and assist you in developing a personalised creativity improvement program.

Lateral thinking

In recent years, creativity researchers have devised specific techniques to 'forcibly' generate novel ideas. Among the best known is the *lateral thinking* approach developed by Edward de Bono. Lateral thinking

FIGURE 5.2 THE MOST COMMON IDEA STOPPERS

- 'Naah.'
- 'Can't.' (said with a shake of the head and an air of finality)
- 'That's the dumbest thing I've ever heard.'
- 'Yeah, but if you did that…' (poses an extreme or unlikely disaster case)
- 'We already tried that – years ago.'
- 'We've done all right so far; why do we need that?'
- 'I don't see anything wrong with the way we're doing it now.'
- 'That doesn't sound too practical.'
- 'We've never done anything like that before.'
- 'Let's get back to reality.'
- 'We've got deadlines to meet – we don't have time to consider that.'
- 'It's not in the budget.'
- 'Are you kidding?'
- 'Let's not go off on a tangent.'
- 'Where do you get these weird ideas?'

Source: Adapted from Biondi, A. M. (Ed.) (1986). *The creative process*. The Creative Education Foundation.

is concerned with the generation of new ideas. It is also concerned with 'breaking out of the concept prisons of old ideas'.[14] Lateral thinking is not a substitute for vertical thinking (in a logical sequential manner). Both are required – they are complementary: lateral thinking is generative, vertical thinking is selective. For instance, during brainstorming meetings, you encourage lateral thinking throughout the first session to generate as many creative solutions as possible and vertical thinking during the second session to select the feasible ideas.

In traditional vertical thinking (logic or mathematics), you move forward by sequential steps, each of which must be justified. You select out of only what is relevant. You must be right at each stage in order to achieve a correct solution.[15]

In lateral thinking, you may deliberately seek out *irrelevant* information – you use information not for its own sake but for its effect. You may have to be wrong at some stage in order to achieve an innovative and correct solution (see Table 5.1).

TABLE 5.1 LATERAL THINKING VERSUS VERTICAL THINKING

LATERAL THINKING	VERTICAL THINKING
Collects	Chooses
Looks for what is different	Looks for what is right
Makes deliberate jumps	One thing must follow directly from another
Welcomes chance intrusions	Concentrates on relevance
Explores the least likely directions	Moves in the most likely directions

The entrepreneur needs both types of thinking so that no new idea will be wasted. The wider the net, the greater the catch. True opportunity spotters identify opportunities laterally (through intuition and gut feeling), but they analyse them vertically (through testing and commercialisation processes).

Recognising relationships

Many inventions and innovations are a result of the inventor seeing new and different relationships among objects, processes, materials, technologies and people.[16] Examples include: (1) biodegradable packaging materials made out of starch; (2) combustion technology plus the wheel to create the automobile; and (3) using a winged keel on an Australian yacht to break the then longest winning streak in modern sports and wrest the America's Cup away from the Americans for the first time in 132 years.

If you wish to improve your creativity it helps to look for different or unorthodox relationships among the elements and people around you. This involves *perceiving* relationally. You can develop this talent by viewing things and people as existing in a complementary or **appositional relationship** with other things and people. Simply stated, things and people exist in the world in relation to other things and people. Creative people seem to be intuitively aware of this phenomenon and have developed a talent for recognising new and different relationships. These relationships often lead to visions that result in new ideas, products and services.[17] In order to develop the ability to recognise new relationships, you must practise perceiving in a relational mode.

appositional relationship
A relationship among things and people existing in the world in relation to other things and other people.

Thinking outside the box

Thinking outside the box is never easy, nor is it merely a reflection of mental brightness. To leave your psychological comfort zone and explore 'solutions in the unknown world on the outside requires large measures of mental agility, boldness and creativity – and/or a leader who makes life in the old box so uncomfortable that getting out is the only option. The future rests in those willing and able to do so'.[18] Here are some tips for challenging assumptions:

- Understand the problem – recognise that you and everyone else have ingrained assumptions about every situation.
- Play a child – ask plenty of basic 'why?' and 'why not?' questions in order to discover and challenge those assumptions.
- Play an external observer – pretend you are a complete outsider and ask questions such as: 'Why do they do it this way at all?'
- Disassemble the problem – reduce a situation to its simplest components in order to take it out of your environment.
- Reframe – consider an issue from many different angles; restate a problem in different terms.
- Consider what the experts and professionals advise and then consider doing the opposite.[19]

Using your brains – plural

Ever since split-brain studies were conducted in the 1950s and 1960s, experts on creativity, innovation and self-development have emphasised the importance of developing the skills associated with both hemispheres of the brain.[20]

The **right brain** hemisphere helps an individual understand analogies, imagine things and synthesise information. The **left brain** hemisphere helps the person analyse, verbalise and use rational approaches to problem solving. Although the two brain hemispheres (right and left) process information differently and are responsible for different brain activities and skills (see Table 5.2), they are integrated through a group of connecting nerve fibres called the *corpus callosum*. Because of this connection and the nature of the relationship between the activities of each hemisphere, each hemisphere should be viewed as existing and functioning in a complementary relationship with the other hemisphere.[21]

right brain
The part of the brain that helps an individual understand analogies, imagine things and synthesise information. (See also *left brain*.)

left brain
The part of the brain that helps an individual to analyse, verbalise and use rational approaches to problem solving. (See also *right brain*.)

TABLE 5.2 PROCESSES ASSOCIATED WITH THE TWO BRAIN HEMISPHERES

LEFT HEMISPHERE	RIGHT HEMISPHERE
Verbal	Non-verbal
Analytical	Synthesising
Abstract	Seeing analogies
Rational	Non-rational
Logical	Spatial
Linear	Intuitive
Prescriptive	Imaginative

Source: Edwards, B. (1979). *Drawing on the right side of the brain*. Los Angeles: Tarcher.

The creative process involves logical and analytical thinking in the knowledge accumulation, evaluation and implementation stages. In addition, it calls for imagination, intuition, analogy conceptualisation and synthesising in the incubation and idea-creation stages. So to become more creative it is necessary to practise and develop both right- and left-hemisphere skills. See Table 5.3 for ways to develop left- and right-hemisphere brain skills.

TABLE 5.3 WAYS TO DEVELOP LEFT- AND RIGHT-HEMISPHERE SKILLS

LEFT-HEMISPHERE SKILLS	RIGHT-HEMISPHERE SKILLS
1 Step-by-step planning of your work and life activities 2 Reading ancient, medieval and scholastic philosophy, legal cases and books on logic 3 Establishing timetables for all of your activities 4 Using and working with a computer program	1 Using metaphors and analogies to describe things and people in your conversations and writing 2 Taking off your watch when you are not working 3 Suspending your initial judgement of ideas, new acquaintances, movies, television programs and so on 4 Recording your hunches, feelings and intuitions and calculating their accuracy 5 Detailed fantasising and visualising of things and situations in the future 6 Drawing faces, caricatures and landscapes

Eliminating muddling mindsets

A number of mental habits block or impede creative thinking. It has been estimated that adults use only 2 to 10 per cent of their creative potential.[22] People tend to be judgemental too quickly about new things, people and ideas. Another inclination is to point out the negative components of a new or different idea because of the psychological discomfort associated with change. Some common mental habits that inhibit creativity and innovation are either/or thinking, security hunting, stereotyping and probability thinking. These habits, or **muddling mindsets**, tend to muddle creative thought processes, which requires different thought processes to be used to enhance creative thinking.[23]

- **Either/or thinking**: Because of the speed of change in the modern world, personal lives are filled with a great deal of uncertainty and ambiguity. People often get bogged down with striving for an unreasonable amount of certainty in their lives. But the creative person learns to accept a reasonable amount of ambiguity in their work and life. In fact, many exceptionally creative people thrive in an uncertain environment and find it exhilarating.[24]
- **Security hunting**: Many people try to make the right decision or take the correct action every time. In doing so, they rely on averages, stereotypes and probability theory to minimise their risks. Although this strategy often is appropriate, at times a creator or innovator must take some calculated risks.[25] Sometimes this means being wrong and making mistakes. Yet by recognising this as part of the innovative game, the creative person learns from their mistakes and moves on to create bigger and better things. We all know Thomas Edison failed many times when searching for the correct materials to use inside the incandescent light bulb.
- **Stereotyping**: It is ironic that although averages and stereotypes are abstractions that people fabricate, people act and make decisions as if these existed the real world. For example, one could hypothesise that the average homemaker is female, 38 years old and 160 cm tall, weighs 55 kg, and has two children, a part-time job, and 14.5 years of formal education. But it would be hard to find a person who fits this precise description. In short, the more descriptive the abstraction or stereotype, the less realistic it becomes. Predicating actions on stereotypes and averages can cause an individual to act on the basis of a distorted picture of reality. More importantly, relying on these abstractions can limit a person's perception of the real entities and possibilities in the world. Edward de Bono argues that people must alter their thinking to enhance their creativity. Only new patterns of thinking will lead to new ideas and innovations.[26]
- **Probability thinking**: In their struggle to achieve security, many people also tend to rely on probability theory to make decisions. Overrelying on the 'odds' can distort reality and stop you from taking calculated risks that may lead to creative endeavours. Probability experts say that the power of probability theory increases in proportion to the number of times an event is repeated. If a person wishes to predict the probability of tossing the number 3 when rolling a die a certain number of times, probability theory is extremely useful. However, if the person wishes to know the likelihood of rolling a 4 with one roll of the dice, the predictive ability of probability theory is much less valuable.

In the game of creativitiy, often you are looking for a once-in-a-lifetime opportunity. In a single-event situation, intuition and educated guesses are just as useful, if not more useful, than logic and probability.[27] One way of increasing your creative capacities is to practise looking at some of the situations in your life as a 50/50 game and then begin to take some risks. Additionally, the following problem-solving exercises are designed to help eliminate muddling mindsets.

muddling mindsets
Habits such as either/or thinking, security hunting, stereotyping and probability thinking that block or impede creative thinking.

either/or thinking
A way of thinking that supposes there are only two possible positions that establish clear and stark choices. Either/or thinking denies further possibilities and closes down the opportunity to perceive other alternatives.

security hunting
Persistence to eliminate risk. A common mental habit that inhibits creativity and innovation by hindering creative thought processes.

stereotyping
Applying a description to a person based on generalised population norms and observations without a genuine basis for doing so.

probability thinking
A reliance on probability to make decisions in the struggle to achieve security.

- Practise taking small risks in your personal life and at work, relying on your intuition and hunches. Keep a log of these risks and chart their accuracy and consequences. For example, next time you're in the supermarket pick up a product you would not regularly buy just to try. In a news agency, bookstore or library go to a section that is foreign to you to locate material you would not normally read.
- Go out of your way to talk to people whom you think conform to a commonly accepted stereotype.
- Take on complex projects at work and at home that do not lend themselves to guaranteed and predictable results. Allow yourself to live with a manageable amount of ambiguity. Notice how you react to this ambiguity.
- When an idea is presented to you, first think of all the positive aspects of the idea, then of all the negative aspects and, finally, of all the interesting aspects of the idea.
- When listening to people, suspend initial judgement of them, their ideas and their information, and simply listen.
- Try making some decisions in the present. That is, do not let your personal history or your estimates about the future dominate your decision-making process.[28]

THEORIES AND SOURCES OF OPPORTUNITY

In this chapter, we dive into how to identify and assess an idea, one that 'has legs', one that 'will fly', one that is commercial and high-impact. Then we learn how to create a 'value proposition' of our opportunity.

Opportunity is so fundamental to entrepreneurship that for centuries understanding it has been one of the primary preoccupations of our research. In the present era, there are four theories that most contribute to our understanding of how entrepreneurs identify opportunities. Cantillon's entrepreneur identified opportunities as market discrepancies seeking a new point of equilibrium.[29] Schumpeter's entrepreneur disrupted existing markets and created new ones.[30] Kirzner placed emphasis on the entrepreneur's alertness to opportunities that are 'out there' waiting to be discovered.[31] Attention has also focused on social opportunities, different from economic opportunities, seeking to satisfy needs not satisfied by the market.[32] In the end, identifying and shaping opportunity is so central to what we entrepreneurs do that Shane and Venkataraman define the very field of entrepreneurship as 'how, by whom and with what effects opportunities to create future goods and services … [are] discovered, evaluated and exploited'.[33] Many quip that entrepreneurs 'never waste a good crisis' because they recognise opportunities where others see chaos or confusion.[34]

Understanding the **opportunity identification** process is one of the primary preoccupations of entrepreneurship research today.[35] 'At its core entrepreneurship revolves around the questions of why, when and how opportunities for the creation of goods and services in the future arise in an economy', and understanding this is one of the key competencies in being an entrepreneur.[36]

opportunity identification The recognition of a viable business opportunity within a variety of good ideas.

Opportunity-sensing entrepreneurs have an uncanny knack for avoiding misleading information that might derail the focus of others.[37] Entrepreneurs tend to have a capacity to assess uncertainty and to figure out what is relevant and what is not.[38] Others have emphasised personality traits, social networks and prior knowledge or availability of resources.[39] Many models depict opportunity identification as a staged process[40] or see opportunity identification as a special case of the same elements of the creative process that were first introduced by Wallas back in 1926: preparation, incubation, insight, and evaluation.[41]

ENTREPRENEURIAL EDGE

WHAT ABOUT SOCIAL START-UPS AND NON-PROFITS?

Opportunity identification is not just for business entrepreneurs. Social entrepreneurs with a mission to solve a social problem can use the method equally well. When you see the word 'value', think of social value. When you see the customer's 'pain', think of the frustration and inequities. When you see 'product', think of your innovative social service. The only thing that is different between social and business entrepreneurs when identifying opportunities is how they allocate added value. In a social enterprise, you do not put the value in your own pocket, you distribute it for the community's good. Social entrepreneurs' revenue model may also be different: You may depend more on donations or fundraising. Many social businesses also have for-profit arms, which means they are hybrid businesses. Like all entrepreneurs, you will be carrying out experiments, the difference being that your measurements will focus more on impacts.[42] Social entrepreneurs have a 'mission' in the sense that they have social, economic, earth-friendly or even political goals. Not that commercial businesses can't have a mission: Many entrepreneurial ventures are hybrid social/economic enterprises. In either case, both social and business start-ups face the same types of uncertainties, including technical, market, resource and organisational ambiguities.

What is an **entrepreneurial opportunity**? Opportunity arises more through creativity and intuition than from scientific analysis. An entrepreneurial opportunity occurs when an entrepreneur recognises and validates the potential of a product and/or service that solves a real-world **pain**, or adds value for a customer. The best opportunities are ones that solve the problems of everyday life. What 'pain' does a customer experience regularly? How do they solve that 'pain' now? Does your product or service solve that 'pain' better than the competitors? Bottom line: If your bright idea solves a pain or adds value, then it is potentially a highly attractive entrepreneurial opportunity.[43]

Research shows several firm conclusions. People generally find more opportunities in industries with which they are familiar.[44] Familiarity with an industry boosts confidence, which is also a predictor of moving into business start-up.[45] Interestingly, there seems to be a correlation between opportunity recognition and having 'weak ties' to some sectors. Strong ties are like your friends and family. Weak ties are your acquaintances, business colleagues, association members. People with weak ties to an industry tend to recognise more opportunities than those who do not.[46] Recognising opportunities can be serendipitous or can be planned.[47] Ajzen sees opportunity identification as planned behaviour, an intentional process responding to certain on-the-ground conditions, such as discovering an intriguing market niche.[48]

Do entrepreneurs see opportunity where other people see chaos? Yes, indeed, according to Sarasvathy's famous **effectuation theory**. The verb 'to effectuate', rarely heard outside of entrepreneurship, means to implement, create or cause something to happen using practical tools of change. For example, 'City Council decided to effectuate a more practical approach to homelessness'. When we talk about entrepreneurs, effectuation is a scientific habit of mind that helps entrepreneurs identify opportunities. The theory is most associated with Saras Sarasvathy, who set out to understand how 'expert entrepreneurs' think.[49] Her conclusion was that these masters depended on what she called 'effectual logic'. Great entrepreneurs do not use 'causal reasoning' like most corporate managers do. Instead, they 'roll with the punches' and make decisions 'on the fly' in response to life's 'contingencies'.

entrepreneurial opportunity
An opportunity for the creation of a new venture that can attain an identified and superior competitive advantage and provide a profitable return to its investors.

pain
The problem that you actually solve by your venture, that satisfies the needs, fears and desires of the consumer. A 'painkiller' solves the pain that the customer experiences. (See also *PITA products*.)

effectuation theory
A theory that explains how entrepreneurs identify opportunities. Great entrepreneurs do not use 'causal reasoning' like corporate managers do. Instead, they 'effectual logic' and make decisions in response to 'contingencies'. Entrepreneurs focus on the end and try to find the best means to achieve it. They believe, 'If I can predict the future, I can control it.'

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Expert entrepreneurs are always responding to but also modifying the conditions they encounter to favour their own goals. Here are five guiding principles of effectuation theory:

- While corporate managers go into the kitchen with a firm decision to make *coq au vin* for their guests, entrepreneurs look what's in the refrigerator and choose from the motley ingredients to whip up something with imagination but also with expediency. This is called the **bird-in-hand principle**. Beyond what they have, they also are aware of who they are, what they know and especially whom they know. For 'bird-in-handers', know-who is as mighty as know-how'. They do not immediately go to the bank or venture capitalist; they bootstrap (see Bootstrapping and minipreneurship, p. 114) with what they have available, especially from their four Fs: family, friends, other founders and other 'foolhardy investors'.
- From lemons, entrepreneurs make lemonade. This is called the **lemonade principle**. When faced with chaos, the expert entrepreneur sees opportunity. They embrace surprises and remain flexible. They do not make countless 'what-if' scenarios to deal with rare but possible catastrophes. They welcome bad news as market information.
- Entrepreneurs work under the **affordable loss principle**. Rather than getting starry eyed about possible profits, they focus on how they can minimise possible losses. They make risk calculations by understanding what they can afford to lose, instead of seeking all-or-nothing opportunities. In other words, they ask 'Is the downside acceptable' under the circumstances?
- The **patchwork quilt principle** means that entrepreneurs patch together collaborators they can trust. They get pre-commitments early on in order to reduce uncertainty. Pre-orders can limit the affordable loss. They get a trusted supplier to give them longer credit terms. They tap into informal networks of knowledge and expertise.
- The **pilot-in-the-plane principle** brings it all together. Entrepreneurs focus on activities only within their control. They believe their actions will result in the desired outcomes. An effectual mindset is rooted in the belief that the future is neither found nor predicted, but rather purposefully constructed.

bird-in-hand principle
From effectuation theory, this principle comes from the proverb 'a bird in the hand is worth two in the bush'. It means entrepreneurs look first at what they have and whom they know, especially from their four Fs: family, friends, other founders and other foolhardy investors.

lemonade principle
From effectuation theory, refers to the proverbial phrase 'When life gives you lemons, make lemonade'. It means leveraging contingencies, because surprises generally mean a new need or market can open up.

A second theory that helps us understand opportunity is called **bricolage theory**.[50] Bricolage is to the French what 'DIY' is to English speakers. It means 'making do with whatever is at hand'. It comes from the French verb *bricoler*, 'to tinker'. In our field, it means *recombining* existing (scarce) resources in ways that add value. This is also known as bootstrapping (see Chapter 4). Bricolage entrepreneurs know how to create 'something from nothing' by exploiting resources that others do not know exist or have rejected. This resembles what famous Harvard entrepreneurship professor Howard Stevenson once described as 'the pursuit of opportunity beyond the resources you currently control'.[51] But today it goes beyond Stevenson's maxim because it includes the word 'recombining'.

affordable loss principle
A risk minimisation principle whereby an investment in a project, like a new venture, is limited to what the investor or entrepreneur is willing to lose.

patchwork quilt principle
From effectuation theory, this principle means that, like a quilt made of small pieces sewn together, entrepreneurs love to create something new with their personal patches: 'who I am', 'what I know' and 'whom I know'.

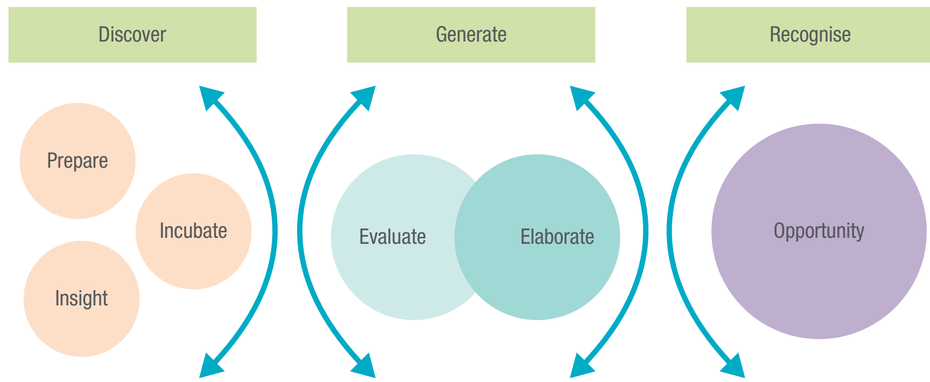
pilot-in-the-plane principle
In effectuation theory, this principle means that although the future cannot be predicted, entrepreneurs are in control, much like a pilot, who can control factors which determine the future course.

HOW CAN WE VISUALLY DEPICT OPPORTUNITY RECOGNITION?

The first step for any entrepreneur is coming up with a bright idea. The search for good opportunities starts with the recognition of ideas that have potential. The most important areas to be aware of are often within the scope of our own knowledge. Let us examine some of the key sources of innovative ideas, which are everywhere and easy to find.

We see them while standing at a bus stop, or while in the shower. But *viable* opportunities are less easy to find. Rarer still are highly viable commercial opportunities. Ideas come relatively easily; identifying an entrepreneurial opportunity, though, raises the bar. Let's see if we can depict it visually.

FIGURE 5.3 THE OPPORTUNITY RECOGNITION PROCESS MODEL



bricolage theory
Theory of entrepreneurship that emphasises making do with whatever is at hand by combining existing (scarce) resources in ways that add value. Bricolage means to 'tinker' or 'do-it-yourself' in French.

eureka moment
The 'aha' moment when your consciousness finally realises that an idea might actually be an opportunity. Attributed to Archimedes, 'eureka' means 'I have found it' and is used to celebrate a discovery.

Many researchers believe that a good model of opportunity recognition would be based in a process of iterations of creative thinking.[52] Csikszentmihalyi, in his famous book *Creativity*, identified five phases in the opportunity recognition process:[53]

- *Phase 1: Preparation* begins with your natural curiosity and your sometimes-unplanned knowledge acquisition and experiences. Something piques your interest and curiosity in particular area of knowledge. This pique might come from your work experience, knowledge of an industry of market, travel, scanning the media, hobbies, social networks or just happenstance.
- *Phase 2: Incubation* is the mental process of beginning to think about the problem and consider solutions. This incubation process often occurs while you are engaged in activities totally unrelated to the subject or problem. It happens even when you are sleeping. As Csikszentmihalyi says, 'ideas churn about below the threshold of consciousness'. This means not in your conscious, problem-solving mode but rather in your subconscious, with an intermingling of unstructured ideas and experiences – a 'simmering' or stewing over a problem.[54] Some of the most helpful steps to start incubation are: (1) engage in routine, 'mindless' activities (cutting the grass, painting the house); (2) exercise regularly; (3) play (sports, board games, puzzles); (4) think about the project or problem before falling asleep; (5) meditate or practise self-hypnosis; and (6) sit back and relax on a regular basis.[55]
- *Phase 3: Insight* is that remarkable 'aha!' moment – a cognitive shift – when your consciousness finally realises (you become 'alert' in the Kirznerian sense) that an idea (which is really a problem plus a solution) might actually be an opportunity.[56] Sometimes referred to as the **eureka moment**, this phase is the one the average person incorrectly perceives as the only component of creativity.[57] As with the incubation process, new and innovative ideas often emerge while you are busy doing something unrelated to the enterprise, venture or investigation (for example, driving on a highway, leafing through a newspaper).[58] Sometimes the idea appears as a bolt out of the blue. In most cases, however, the answer comes to you bit by bit. Slowly but surely, you begin to formulate the solution. Many people are unaware of moving from phase 2 to phase 3. Here are some ways to speed up the idea experience: (1) daydream and fantasise about your project; (2) practise your hobbies; (3) work in a leisurely environment (for example, at home instead of the office); (4) put the problem on the back burner; (5) keep a notebook at your bedside to record late-night or early-morning ideas; and (6) take breaks while working.[59]

- *Phase 4: Evaluation* is where entrepreneurs refine their ideas by testing them with potential customers and in their social networks. In this stage, you ask yourself 'Is this idea so worthwhile that it warrants my efforts?' This is the most difficult step of a creative endeavour and requires a great deal of courage, self-discipline and perseverance. Successful entrepreneurs can identify ideas that are workable and that they have the skills to implement. More important, they do not give up when they run into temporary obstacles.[60]
- *Phase 5: Elaboration* is when that creative insight is finally put into a prototype, or at least a 'minimum viable product' that possible customers can view or read. This is when you rework the ideas into their final form. Some of the most useful suggestions for carrying out this phase are: (1) increase your energy level with proper exercise, diet and rest; (2) educate yourself in the business planning process and all facets of business; (3) test your ideas with knowledgeable people; (4) take notice of your intuitive hunches and feelings; (5) educate yourself in the selling process; (6) learn about organisational policies and practices; (7) seek advice from others (for example, friends, experts); and (8) view the problems you encounter while implementing your ideas as challenges to be overcome.[61]

We can divide these phases into three parts. *Discover* is when you prepare, incubate and have insight. *Generate* is when the solution emerges and you evaluate and elaborate it. These culminate when you can say to yourself with confidence, 'I have recognised an opportunity that I should pursue'. Although the model shows the phases in a linear form (see Figure 5.3), they are sometimes what Hindle calls 'jerky' processes.[62] If you encounter a major problem while moving through the phases, it is sometimes helpful to go back to a previous phase and try again. Entrepreneurs allow the unconscious mind to begin anew the processing of the data, establishing cause-effect relationships and formulating potential solutions.

ENTREPRENEURSHIP IN PRACTICE

SOLVING THE WORLD'S WICKED PROBLEMS

A wicked problem is an economic, environmental, social or political problem that is difficult or impossible to solve. *World Hacks* is a BBC programme that takes on wicked problems and looks at how they can be solved. In the table below you will see a few of the 'pains' or problems that people have. Brainstorm some solutions to each problem. When you have 2–3 solutions, click on the link and see what really happened. For more information see http://www.bbc.co.uk/programmes/p04d42vf.[63]

PROBLEM	SOLUTION
Cutting cow farts to combat climate change	Methane emissions from the burps and farts of livestock account for around 15 per cent of global greenhouse gas emissions. By using very simple techniques to transform the way they manage their soil and animals, dairy farmers are helping their cows emit less methane per litre of milk they produce. And it's all being paid for by big polluters. http://www.bbc.co.uk/programmes/p058bypc

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PROBLEM	SOLUTION
Respect my remittances	Remittances are the billions of dollars sent home every year by overseas migrant workers. But far from home, many workers fear their families are not spending their money in the right way. What are some solutions for giving overseas earners more control over how their hard-earned cash is being used? http://www.bbc.co.uk/programmes/p04knmlw
Turning goats into water	Fariel is an energy consultant from the US. When she returned for a visit to her village in Pakistan, she saw the pain that the women have to go a long distance to get water. They lack cash to pump the water below the village and to pay for the electricity. There was no cash and no water, but they had heaps of goats. How could the villagers turn the goats into water? https://youtu.be/d0zA3n4XzK8 and http://www.bbc.co.uk/programmes/p052cpx5
Solving the food waste problem	Selina's pain is food waste. Between a third and a half of the world's food is thrown away and ends up in landfill, producing dangerous greenhouse gases that contribute to climate change. Selina has become Denmark's food waste vigilante. Her solution has to do with how supermarkets sell food in the first place. What was her solution? http://www.bbc.co.uk/programmes/p04t9ps4
Lend me your eyes: How smartphones became sight for the blind	Imagine how bad Irma felt when she couldn't even read her pregnancy test because she is blind. A smart entrepreneur has come up with a crowdsourcing technique to allow blind people to 'see'. How could he help blind people solve everyday problems by combining smartphone video technology and an army of micro-volunteers? http://www.bbc.co.uk/programmes/p04rsmmr and http://www.bbc.co.uk/programmes/p04tq5w2
How movie theatres could welcome noisy audiences	Imagine the pain of people with Tourette's syndrome in going to the movies. They have involuntary tics such as coughing, fidgeting, throat clearing, sniffing and yelling. Performer and activist Jess Thom believes theatres should be more welcoming of people who do not follow the regular rules of theatre etiquette. How did she create a 'Relaxed Venue' to attract audiences with the support of theatre owners? http://www.bbc.co.uk/programmes/p04ktkbq
Crowdsourcing ambulances	In a life-threatening situation, the first urge is to call an ambulance. What if your country does not have enough or any ambulances in poor communities? How could mobile phones together with crowdsourced volunteers create a medical emergency network in isolated communities? http://www.bbc.co.uk/programmes/p051pnk5 and http://www.bbc.com/news/av/magazine-39749903/uber-for-ambulances-a-new-type-of-emergency-rescue
Potholes and plastics	It all started in Toby's daughter's primary school when the teacher asked what lives in the oceans. The daughter said, 'Plastics, miss.' So Dad, whose daily commute included huge potholes, started thinking, How could we solve two of the world's worst problems in one stroke? The poor quality of roads we drive on and the waste plastic epidemic. http://www.bbc.co.uk/programmes/p050z42h

WHEN IS AN IDEA NOT AN OPPORTUNITY?

One of the most important questions an entrepreneur should ask is: Is it an opportunity or just a (mere) idea? Some say, 'ideas are a dime a dozen'. So the challenge becomes how to screen ideas to find the best opportunities. Everyone has a story about how they had an idea that someone else later turned into a million dollar operation. Assessing whether an idea is a potential entrepreneurial opportunity is the first key area of analysis in the new-venture process. This stage of moving an idea to reality can be the most critical for understanding new-venture development. But the mind can be muddled by biases and pitfalls.

BIASES AND PITFALLS IN OPPORTUNITY RECOGNITION

We can easily deceive ourselves about opportunities. All of us have inherent biases, and sometimes these can be hard to recognise. We cannot eliminate these inherent biases, but we can lessen the impact of this wrong thinking if we know what to look for. Here are some of the biases, fallacies and pitfalls that affect our ability to recognise whether an opportunity is viable.

- **Confirmation bias**: Confirmation bias is an in-vogue term these days because – through the proliferation of social media – people now are more likely to look for news that validates rather than challenges their beliefs. For example, Facebook users are more likely to get news that fits their political beliefs.[64] If we do not seek out contrary evidence, our decision making will be biased. We could end up with 'false positives', where our results incorrectly predict success, for example by sampling only our Facebook friends, who want us to succeed. To minimise this, be sure to interview sceptics and naysayers.
- **Optimism bias**: Optimistic people play a disproportionate role in shaping our lives. Entrepreneurs can be relentlessly optimistic and can underestimate the likelihood of negative factors impacting their projects. Some say that Apple's Steve Jobs was able to literally mesmerise his customers through charisma and rhetoric. Related to this is the 'bright side of everything' bias, whereby, in the interest of sociability and wellbeing, entrepreneurs highlight the upside of their project to the exclusion of critical thinking.
- **Hindsight bias**: Everyone knows that many new businesses will fail. In one study of 700 entrepreneurs, the average entrepreneur predicted a 77 per cent chance of success. In the end, the 40 per cent who failed were asked in retrospect what they thought their chances were before they started. This time they said only 59 per cent. The hindsight bias was almost 20 per cent. With hindsight, their estimate became more realistic.[65]
- **Planning fallacy**: The planning fallacy is a bias toward underestimating the duration, costs and risks of a venture. This means it takes much longer than the founder predicted to penetrate the market. For example, the Sydney Opera House opened 10 years after the expected date. The original cost was estimated at $7 million, but its delayed completion led to a cost of $102 million.
- **Sunk cost fallacy**: Ambitious entrepreneurs, when they confront the inevitable, sometimes say 'Why waste all this work? We should just persevere'. The flaw here is that a rational entrepreneur should focus on future benefits and costs, not already-sunk costs. The sunk cost fallacy is that we are all psychologically averse to losses, and find it hard to drop a course of action.[66]
- *Managerial short-sightedness pitfall*: Many entrepreneurs do not realise the importance of developing a marketing approach in laying the foundation for a new venture.[67] They do not understand the life cycle that must be considered when introducing a new product or service. No product is instantaneously profitable, nor does its success endure indefinitely. Entrepreneurs must not only forecast the life cycle of the new product, but also recognise that introducing the product at the right time is important to its success.

confirmation bias
The human tendency to interpret new evidence as confirming existing beliefs, especially true for exciting entrepreneurial ideas.

optimism bias
When you think you are less likely to experience a negative event compared to others, for example, smokers who think they are less likely to contract lung cancer than other smokers.

hindsight bias
Also known as the 'knew-it-all-along effect', refers to entrepreneurs' increasingly realistic estimate of their own success with the benefit of hindsight.

planning fallacy
A cognitive bias whereby entrepreneurs tend to underestimate the duration, costs and risks associated with a venture.

sunk cost fallacy
A cognitive bias reflecting the misgivings one has to waste resources. Also called loss aversion.

- *Technical understanding pitfall*: Failure to anticipate the technical difficulties with developing or producing a product can sink a new venture. Entrepreneurs cannot be too thorough when studying the project before initiating it. Encountering unexpected technical difficulties frequently poses time-consuming and costly problems.
- *Financial understanding pitfall*: A common difficulty is an overly optimistic estimate of how little it will cost to fund a project to completion. Quite often, entrepreneurs underestimate development costs by wide margins.
- *Uniqueness pitfall*: A new venture should be unique. Uniqueness is found in the special characteristics and design concepts that should draw the customer to the venture and should provide performance or service superior to competitors' or alternate offerings. A product that is unique in a significant way can gain the advantage of differentiation. However, an entrepreneur's optimism for a product or service can obscure judgement on whether there is a real distinctiveness and customer appreciable differentiation.
- *Legal/regulatory pitfall*: When legal and regulatory issues are overlooked, major problems can result. Employees must have a safe workplace. Products and services must be safe and reliable. Patents, trademarks and copyrights are needed to protect inventions and products.
- *Lack of industry knowledge pitfall*: Understanding the dynamics of the industry you wish to enter with a new venture is paramount for assessing the opportunity. Not being aware of the issues of control and power within an industry value chain may mean that, even with a great product that customers or end users are willing to purchase and pay for, a business can fail because of the entrenched competitors, the power of suppliers, unreliable distributors or other forces. You will need to learn how to stay out of harm's way, stay under the competitors' radar or just file the idea away in the drawer. It may not be a long-term profitable opportunity.

SOURCES OF OPPORTUNITY

Entrepreneurs, ever alert to opportunities that inhabit the environments around them, often spot potential opportunities that others simply cannot recognise. Where do they find inspiration? All of the following places:

1 *Trends*: Trends signal shifts in the current paradigm (or thinking) of the major population. Observing trends closely will enable you to position an idea fitting with the trend and recognise a potential opportunity. Following are some examples of such trends:
   a *Societal trends*: aging demographics, health and fitness growth, senior living, social media
   b *Marketplace trends*: ability to buy anywhere, anytime on any device; decreased delivery costs regardless of distance; rise of the digital store with no bricks and mortar
   c *Technology trends*: smartphone technology, e-commerce, internet advances, drones, miniaturisation, optical systems, fibre optics and lasers, micro-electric mechanics, nanotechnology, wireless, mixed reality
   d *Economic trends*: higher disposable income, dual wage-earner families, performance pressures, rising fuel costs, import tariff imposts or retraction
   e *Political trends*: increased regulations, terrorism, sovereign debt, military alliances, free-trade agreements, community governance
   f *Environmental trends*: global warming, drought, increased severity of storms, increased frequency of bushfires, pollution, rise of a new generation of conscious consumers

2 *Unexpected occurrences*: These are your successes or failures that, because they were unanticipated or unplanned, often end up proving to be a major, innovative surprise to you. For example, Alexander Fleming was surprised to note that a contamination of a bacterial plate culture suppressed the growth of his bacteria. He identified the contamination as penicillin mould. Later, Australian scientist Howard Florey drew on Fleming's observation to create the industrial-scale manufacture of penicillin.[68]

3 *Incongruities*: Drucker described an incongruity as a discrepancy, a dissonance, between what is and what 'ought' to be, or between what is and what everybody assumes it to be. One example is the container ship. In the 1950s, everyone thought the ocean freight industry was dying due to slow and inefficient ships, too many crew members and so on. Famous shipping container-preneur Malcolm McLean saw what others missed: Major costs were borne while the ship was idle in port, awaiting unloading and loading of cargo. His great innovation was that the cargo container should roll on and off the vessel, just like (his other invention) moving a patient from a stretcher to a hospital bed with the minimum of discomfort.[69]

4 *Process needs*: These occur when an answer to a particular need is required, for example, to address process gaps or bottlenecks. Entrepreneurs often refer to these as '**consumer pains**' that exists in the marketplace. The entrepreneur must recognise an innovation solution, or 'painkiller'. Examples include the creation of new medical devices, health foods, pharmaceuticals, timesaving devices and eco-sustainable green manufacturing.

consumer pain
See *pain*.

5 *Industry and market changes*: Continual shifts in the marketplace occur, caused by developments such as shifting consumer attitudes, advancements in technology, industry growth and the like. Industries and markets are always undergoing changes in structure, design or definition. An example is found in the healthcare industry, where hospital care has undergone radical change and where home healthcare and preventive medicine have replaced hospitalisation and surgery as primary focus areas. The entrepreneur needs to be aware of and seize these emerging opportunities.

6 *Demographic changes*: These arise from trend changes in population, education, income, age, occupation, geographic location and similar factors. Demographic shifts are important and often provide new entrepreneurial opportunities. Global migration has caused 'distributed families' in various countries under different cultural norms. Populations are concentrated in cities. Age bands are shifting.

7 *Perceptual changes*: These changes occur in people's interpretation of facts and concepts. They are intangible yet meaningful. Perception can cause major shifts in ideas to take place. For example, the increasingly popular perceived need to be healthy and physically fit has created a demand for both health foods and health facilities. This has led to a new consumer segment, **Lifestyles of Health and Sustainability (LOHAS)**, encompassing people who seek sustainable living and 'green' ecological initiatives, which is generally a relatively upscale and well-educated population segment.

lifestyles of health and sustainability (LOHAS)
An upscale demographic category of consumers who value sustainable living, organic foods, alternative healthcare, renewable energy and energy-efficient cars and appliances.

8 *Knowledge-based concepts*: These are the basis for the creation or development of something brand new. Inventions are knowledge-based; they are the product of new thinking, new methods and new knowledge. Such innovations often require the longest time period between initiation and market implementation because of the need for testing and modification. For example, today's smartphone technology has advanced to transform the mobile phone into a camera, internet access resource and music provider. This has revolutionised the way we use different technologies today. These concepts were not thought possible 10 or so years ago.

Some examples of innovations that have emerged from the sources of ideas are presented in Table 5.4.

TABLE 5.4 SOURCES OF INNOVATION

SOURCE	EXAMPLES
Unexpected occurrences	Viagra; Apple Computer; Klingon language from Star Trek; penicillin; WikiLeaks
Incongruities	Overnight package delivery; PlayStation; steel mini-mills; roll-on, roll-off container shipping
Process needs	Sugar-free products; caffeine-free coffee; microwave ovens; nicotine patches
Industry and market changes	Demise of the shopping mall – rise of ecommerce; telecommuting/ flexible hours
Demographic changes	Baby boomers in the healthcare industry; retirement communities; increase in city living; ethnic communities; home ownership patterns
Perceptual changes	Growing concern for fitness and body image; same sex marriage; fake news; environmental protection; new ways of viewing beauty
Knowledge-based concepts	Smartphone technology; pharmaceuticals; robotics and drones

ENTREPRENEURIAL EDGE

INNOVATIONS THAT CAN CHANGE THE PLANET

Could climate change be the first wicked, irreversible problem that entrepreneurs can never solve? Enterprising people have created solutions to many other problems in the past. We can protect against chemical and nuclear accidents, the spread of disease, depletion of resources, and disasters and pandemics. Today even species extinction seems correctable through emerging gene technology. Climate scientists are sceptical, though; they are increasingly convinced that runaway climate change might defy this history of positive innovation.

We have talked about the basic sources of innovation (see Table 5.4). In essence, extension, duplication and synthesis come from technologies that we already have. The history of technology is one story after another of inventions getting smaller, smarter and cheaper. It comes from making little improvements on existing technology.

Innovation is not an incremental process. Sometimes there are breakthrough innovations. Good examples are wind and solar technologies that are already cost-effective. Yet amazingly, we still haven't seen the commercial introduction of hydrogen fuel cells 160 years after they were invented. As Friedman says:

> . . . that is why we need to be constantly trying to invent new forms of abundant, clean, reliable and cheap electrons and constantly trying to make the technologies that already exist today for producing clean electrons – solar photovoltaic, wind, solar thermal and geothermal – more abundant, reliable and cheap.[70]

downcycling
Recycling of a material into a material of lesser quality.

upcycling
Reusing a waste material in a way that increases its value.

Here's an example of how entrepreneurs are taking advantage of this trend. We all know **downcycling**, which transforms waste materials into lower uses. The obvious example is the recycling of plastics, which turns them into lower-grade plastics without regard to the huge energy losses that were incurred in their production. **Upcycling** entrepreneurs do just the reverse. They use waste materials to provide new, higher-valued products.[71] We discussed examples of upcycling in Chapter 3, such as using wooden pallets to make designer furniture and converting waste into art, edible chopsticks and compostable shoes. In Table 5.5 we examine the candidates for top sustainable innovations for the coming century.

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TABLE 5.5 INNOVATIONS THAT CAUSED AND CAN SOLVE GLOBAL WARMING

TOP 20TH CENTURY INNOVATIONS THAT CAUSED GLOBAL WARMING	CANDIDATES FOR TOP SUSTAINABLE 21ST CENTURY INNOVATIONS
Electrification; automobile; aeroplane; water supply and distribution; agricultural mechanisation; air conditioning and refrigeration; highways; household appliances; petroleum and petrochemical technologies; nuclear technologies.	Graphene sieve could make seawater drinkable; a drone that pollinates trees; a plant-based 'plastic' that doesn't pollute; an aeroplane that emits only water vapour; genetic engineering; artificial trees; species preservation; geo-engineering; carbon sequestration; free non-fossil-fuel power systems; gene sequencing; hydrogen-powered cars; methane-fuelled rockets; smog-eating cement; waste management; weather prediction.

Sources: Adapted from National Academy of Engineering (2018). Greatest engineering achievements of the twentieth century. http://www.greatachievements.org; Abraham, J., Vasu, K. S., Williams, C. D., Gopinadhan, K., Su, Y., Cherian, C. T., Dix, J., et al. (2017). Tunable sieving of ions using graphene oxide membranes. *Nature Nanotechnology*, 12(6), 546–50. doi:10.1038/nnano.2017.21; Chechetka, S. A., Yu, Y., Tange, M., and Miyako, E. (2017). Materially engineered artificial pollinators. *Chem*, 2(2), 224–39. doi:10.1016/j.chempr.2017.01.008; Escobedo, T. (2017). 5 cool inventions that could save the planet. *CNN*. http://www.cnn.com/2017/05/11/tech/ecosolutions-5-ways-tech/index.html; Monks, K. (2017). The plastic bag you can drink. *CNN*. http://www.cnn.com/2017/01/16/world/cassava-plastic/index.html; Morlin-Yron, S. (2016). The plane that emits only water. *CNN*. http://www.cnn.com/2016/10/19/world/hy4-fuel-cell-plane/index.html; Prisco, J. (2017). Researchers use drone to pollinate flower. *CNN*. http://www.cnn.com/2017/03/09/world/artificial-pollinator-japan/index.html; Said-Moorhouse, L. (2017). Graphene sieve could make seawater drinkable. *CNN*. http://www.cnn.com/2017/04/04/health/graphene-sieve-drinkable-seawater/index.html.

MAPPING OUT YOUR VALUE PROPOSITION

We have examined the concept of opportunity from a conceptual level. We now turn to how to map the concrete needs and desires of real people through a value proposition.

Customers rationally evaluate a product's functional benefits against their own needs, but they also evaluate the *emotional value of the product*.[72] This means that as entrepreneurs we need not only to design features and performance attuned to the customer, but we also have to pay attention to individual customers' personality and emotional needs.[73] When we combine the features/performance of our product or service with the customer's pains and emotions, we have the **value proposition**.[74]

Pains + features = value proposition

Like an iceberg, some customer pains and emotions are easy to see; other needs are deep and hidden, or latent. **Explicit needs** and behaviours come from above the waterline on the iceberg, are normally easy to see and hear from clients, and can lead to incremental improvements. However, real innovations often come from understanding **implicit needs** under the waterline of the iceberg, such as thoughts, feelings and emotions. Understanding latent needs leads to unique insights and big new ideas. But to get these, you have to listen to people's stories. Observations and interviews are the key.

DESCRIBING A VALUE PROPOSITION

A value proposition is described as a succinct statement (usually 1–3 sentences) that tells your potential customers what your project's key value-creating features are. Here's a value proposition for a product that combats childhood anaemia (red blood cell deficiency):

> For millions of children worldwide, Sprinkles provides a unique, safe, easy to use, and scientifically-proven food supplement. Distributed through partnerships, low-cost Sprinkles 'sachets' improve the nutritional quality of traditional foods and enhance the health, development, and well-being of children who otherwise would suffer from vitamin and mineral deficiencies.[75]

value proposition
A strategic concept that accounts for the value of a firm's product or service offering to a particular customer or to a market segment. The product or service must provide customer value in terms of one or more of functionality (it must do something the customer needs to be done), emotional considerations (it must make the customer feel good by or about the purchase) or expected ideals or beliefs (it must align with the value system of the customer) for a price the customer is prepared to pay.

explicit needs
Wants or desires specified by a customer. For example, 'I need a new watch to record the data from my elliptical exercise machine.' (See also *implicit needs*.)

implicit needs
Needs that people do not talk about, may not be aware of or might even deny if confronted with. (See also *explicit needs*.)

Based upon the opportunity that *you* have identified, can you fill in some or all of the parts of the following sentence?

We [your business name] provide [offering, product, service] to help [target customer] to solve their problem [customer pain and unmet needs] and achieve their objectives [customer jobs] by [unique customer gain] and [statement of social value/impact], unlike [competitors], who cannot beat our [unbeatable features].

If you cannot yet write this sentence for your own product or service, the exercise 'Experiencing entrepreneurship: Developing your value proposition' will definitely help you.

ENTREPRENEURIAL EDGE

DON DRAPER AND CUSTOMER DISCOVERY

The opening scene of *Mad Men* reveals Don Draper doing customer discovery at a bar, iterating taglines for Gold Cigarettes. He is looking around, focused and observant. He is a student of human behaviour, picking up cues from the people around him.

A waiter approaches and shyly takes Don's drink order. Don gently probes him about his smoking habits, not as a researcher but as an equal. 'Hey, do you have a light? You're a Golds man, Lucky Strike man myself. . .' He smiles. 'Can I ask you a question? When do you smoke Old Gold?' In start-up language, that is proto customer development.[76]

Your value proposition should describe the opportunity, tell why it is important, mention the benefits and describe how to apply it. Use short phrases like: 'Saves you 30 minutes every day', 'Helps you stop smoking so you can live longer', 'Make sure you never miss your favourite TV show', 'Helps you look 10 years younger', 'Lets people know you're stylish and trendy'. Can you recognise the value propositions of some famous products?

1. You will always be able to get a ride home. One tap and a car comes directly to you. Your driver knows exactly where to go. And payment is completely cashless.
2. Keeps the world talking, for free. Share, message and call. Now with group video on mobile and tablet too.
3. World's largest provider of accommodation, owns no real estate.
4. World's largest encyclopaedia, produces no content.[77]

Answers: 1. Uber; 2. Skype; 3. Airbnb; 4. Wikipedia

Here's another way to learn value propositioning. From **Table 5.6**, can you write or recite the value proposition for Budget Airlines and for Nespresso?

TABLE 5.6 VALUE PROPOSITIONS OF BUDGET AIRLINES AND NESPRESSO

BUDGET AIRLINES[78]		NESPRESSO[79]	
VALUE PROPOSITION	**CUSTOMER SEGMENTS**	**VALUE PROPOSITION**	**CUSTOMER SEGMENTS**
Cheap flights No frills	Budget travellers	Nespresso machines Nespresso pods	Households Businesses
REVENUE STEAMS		***REVENUE STEAMS***	
Tickets Fees		Single machine sales Repeated pod sales	

SOURCES OF VALUE

We talk about 'value' propositions, so what are the sources of value for your customer? Obviously, the *features and characteristics* of a product are essential. But other sources of value include the *emotional and social needs* of customers. Here are some of the values that you might build into your product. Which are 'feature value' and which are 'emotional value'?

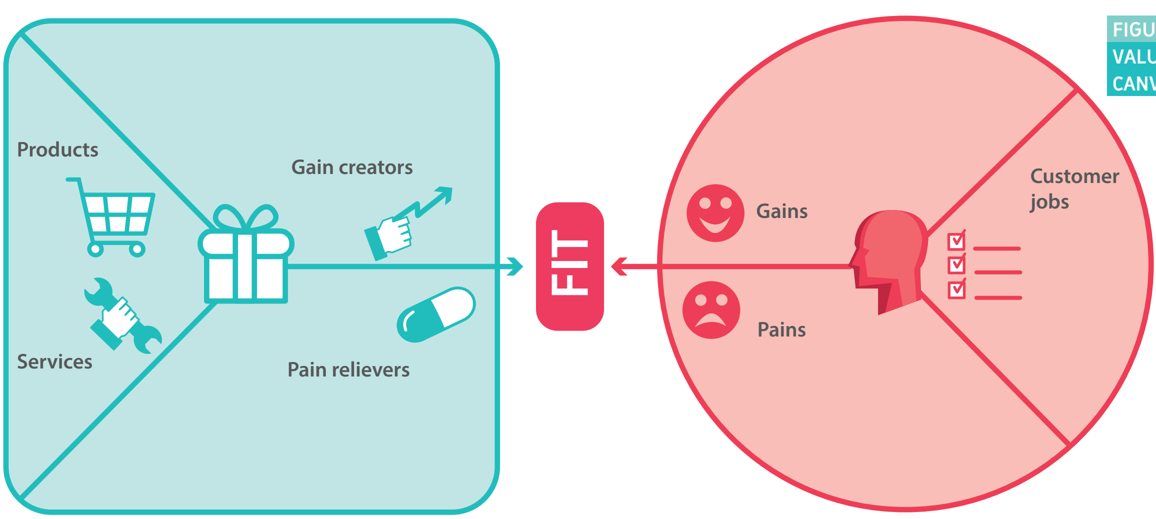
- *Convenience*: Can we offer simple, productive and creative solutions and features?
- *Cost*: Can we offer solutions that reduce costs so that the customer can solve their needs more cheaply?
- *Design*: Can we design products with functional style and superior aesthetics?
- *Experience*: Does our product or service give a distinctive, authentic and memorable experience to the customers?
- *New market segment*: Can we bring in a new market segment that previously could not access our technology or service?
- *Newness*: Will the customer be able to satisfy previously unsolved needs in a new way?
- *Performance*: Can we improve performance and disrupt the market?
- *Personalisation*: Can we customise and individualise our offerings to the customers?
- *Price*: Can we offer solutions of similar value at lower price than our competitors?
- *Risk*: Can our product increase the customer's feelings of security and decrease the risks that they face?
- *Status*: Do our products and services express attractiveness, celebrity and mood?

Features alone do not equal a value proposition. Do not use phrases like: '10× faster (speeds and feeds)', 'colour screen', 'one-click purchase', 'automatic buttons', 'multi-channel recording'. Features are what makes the value proposition possible. But alone, they are insufficient.

HOW YOUR VALUE PROPOSITION CANVAS WORKS

Here is a simple way to understand your customers' pains and needs, and to design products that they actually want. It is called the value proposition canvas (VPC; see Figure 5.4). On the left, you have the

FIGURE 5.4 VALUE PROPOSITION CANVAS



Source: Adapted from Osterwalder, E. (2012). Achieve product-market fit with our brand-new value proposition designer canvas. http://businessmodelalchemist.com/blog/2012/08/achieve-product-market-fit-with-our-brand-new-value-proposition-designer.html.

beautiful wrapped gift that you want the customer to buy – that's your product. On the right, you have the customer whose pain you want to solve.

In the middle, you have the 'fit'. When the features of your product perfectly match the needs of the customer, then you have '**problem-solution fit**'. When the market validates this match, and you get traction with real customers, you have '**product-market fit**'.

problem-solution fit
Correspondence between problem and solution, achieved when you have correctly identified your customers and why they need the product, and found an efficient and feasible way to solve their problem.

product-market fit
Correspondence between product and market, achieved when your early adopters love your product, you start bringing in late adopters and you are expanding the market.

To accomplish this, you have to observe the market and interview the potential customers. What are the 'jobs' the customer needs to do? These are called the **customer jobs**. Think of someone buying an expensive mobile device. Yes, they want to communicate, but are there any social aspects such as how it affects their ego, how they feel when they use it, whether it attracts envy or how often they display it in front of other people? The jobs of this mobile device are more complicated than just messaging and phoning. We need to understand what motivates our customers and to list a hierarchy of jobs they want to resolve. Do they just want to buy? Or do they want to display, co-create, be creative, connect with a community, show off?

customer jobs
What customers are trying to get done, solve or satisfy. May be functional (e.g. perform a task), social (e.g. gain status), emotional (e.g. security) or basic needs (e.g. communication).

Also on the right-hand side, we have to identify the customer's frustrations (pains) and joys (**gains**). What frustrations do they have that make them unhappy? Do current solutions satisfy them or keep them from solving their frustrations, like price or complexity? What about inefficiency, unreliability and fear of losing out? What keeps them awake at night?

gains
The benefits your customer expects, desires or would be surprised by. These can include its functions, social gains, positive emotions and cost savings.

In the same way, what are the positive benefits that our customer wants to achieve or enjoy that are connected to the jobs that we have identified? Do they want to save time or money, or have higher quality or convenience? We also need to examine what alternative solutions they may be using. We have to rank-order customer jobs according to the severity of the frustration or pain that they produce.

On the left side of Figure 5.4 is the actual product and its features. Many entrepreneurs first come up with the product and then look for customers to serve. But in reality we should do just the opposite. Only after identifying the customers' needs should we design the product. First, we identify the pains worth solving, then we see how to solve it. After identifying the customer's pains, then we focus on the features and functionalities that our product/service should cover to solve the customer's problems. If the pain is headache, infectious disease or erectile dysfunction, then we create aspirin, vaccinations or Viagra, respectively. We analyse what aspects of the product or service can help the client be happier, feel better or alleviate some frustration.

Again, you know you have found the perfect product-market fit when the other two elements of the value proposition perfectly correspond. This is when you're ready to write that sentence that perfectly describes the value you want to give the customer.

For more detailed information about how to create your own value proposition, see the 'Experiencing entrepreneurship: Developing your value proposition' exercise later in the chapter.

SUMMARY

This chapter is about opportunity identification.

We examined the importance of creativity to the entrepreneur, especially the role of creative thinking and the nature of the creative process. Especially important are the ways you can develop your own creativity through lateral thinking, recognising relationships, thinking outside the box and other strategies.

Opportunity is a fundamental part of entrepreneurship. There are several models of entrepreneurial opportunity, relying on greats in the field such as Cantillon, Schumpeter and Kirzner. The opportunity recognition process model helps us to see the centrality of opportunity and to understand the iterative nature of problem discovery and solution generation.

Not all ideas are opportunities, and not all opportunities are innovative. The search for good opportunities starts with the recognition of ideas that have potential. We examined sources of innovative ideas that can be used for this search and the models of opportunity to which ideas can be applied. We also explored the identification of ideas that are not opportunities and examined common biases and pitfalls encountered in the process.

The chapter put special focus on value propositions. These are statements that combine the features and performance of a product and service together with the customer's pains and emotions. We can write these statements after we have thoroughly studied the expressed and latent needs of the customers. We also studied the sources of value. Of particular interest is the value proposition canvas (VPC), which allows us to depict our value proposition on one page that outlines the customer segment, the product and the product-market fit.

KEY TERMS & CONCEPTS

affordable loss principle
appositional relationship
bird-in-hand principle
bricolage theory
creative process
creativity
customer jobs
downcycling
effectuation theory
either/or thinking
entrepreneurial opportunity
eureka moment
explicit needs
gains
hindsight bias
implicit needs
left brain
lemonade principle
lifestyles of health and sustainability (LOHAS)
muddling mindsets
opportunity identification
pain
patchwork quilt principle
pilot-in-the-plane principle
planning fallacy
probability thinking
problem-solution fit
product-market fit
right brain
security hunting
stereotyping
sunk cost fallacy
upcycling
value proposition

REVIEW & DISCUSSION QUESTIONS

1. What are some of the steps involved in developing personal creativity?
2. What is opportunity identification? What are some of its distinguishing factors?
3. What is effectuation theory? How does it explain your own personal life goals?
4. What is the connection between bricolage and resources?
5. What are five major phases of entrepreneurial opportunity recognition? Explain and give an example of each.
6. What are some examples of wicked problems in your community?
7. In what ways is the opportunity recognition process model also a feedback loop?
8. Why are ideas not necessarily opportunities? Explain the difference between an idea and an opportunity and how to improve your chance of spotting an idea that could be an opportunity.
9. How would you define a value proposition? Include a discussion of expressed versus latent needs.

10 What are the three major components of a value proposition?
11 Pick an opportunity and name the sources of value in it.
12 Quickly sketch a value proposition.

EXPERIENCING ENTREPRENEURSHIP

Opportunity identification exercise

Your mission, should you choose to accept it: To identify bright ideas for your projects. After reading this chapter, you will use your collective creativity to generate and filter ideas.

To get the juices running, answer each question five times:

- The five things that really annoy me are…
- What this country/city/world needs is a good ______________.
- There's no app for that. I wish I had a ______________ to ______________.
- When I use a ______________, I find ______________ very frustrating.
- ______________ is inefficient/frustrating/makes no sense.

Did you know that ideas have an 80 per cent chance of becoming true if you record them on paper?

Here's the exercise: Take your time, focus, and **write down your top five ideas** that you think would make an excellent business or social project. (No ideas permitted about: healthy fast food, parking, crowded gyms, etc.). Use separate paper.

IMPORTANT: Each of your written ideas **must have two parts: Problem + Solution, like this**. Your top five ideas should look like these examples.

- *Problem*: Our reservoir is contaminated and dangerous. *Solution*: Let's use iris, water hyacinth or lilies to absorb heavy metals; from the plants we can create metal nanoparticles.
- *Problem*: There is bacteria in the food that we eat. *Solution*: Why don't we create a portable tester that can tell you if your food is contaminated by bacteria?
- *Problem*: People in my town can't drink tap water. *Solution*: Why do not we build a filter to help people make water available to anyone and at a lower price?
- *Problem*: Why do I have to pay late fees on rented videos? *Solution*: What if a video rental business were run like a health club?

After you have five ideas, analyse them using the screening criteria below. Give them a score of 0 to 20. Bring your top two ideas to class (or post them online) and be prepared to defend them.

Screening criteria for identified opportunities

CHARACTERISTICS	0 POINTS	20 POINTS	SCORE 0–20
Innovation	The solution already exists and has no advantages.	The solution does not yet exist. Or if it does, it solves the problem in a new and different way?	
Sustainability	Does not solve any economic, social and environmental problems equitably.	Your solution takes into account equitable (fair and just) economic gains, care of the environment, and benefit for society at large? Your product improves the living conditions of some group.	

CHARACTERISTICS	0 POINTS	20 POINTS	SCORE 0–20
Implementation	We cannot see the scope of the solution or how it could be implemented.	We can readily imagine a plan to implement this solution. We can deliver the solution timely and efficiently. The costs be manageable.	
Feasibility	There are no resources to set up the project	We can imagine how to turn this new product/solution into reality. We can demonstrate its feasibility through tools like simulation, pretotype/prototype, real-life testing (read ahead Chapter 7, pp. 221–228).	
Technical knowledge	The team has no technical expertise or ability to quickly acquire it.	Your team understands the technology and have the technical knowledge. You are certain you can overcome the technical challenges to develop the product. There is potential to significantly improve or drastically reduce the price of your new product.	
Market	The team doesn't know the market and lacks the ability to quickly find out.	You can already identify the early adopters. You understand the market drivers, value creation, and business viability for your opportunity. The market is large and healthy. There are customers out there who want you. You can identify new applications for your product/service.	
Resources	We have no resources and we do not know how to acquire them.	You are confident that you can access the needed money, partners and expertise. You know where to get the funding. You have the internal wherewithal to pursue this opportunity. You know where to get help/strategic partners. You have the resources (economic, human, infrastructure) to set it up.	

Source: The authors wish to thank three colleagues for inspiring this exercise: Alex Bruton of The Innographer (http://theinnographer.com/about); Jane Robbins of Bryant University (https://www.linkedin.com/in/jane-robbins-854a8110/); and Sergio Ortiz of Monterrey Institute of Technology (https://www.linkedin.com/in/sergio-ortiz-32b9392/).

EXPERIENCING ENTREPRENEURSHIP

Developing your value proposition

A. Research a big idea

Form teams. Prepare an annotated bibliography of sources of information on your idea. Each team member should contribute 10 resources. Share these with team members so that everyone has read every resource.

B. Observations in the field

Every team member should do three market observations and six field interviews with potential customers. This could be at a shopping centre, on the street, in a park, in class, at home or anywhere! When you are observing, be an 'active observer'. Think like an outsider. Outsiders see things that local people do not see. Observe what triggers a customer to use a product or service. Watch the interaction between the user and the environment. List all the 'pains' that the customer has. See if they have any 'workarounds' (methods that resolve the problem temporarily). Do they have any unexpressed needs (e.g. do they not know they have a problem?). Write a report with some or all of the following components.

- I observed… (Mention the place, and describe the context, experience and type of possible customers you observed)
- I discovered that the customers do not like…
- I discovered that customers prefer…
- I noticed customers waste their time in…
- I discovered that customers have needs that they do not even realise, such as…
- I saw the tremendous 'pains' that customers have in regard to…
- Customers' needs were triggered by…
- Customers worked around their pains by…

C. Interviews

We continue the process of finding out our customers' needs by interviewing actual customers. Ask questions like:

- Our project sees this problem or pain. Do you have the same problem? Does it match your experience?
- Tell me more about your experience. What current solutions do you have?
- Does something like [our solution] solve your pains? (Advice: do not mention all the specific details of your solution, but give them something concrete to respond to.)

Listen to your customers' stories. Try to discover or uncover problems they have 'below the surface' or ones that they didn't even know they have. The customers do not do the innovating; you have to extrapolate what they need most by listening with empathy. Give a complete description of your customers, including age and other demographic factors. In your interviews, dig for stories, ask why. Synthesise what you hear from your possible customer with at least the following elements:

- Whom did you talk to? (Their names and description, age, class, dress or anything)
- What did you learn about their feelings, motivations and objectives?
- Is there anything that *you* see about your possible customer's needs that they didn't express or possibly even recognise? (Move from what was said to what you can infer from that.)

D. Summary

Based upon your observations and interviews, answer these questions:

- Who are your target customers?
- How many customers are there?
- What jobs are your customers trying to do?
- What pain do your customers have when trying to do those jobs?

- How big is their pain?
- What are they willing to pay (or give) to solve their pains?

E. Value proposition canvas

Finally, with all of this information, fill in the value proposition canvas.[80] You can use the Google template found here: https://goo.gl/2nuc8j.

F. Write your value proposition.

Using your insights from relieving pains and creating gains, write your value proposition using the examples earlier in the chapter to help you.

We [your business name] provide [offering, product, service] to help [target customer] to solve their problem [customer pain and unmet needs] and achieve their objectives [customer jobs] by [unique customer gain] and [statement of social value/impact], unlike [competitors], who cannot beat our [unbeatable features].

CASE STUDIES

CASE 5.1

CREATIVITY IS NOT JUST FOR START-UP IDEAS

Creel Price, serial entrepreneur, author and founder of the Entreprenaissance Movement, recounts a time when creativity was needed to fake it to make it:

Within months of opening our marketing business, yet without a client, we secured the opportunity to pitch to one of the major banks. After a well-received presentation in their office, they indicated we could have their business but first they wanted to check out our operation. We had 18 hours to miraculously convert our exhausted, dishevelled office into something that could even remotely back up our loose-lipped assertion of 'state of the art'.

We needed a makeover … fast!

A plan that has since been dubbed 'Operation Hollywood Set' was swung into action. We couldn't pass up the opportunity for our two-bit company to achieve a major bank as a client, so we decided to roll the dice and spend every last remaining dollar to hire all the furniture and technology we needed to look huge. We'd either get rich, or go broke.

Delegating the tasks, we sent someone to buy secondhand computer monitors for all the desks. This way we'd at least look like we had a technology-enabled business, albeit we hoped they wouldn't notice there were no hard drives attached. Someone else started hiring enough temporary staff to create the buzzing atmosphere of a thriving business. Next, we had to make the place look less drab and dingy. Someone was assigned to hire plants and paintings to take the bank team's eyes away from the holes in the carpet and the tangle of cables dangling down everywhere. Our masterstroke was commandeering the vacant office next door and turning it into 'our boardroom'. A huge, shiny new mahogany-coloured table and plush black leather chairs were ordered for the day and my grandfather's battered old dining table was relegated to the scrap heap.

The next day, our adrenaline levels were off the charts. You could smell the electric excitement in the air. Van after van after van arrived to deliver our props and we felt like the directors of a blockbuster movie about to start filming. With our set ready and our extras in place, all we needed now were the stars – our prospective client team.

Welcoming them into our 'call centre', the illusion looked perfect. And with the confidence it gave us, we secured the deal. It took us a few years to fess up to our client that we had conducted 'Operation Hollywood Set' in their honour. He responded without surprise: 'I figured as much because the next time I turned up to your office the cool furniture had disappeared!'

Yet, putting our best foot forward had worked for both of us. We helped our client build a significant client segment over a decade and they morphed into a $20-million-a-year client for us.

In business, it is times like these – when you back yourself and gamble everything on one roll of the dice – that become your fondest memories. Yes, we used a hell of a lot of front to win a client, but we had complete confidence in our ability to deliver a fantastic job providing they didn't judge us merely on our looks.

Now with more grey hair than youthful enthusiasm, I think the key to 'faking it until you make it' is much more than staying within the lines of the law. There is a moral code in business that must be obeyed so that you can build a brand and culture that has lasting integrity. For me, the key is to satisfy the self-mirror test. If you are confronted with an opportunity to express some overzealous front, first look yourself in the mirror and only proceed if you can be sure that you will have respect for the person who looks back at you now, as well as in the future.

QUESTIONS

1. What model of opportunity was this venture following and what was creative and innovative about their actions?
2. What would define the creativity in this case as lateral thinking?
3. What arenas of creativity are exhibited in this case?
4. Is this case creative or just plain deceptive? Justify your answer and discuss any ethical dilemma.

Source: Price, C. (2014). Fake it 'til you make it: How far is too far? Copyright 2014 by Creel Price. Used by permission.

CASE 5.2

POST-IT® NOTES

One way new products are developed is to take a current product and modify it in some way. Another way is to determine how a previously developed product can be marketed or used by a particular group of customers.

The 3M Company is famous for many products, among them adhesives and abrasives. A few years ago one of the 3M managers, a member of a church choir, wanted to mark the pages of his hymnal so he could quickly find them. A bookmark would not do because the piece of paper could easily fall out. The manager needed something that would adhere to the page but not tear it. Back at work, the manager asked one of the members of the research and development department if an adhesive existed that would do this. One did, but it had never been marketed because the company found that the adhesive was not strong enough for industrial use. At the manager's request, a batch of the glue was prepared and applied to small pieces of paper that could be used as bookmarks.

As the manager who had requested the product began to think about the new product, he concluded it had uses other than as a bookmark. Secretaries could use it to attach messages to files and managers could use it to send notes along with letters and memos. In an effort to spur interest in the product, the manager had a large batch of these 'attachable' notes, now called Post-it Notes, made and began distributing them to secretaries throughout the company. Before long more people began to ask for them. The manager then ordered the supply to be cut off and told everyone who wanted them that they would have to contact the marketing department. When that department became inundated with calls for Post-it Notes, it concluded that a strong demand existed throughout industry for these notes and full production began. Today Post-it Notes is one of the largest and most successful product lines at the 3M Company.

QUESTIONS

1. In the development of this product, how did the creative thinking process work? Describe what took place in each of the four steps.
2. Why did the manager have the Post-it Notes sent to secretaries throughout the company? What was his objective in doing this?
3. What type of innovation was this – invention, extension, duplication or synthesis? Defend your answer.
4. Which of the innovation sources discussed in the chapter help account for this product's success? Explain in detail.

CASE 5.3

AN IDEA FOR THE BIRDS!

Thanaphol Virasa is a salesperson for a large Thai company. He has a bachelor's degree in marketing and is one of the company's best salespeople. It is likely that Thanaphol will one day become a sales manager if he stays with the company. However, he secretly hopes to start his own business.

Since he was hired seven years ago, Thanaphol has managed to build a nest egg of 5 million Thai baht (about AUD$170 000). He is now looking for a business that would require no more than THB 2 million to get started. The rest would be used for operating capital and to keep him going until the company became profitable. In the past, Thanaphol has gathered ideas by reading magazines that report new types of businesses.

Last week, Thanaphol read a story that intrigued him. A man on the Malaysian border has been building 'bird houses' so that anyone can get into the lucrative Chinese Bird's Nest business. These bird houses are purpose-built, reinforced-concrete structures designed for swifts or swallows to build their nests. The white swiftlet's bird's nest is both a Chinese edible delicacy and a centuries-old Chinese medication (*yan wo*; *yan* = swiftlet, *wo* = nest). Swiftlets weave their nests from long, gooey saliva strands that come from glands under their tongues. The birds coil the threads of saliva into nests shaped like half a teacup. They attach them high off the ground against the walls of caves, abandoned apartments and now even small custom-built concrete bird houses. A bird's nest factory can now be run by anyone as long as they are situated near the sea. Although the benefits of edible bird's nests are still scientifically disputed, Bird's Nest has been used for thousands of years in traditional Chinese medicine and cooking. Bird's Nest is one of the most valued commodities on the market today, typically costing about AUD $4000 per kilogram. Currently these Bird's Nest 'factories' sell for THB 300 000 each.

Thanaphol knows that few people can afford to pay this much for a bird house. He believes a market may exist for cheaper bird houses, in the range of THB 20 000 each. Thanaphol has done the research and believes it would not be too difficult to differentiate his product from the standard bird house with all the same functionality. The two biggest obstacles will be marketing and production; that is, getting people to order bird houses from him rather than copying the design and building it themselves. Thanaphol believes that, with his background, he can handle the marketing and it should not be too difficult to find someone to handle the construction. Moreover, until the business takes off, he believes he can continue with his sales job.

QUESTIONS

1. Is anything unique about Thanaphol's idea? Explain.
2. What is the first thing Thanaphol should do to follow up on his idea? Explain.
3. When this is done, what else should Thanaphol do? Outline a general course of action for him.

ONLINE STUDY RESOURCES

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CHAPTER 6

DESIGN THINKING FOR ENTREPRENEURIAL VENTURES

Everything around you […] was designed by people that were no smarter than you.

Steve Jobs[1]

Business people don't just need to understand designers better – they need to become designers.

Roger Martin[2]

The mere formulation of a problem is far more essential than its solution.

Albert Einstein[3]

CHAPTER OBJECTIVES

1. To appreciate the wonder of design
2. To understand how ways to think about design can solve wicked problems
3. To appreciate how theory and perceptions contribute to design thinking through mindset, perceptions, problems and cognition
4. To understand the history and use of process models in design thinking
5. To grasp the extent and variety of design thinking tools

NOTHING MORE NOBLE THAN DESIGN

Human-centred design (HCD) means serving real people; developing empathy with them; building as many possible solutions to their pains and frustrations as possible; testing low-resolution pretotypes with them; and eventually implementing new solutions to improve their lives.[4]

We know what the human means, but what does **design** mean? Bear with us while we explain. As a *noun*, design has two meanings: either a scheming plan, aim, intention, goal or purpose; or a concept, drawing, shape, sketch or blueprint – even the entire finished product. As a *verb*, it also has two meanings: either to scheme, connive, plan, devise or intend; or to invent, create, fabricate or build. So, we could humorously say 'our design (purpose or intention) is to design (create or fabricate) the design (sketch or blueprint) of a design (finished outcome or product)![5] Design is a complex business activity that uses design tools to meld form and function with manufacturability and marketability.

Design thinking is the approach to innovation that marries the core principles of design with best customer- or stakeholder-centric business practice. Design thinking is the ultimate form of creative enterprise because it uses creativity and imagination to achieve breakthrough innovations that solve real problems and create value for actual people.[6]

In this chapter, you will learn how to channel the natural creativity you discovered in Chapter 5 into the systematic creation of solutions for your stakeholders, users or customers. You will learn how to ideate, compose, frame, form and build – in short, design – to deliver innovative solutions to your customers, clients or stakeholders. You will take the opportunities you have identified and use design theory, practice and process to build testable trials of the solutions that your customers are seeking.

human-centred design (HCD)
Is all about usability. HCD looks at real people with real 'pains'. It seeks to design solutions useful to their exact needs and requirements.

design
(1) A complex business activity that uses design tools to meld form and function with manufacturability and marketability. (2) To devise courses of action aimed at changing existing situations into preferred ones.

DESIGN IS ALL AROUND YOU

Look around you. Everything you see has been designed – sometimes, as Steve Jobs once said, 'by people that were no smarter than you'.[7] If you look up from this book, almost everything you see is the product of the force of human intelligence to generate a solution for human needs. If you are indoors, you will first see the more obvious objects of design: a telephone, a cup, a desk light, a building opposite, a computer, a chair and even clothes. But don't forget the intangible, sometimes hidden, products of design, such as word-processing software, computer circuit boards and chips, telephone SIMs, even the order of books on the shelf, not to mention images, documents, lists and reminders.

Looking outside, you might think that natural things like trees were not designed, yet these objects often are planned, propagated and pruned by human design. Stepping back again, you might also agree that nature itself was designed with a purpose by someone or something, be it God, Allah or Gaia, the Greek Goddess of Earth. According to James Lovelock's '**Gaia hypothesis**', life does not merely react and adjust to changing conditions; it also positively shapes and designs conditions to its own advantage. Lovelock's hypothesis rests on the premise that none but the deities above could have designed such an elegant system that pumps toxic carbon dioxide out of the atmosphere and sequesters it in plants and underground, thus allowing life-giving oxygen to flourish on Earth.[8]

Gaia hypothesis
Hypothesis developed by chemist James Lovelock in 1972 that proposes that living organisms work together with their mineral surroundings to form a complex, self-regulating system that maintains life on Earth.

Everywhere we look, we are immersed in a world of designed stuff, what Gold calls 'the plenitude'.[9] Count how many designed objects there are in your kitchen. Every appliance, every utensil, everything is composed of tens, hundreds, even thousands of other designed things. Each piece of stuff satisfies some desire, and it requires yet more designed stuff. Cereal demands a spoon, a television a remote. Stuff called media compels us to buy more stuff. Look around you and imagine how many things are solving your pains and frustrations. In the right hands, design reduces pain. Design satisfies need. Design creates value. Design changes behaviour. Design even regulates our behaviour.

Throughout history, designers have applied the human-centric creative process to build meaningful and effective solutions. Monuments, bridges, automobiles and subway systems are all end products of the design process. Design thinkers were part of great deeds in history even before there was such a profession. More than mere inventors, designers see customer needs that others do not, and they cross the frontiers of imagination to make new connections and insights. There are great design mavericks of the past that inspire us today. Here is a smattering:

- In the early 1900s, husband-wife designers Charles and Ray Eames analysed human needs and constraints before designing their famous Eames chairs, which continue to be in production even now, 70 years later.
- 1960s dressmaker Jean Muir was well known for emphasising how her women's fashion felt as well as how it looked. For example, Muir placed pockets at hip level to encourage the wearer to hold her shoulders back confidently.
- Steve Jobs created the iPad before a market for tablets even existed. He didn't make things his customers wanted. Rather, he created things that moved people to say, 'I want one.'[10]
- Thomas Edison realised early on that his light bulb invention was little more than a magic trick. Yes, it satisfied deep human needs. But what was truly impressive about Edison was not the invention itself but how he imagined an entire industry of power generation and transmission.
- George Lucas reinvented an entire movie industry through his know-how, ingenuity, flair, storytelling and business acumen by bringing together sculptors, camera operators, filmmakers and artists to use new cameras and miniature modelling to augment reality in *Star Wars*.

anticipatory design science
Human practice that would align men and women to the conscious design of our total environment, making Earth's finite resources meet the needs of humanity without disrupting the ecological processes of the planet.

What unites all great design thinkers is what famous American architect, systems theorist, designer and inventor Buckminster Fuller called '**anticipatory design science**', which he defined as human practice that would align men and women to the conscious design of our total environment, making Earth's finite resources meet the needs of humanity without disrupting the ecological processes of the planet. What nobler cause than to use design for a sustainable environment. Nobel laureate Herbert Simon agreed: 'To design is to devise courses of action aimed at changing existing situations into preferred ones'.[11]

ENTREPRENEURSHIP IN PRACTICE

DESIGN FOR A DESERT ISLAND

Steve Jobs once challenged his audience to imagine being trapped on a desert island with only a tin can. What could it be used for? They came up with more than 70 uses. Can you think of yet another?[12]

- Cup
- Shovel
- Net
- Storage container
- Noisemaker
- Knife (when broken)
- Rainwater collector
- Reflector
- Bucket
- Dumbbell
- Maracas
- Drum
- Sheet of metal
- Tube
- Plate
- Heating device
- Friend (Mr Can? Mr Tin? Wilson?)
- Sandcastle builder
- Fire starter
- Trap
- Ocean sound-maker device
- Ant house
- Bird house
- Toilet
- Decoration
- Game
- Weapon

continue

continue

- Tiny hat
- Geographical marker
- Colonial accessory
- Signal for help
- Bullhorn
- Stress ball
- Protector from the elements
- Mirror
- Cookie cutter
- Fish hook
- Colander
- Boat
- Message in a can
- Brick mould
- Measuring cup
- Bad hat
- Bongo
- Washing tool
- Megaphone
- Tiny seat
- Saw (unrolled)
- Fan (unrolled)
- Toy (kick the can)
- Stamp
- Bracelet
- Dinner bell
- Juggling device
- Wind chime
- Bartering currency
- Post end
- Razor
- Weight
- Rolling pin
- Wheel
- Spittoon
- Water evaporation device (salt)
- Basketball hoop
- Golf hole
- Pillow (ouch)
- Gauntlet to fight piranhas
- Press
- Car piece
- Tail pipe patch/connector

WAYS TO THINK ABOUT DESIGN

We can look at design thinking through a variety of lenses, including history, mindsets, perception, problems, cognition/reasoning, and tools and practices.

The historical roots of design thinking theory go back to two streams of literature: the design literature, dating back to the 1960s; and management literature, starting around the turn of the millennium.[13] Most people date the origin of design thinking to Herbert Simon's 1969 book *Sciences of the Artificial*. Simon wrote that 'everyone designs who devises courses of action aimed at changing existing situations into preferred ones'.[14] Yet Simon's notion was largely limited to architecture, engineering and urban planning. The field had to wait for its breakthrough moment until the 1980s reverse: until the 1980's for its breakthrough moment, when Cross made the mental leap to '**designerly ways of knowing**', bridging the gap between architecture and social sciences. Cross' conceptual breakthrough was to see design as one of three 'cultures' of knowing, the others being science (as in physics or chemistry but also the social sciences) and the humanities (as in arts and history). There are things to know, ways of knowing them and ways of finding out about them that are specific to each 'culture'.

- What do we study? In science we study the natural world; in humanities the human experience. But in design we study the artificial world that is all around us.
- How do we study each culture? In the sciences we use experimentation, analysis and classification; in the humanities, analogy, metaphor, criticism and evaluation. However, in design we study pattern formation, synthesis and modelling.
- What are the supreme values of each culture? In the sciences we value above all else objectivity, rationality, neutrality and truth; in the humanities, subjectivity, imagination, commitment and justice. What makes design different is that here we value most highly practicality, ingenuity, empathy and appropriateness.[15]

designerly ways of knowing
A 'culture' of knowing and understanding the natural world that uses pattern formation and modelling and values empathy, practicality and ingenuity above all else, in contrast to knowledge creation in science and the humanities.

Despite this breakthrough, for years, scientists, humanists and designers continued down their separate paths. Lawson lamented the situation that 'the psychologists and sociologists have gone on researching and the designers designing, and they are yet to re-educate each other into more genuinely collaborative roles … the creators and users of environments often remain uncomfortably remote'.[16] But the connections really came together in the 1990s when Rittel and Webber argued that design and planning should address humanity's **wicked problems**[17] and Buchanan noted that design thinking could

wicked problem
A problem that is difficult or impossible to solve due to incomplete, contradictory and difficult-to-recognise information.

address intractable human concerns.[18] A wicked problem is a problem, usually social or cultural, that is challenging or impossible to solve because not enough is understood about either the problem, the number of stakeholders involved, the number of varying opinions, the economic burden or the impact of these problems on other problems. Cross originally argued that design should be considered part of general education because, quite like science and the humanities, design develops unique innate abilities in solving real-world, ill-defined problems and sustains unique forms of cognitive development. This has now become a creed: 'Design Thinking is the new Liberal Arts.' Design thinking helps overcome the false dichotomy between the humanities and science because it prepares students for the *active creation* of the new realities that science and the humanities have imagined as possible.[19]

Finally, in the early 1990s, design thinking began to be adapted for business and social purposes by brothers Tom and David Kelley, who as practitioners took these lessons and founded the global design and innovation consultancy IDEO, and who produced significant works connecting design, management and entrepreneurship. The Kelleys' most enduring contributions are to human-centred design methodology, design thinking and unlocking the capacity of 'creative confidence'.[20] Even so, it took yet another decade for serious literature on the design-focused workplace to appear.[21] Since about 2000, serious works have poured forth a theory and practice of design thinking in the business realm that entrepreneurs cannot ignore.[22] In 2008, the Bill & Melinda Gates Foundation asked IDEO to codify the process of human-centred design, which resulted in the *Human-Centered Design Toolkit*.[23] The teaching approach of design thinking as we know it today goes back to Hasso Plattner's and IDEO's influence on Stanford's d.school and the University of Toronto's Rotman School, among others, who collectively over some three years outlined the design thinking process model (see **Figure 6.3** later in the chapter).[24] These works are now best represented in the *Field Guide to Human-Centered Design* and *the Designing for Growth Field Book*.[25]

Design thinking is now conceived as a method that allows non-designers, including business and social entrepreneurs, to innovate proactively. The use of design thinking in business is seen in Roger Martin's article 'Design and business: Why can't we be friends?'.[26] Tim Brown, former CEO of IDEO, described the sea change in business logic:

> Most of us are trained in what I would call analytical thinking. Analytical thinking is … good for analysis and cutting things apart and slicing and dicing the world. It's also good for extrapolation or prediction from the past into the future. What analytical thinking isn't very good for is trying to envision a new future and figure out how to change it. … In design thinking, … you're trying to create a future.[27]

WHAT CAN YOU DO WITH DESIGN THINKING?

design thinking
A proven and repeatable creative problem-solving and product development methodology that combines the needs of real people with the possibilities of technology and the necessary business success.

Design thinking is a habit of mind based on mindset, perception, cognition and process that is used across the widest range of human activities to frame ill-defined yet complex (wicked) problems and solve them with outcomes such as products, services, spaces, business models, operational systems or social benefits. Another word for these outcomes is innovation.[28] What can you do with design thinking? You can:

- *Create new products*. It is not just 'stylish' products but rather thoughtful product design that is integral to social, economic and cultural progress. People deserve thoughtfully designed products within the limits of available resources. Function is more important than elegance.
- *Build spaces*. Physical environments influence how people behave and feel. We can create new human-centred spatial experiences to make the emotional part of human life as delightful as the function. By rethinking space, we send messages about civility and progress to our users.

- *Create new services*. Through empathy and a deep understanding of the people you serve, you can create end-to-end services that serve the limitations, motivations and values that we all have.
- *Design innovative systems*. How do you balance the complexity of diverse stakeholder needs with the needs of society? By setting high-level strategies, writing compelling visions, and stating and communicating priorities across an entire system.
- *Design curriculum*. Teachers are constantly looking for better ways to connect teaching to the interests and desires of today's learners by finding out more about the things that students do outside of school; identifying their passions; and connecting to their actual needs, fears and desires.[29]

Here are some examples of design challenges that design thinkers have tackled:

- How might we design a cook stove that reduces the amount of smoke inhaled by the user?
- How might we build an irrigation pump that can run without the electricity grid?
- How might we design a toilet for families living in areas with no sanitation infrastructure?
- How might we redesign the common areas of a community housing structure to encourage connection and cooperation among neighbours?
- How might we design a water delivery service providing clean drinking water along with health and nutrition products?
- How might we design a sustainable business model for a pit toilet emptying service?[30]

ENTREPRENEURIAL EDGE

DESIGNING A 'NEW YOU'

If design thinking is so human-centred, why not start with the most important human in your life – yourself!? Should be!? Most of us have two lives: the life we live, and the unlived life within us that we would like to live. Between the two stands resistance.[31] How to get from one to the other? What about using design thinking to design a 'preferred state of the new you'? 'We are all capable of reinvention', according to Bernard Roth, one of the founders of Stanford's d.school and author of the book *The Achievement Habit*.[32] Can you apply design thinking to the 'wicked problem' of designing your own life? Yes, you can. After all, design thinking starts with reframing how you view yourself in the world. If you have tried one type of life, and it doesn't work for you, maybe you are trying to solve the wrong problem.

Start with empathy, not for others, but for yourself. Instead of feeling lonely, ask yourself, 'What would it do for me if I solved this problem?' For example, if you are looking for a partner, ask, 'What would a partner do for me?' If you answer, 'Become my soul mate', then you have redefined the problem as 'How can I find a soul mate?' By changing the question, your change your point of view and you expand the number of possible outcomes. The next step is to ideate – brainstorm, make lists, write down ideas and generate possible solutions. Make a list of traits you enjoy in yourself that you want to share with a partner. The more interesting friends you have, the more interesting strangers you will meet through them. The fourth step is to prototype. You can meet friends online, take classes, join a club, take a group trip, join a running group, or get a pet and spend time at the dog park. The final step is to implement the idea and seek feedback from others. You will learn all about how to apply the 'build-measure-learn' approach to prototyping in Chapter 7.[33]

WAYS TO APPROACH DESIGN THINKING

We can approach design thinking in a variety of ways. We could say that design thinkers have 'designerly' (meaning characteristic of designers) ways of knowing about nature, mindsets, human sense perception, addressable problems, and cognitive and reasoning perspectives, not to mention tools and practices. We call this 'designerly ways of knowing', which harks back to Nigel Cross' original use of the term in 1981.[34]

DESIGNERLY MINDSETS

The designerly mindset is an extension of the **enterprising mindset**. In this chapter, we see how these streams converge.[35] Design thinking requires the **empathic mindset**, namely, the ability to put yourself into your customer's/client's/stakeholder's shoes to understand problems from their perspective, to uncover their pains and problems (including some that they didn't even know about), and to generate unexpected solutions (including ones that they had not thought of). 'Empathic' means having a sensitivity to other people's emotions.[36]

enterprising mindset
A mindset marked by imagination, initiative and readiness to undertake new endeavours; reflects a capability to focus on a particular opportunity and how to quickly act upon it while maintaining a broader view of the end position and how the opportunity will be shaped and fit within an enterprise or business model.

empathic mindset
The ability to put yourself into your customer/client/stakeholder's shoes to understand problems from their perspective and to uncover their pains and problems (including some that they didn't even know about), and to generate unexpected solutions (including ones that they had not thought of).

empathy
The ability to be aware of and sensitive to other people's feelings, thoughts and experiences.

creative confidence
The natural ability to come up with new ideas and the courage to try them out.

Traditional business processes do not typically foster empathic engagement with customers. Entrepreneurs use a different approach to managers because they have seen that seemingly linear and analytical businesses have not achieved the results of their dreams. Design thinking is the opposite of the manager's data-driven analysis because **empathy** means a focus on the human angle. Managers pay little attention to how to use customer co-creation and feedback to turn their new ideas into a business model that can be shared with a larger group.[37] As the Kelley brothers put it, it is about **creative confidence**. It is about believing that *you* are the one who can make the difference, that *you* are the one who understand the intentional design process and that *you* are the one who can create solutions that create positive impact. When you understand and practise the principles in this chapter, you will have faith in your own creative abilities and a process for transforming difficult challenges into opportunities for design.[38]

Empathy is made up of the following entrepreneurial mindsets. Empathic entrepreneurs have the capacities to:

- *Understand real human needs, fears and desires*. The entrepreneur/designer must have a deep empathy for what motivates people who make up the social or business world.
- *Be relentlessly optimistic.* Design thinking relies on creative confidence and self-effectuation – a belief that you have the tools and capacities to create change, no matter how wicked the problem or how pressured you are.
- *Tolerate ambiguity.* This means being comfortable with a problem-solving process that is liquid and open, and celebrating unexpected alternative solutions.[39]
- *Collaborate positively.* Two plus two is greater than four. When great minds get together, the outputs are always stronger and more impactful than if each person worked on the problem alone. You use your own creativity, to be sure, but multiple creativities and perspectives strengthen the positive effect of the solution.
- *Experiment joyfully.* An experimental and explorative mindset is seen as key to design thinking. Mistakes are a natural part of the process. Using the methods of hypothesis-driven entrepreneurship (see below), you will have fun in failing and learn from the stumbles that you make. As you will learn in Chapter 7, it is all about repeated cycles of build-measure-learn.
- *Serve the world.* Empathy means being the servant of the customer. You do not design solutions on the basis of 'build it and they will come'. Human-centred designers see the world, and all the opportunities to improve it, through a new and powerful lens.
- *Immerse yourselves in other peoples' lives*. The empathic mindset forces you to immerse yourself in another's world and to leave behind your preconceptions. *The Field Guide to Human-Centered Design* states that '[e]mpathizing with the people you're designing for is the best route to truly grasping the context and complexities of their lives. But most importantly, it keeps the people you're designing for squarely grounded in the centre of your work.'[40]

- *Have self-aware meta-cognition*. Research has confirmed that some of us are more aware and have a better understanding of our own thought processes than others, and this is connected to the development of empathy. There is a 'step-like' pattern in empathy development and even in the neurobiological mechanisms associated with empathy.[41]
- *Visualise new scenarios*. The empathic mindset is future oriented and seeks to improve an existing situation into a preferred one. Using intuition and vision, this means having the urge to challenge the norm and to boldly go where no one has gone before.[42]

Why does empathy matter to entrepreneurs? The market is flooded with products that hope to respond to consumers' ever-changing needs. Some entrepreneurs begin with shiny new technology looking for a market, but ultimately it is the consumer who makes the final judgement as to whether a product is successful or not.[43] Research shows that customer co-creation or co-production achieved through empathy has a positive effect on the outcome of new product development because it results in a better fit to a customer's preferences. That's why letting customers define the critical design criteria has become so important in the innovation process.

The problem is that consumers themselves are sometimes uncertain about their actual needs, even for products and services they use often or desperately want. They are so accustomed to current solutions that they don't ask for a new one. As Steve Jobs once said, 'a lot of times, people don't know what they want until you show it to them'.[44] Here is an example: When radio was first invented, it was used to transmit Morse code! Broadcasting entrepreneurs saw that the same technology could be used for news, music and baseball. But nobody was asking for that. The bottom line is that customers only know what they have experienced. They cannot be expected to imagine what they do not know.[45]

In today's age, designers must consider not only a product's functions and features but also the customer's emotions and experiences. That means entrepreneurs need to study stakeholder experiences systematically. Empathy is about consumer-centred design: designers must devise a solution that corresponds to the emotional aspects of using it. How could one design heart rate monitors without applying empathic design to observe and record how consumers interact with pretotypes and prototypes? All of this must be fed back to designers.

What can we learn through empathic observation? Obviously, we see how users interact with features and functions. Is the packaging difficult to open? Are the knobs ergonomic? Does the user get flummoxed by the manual? But it's the deeper, or latent, meanings that are most important. What need or pain has triggered them to use your new product or service? Are they turning to you for the reasons you expected? How does your product or service interact with the user environment or interface? Does it fit the user's peculiar routines or processes? Maybe the customer takes your product and re-purposes or re-designs it to meet their desires (like spoilers on a car). Does your product or service have some unseen attributes that show the customer is emotionally invested in it ('wait until I show my friends!')? Very interesting is when you observe the customer using your product for problems that you (or they) never even recognised (like wrestling an Ikea pack into the backseat of a car). The oft-repeated 'delight the customer in unexpected ways' is achieved when your product or service exceeds expectations. As Leonard and Rayport say about empathy in the *Harvard Business Review*, 'consider it a process of mining knowledge assets for new veins in innovation'.[46]

In sum, designers need systematic methods to be able to study consumer experiences, and these methods must enable the empathic understanding of the consumer. Through the empathic mindset, designers get closer to the consumer through respectful curiosity, genuine understanding and suspension of judgement.[47]

DESIGNERLY PERCEPTION

To be a good empathic designer, you must understand how people see and how the brain interprets stimuli.[48] Here are some common examples.

- Most mental processing is unconscious, and people use their peripheral vision to get the 'gist' of a scene or situation.[49]
- People do not like too many choices.[50]
- People can retain only 3–4 items in working memory.[51]
- People prefer curved objects to straight.[52]
- Men prefer symmetry but women not as much.[53]
- The brain processes information best when it is in a story format.[54]

Familiarity with this type of research helps entrepreneurs build websites, apps, products and brands. Weinschenk says there are 10 important things you need to know about people.[55] You need to know:

- *How people see*. This relates to user interfaces, hot maps, optical theories, pattern recognition, people's expectations of graphic communication and visual impairments.
- *How people read.* This involves typography. Why are all-caps harder to read than lowercase? Why do people prefer hard copy to a computer screen?
- *How people remember.* Do they like chunks, bits or long form? Do they remember more or less when they are moving the knobs and features?
- *How people think*. Research suggests that 'progressive disclosure' rewards users for their gradual efforts. Using stories in the communication design breaks up the factual information.
- *What motivates people*. Do they love achieving goals or being rewarded for loyalty? Do they like progress indicators for user tasks?
- *That people are social animals.* How does the innovation fit into their social environment? How do they interact with their friends and peers? Do they freely give social feedback or word-of-mouth feed-forward?
- *How people feel.* Can you read their body language when collecting user feedback? Does graphic design/content affect your trustworthiness (credibility)? Do they have relationships with you?
- *People make mistakes.* How can you learn from the mistakes and errors in your communication design and software?
- *How people decide.* What do they think about when they buy a product? Do they like more or fewer options?

hypothesis-driven entrepreneurship
A lean method of entrepreneurship whereby a start-up enterprise is guided by falsifiable hypotheses (tentative answers to a question) based on observations and controlled experiments. We test, pivot and change the hypothesis using 'minimum viable products' until it is 'validated' such that we can expect a particular outcome.

algorithm
Technically refers to a 'list of steps' written in code and performed by a computer, but we can generalise a 'business algorithm' as a formula that when repeated leads to commercial success.

DESIGNERLY PROBLEMS

One of the design thinking field's seminal thinkers, Roger Martin, says that opportunities usually enter our minds as mysteries that are difficult or impossible to understand or explain. We call them puzzles, riddles or secret, unsolved problems. Observing the traffic in Mexico City, you might remark, 'It's a mystery to me how they ever get where they are going.' But with the force of human intelligence, the newcomer in Mexico sorts out the mystery, which crumbles when he sees the logic system.

Usually we start with some rule of thumb that narrows the mystery down to a 'thinkable' size and guides us toward a solution as we explore the possibilities. The enterprising mind puts the rule of thumb to work, thinking about it intensely, converting it and testing it using **hypothesis-driven entrepreneurship** until it becomes a tested and validated hypothesis, at which point it can become an **algorithm**, or a 'recipe for success' (see Figure 6.1). The result is an explicit, step-by-step procedure for solving the problem, one that is simple enough that you can explain it to others. Through interviews

FIGURE 6.1
FROM MYSTERY TO ALGORITHM

and observation, extraneous factors are pared away, and the result is a causal explanation of the mystery. Algorithms are like recipes; computer code is the ultimate algorithm.

Martin tells the story of the legendary Ray Kroc, who bought out the McDonald brothers' drive-in in 1940s California. Kroc's mystery was 'What and how did the mass post-World War II middle class want to eat when they set out in their new Fords and Buicks?' He pared it down. Consumers wanted out-of-home eating experiences. His first rule of thumb was quick service with limited menu options and accessibility by car, which narrowed the mystery down to a set of testable propositions. Using **A/B testing**, he tested and retested: Do they prefer charbroiled or pressure-cooked? Would a wider menu be attractive? Did they want spaghetti on the menu? Did they prefer drive-in or sit-down? From mystery to opportunity, from rule of thumb to recipe for success, Ray Kroc peeled away the layers and simplified the complexities down to a value proposition, which he tested repeatedly with customers. Finally, he reached a model that he could repeat several times over, and even franchise to others.[56]

A/B testing
A method of hypothesis-driven entrepreneurship in which two (or more) versions of an artefact (e.g. product, service, web page or app) are compared against each other to determine which performs better and which delights the customer more. Also called split testing.

Most entrepreneurs follow a similar path. The opportunity is born through intellectual force and the creative act of an alert entrepreneur who converts the mystery into a recipe through experimentation and intuitive thinking. Alertness: This is the 'lean method' in action. Kirzner's theory of entrepreneurial alertness says that entrepreneurs have a special talent for discovering opportunities 'out there' waiting to be recognised. Where others see chaos and mystery, entrepreneurs see solutions and algorithms. The entrepreneur is an opportunity identifier who can spot unexploited market niches in advance of other people. Entrepreneurs use ideas, networks and relationships to identify future markets and technologies. They are opportunistic and move quickly to realise an opportunity before it is lost. They bring a new product or service onto the market when they think that there is an opportunity to re-deploy the resources away from 'suboptimal' configurations to more promising opportunities.[57] Entrepreneurs do not analyse 'what is' but rather 'what is possible' (see 'abductive logic' below), and this opens an opportunity for entrepreneurial discovery. With design thinking they can recognise what customers are willing to buy, the kinds of services and goods that technology and resources can produce and untouched resources that can be assembled.[58]

Another way of putting it is that entrepreneurs love to solve wicked problems. There are numerous examples of wicked problems. *Climate change* is a pressing and highly complex policy issue involving multiple causal factors and high levels of disagreement about the nature of the problem and the best way to tackle it. *Obesity* is a complex and serious health problem with multiple factors contributing to its rapid growth over recent decades. *Poverty* is a seemingly intractable issue. But it is clear that the motivation and behaviour of individuals and communities lies at the heart of successful approaches.[59]

DESIGNERLY COGNITION

design intelligence
A form of intelligence possessed or acquired by designers to use various forms of reasoning to create novel solutions.

Design thinking involves a set of cognitive processes that are in some ways different from those in other disciplines. Cross calls this '**design intelligence**'. Design intelligence is associated with abductive reasoning, critical thinking, intuitive thinking, reflective reframing, holistic viewing, integrative thinking and divergent/convergent thinking. 'Designerly intelligent' individuals can plan, review, reflect, adapt and, above all, create novel solutions. Like other forms of intelligence and ability, design intelligence is not simply a given talent or gift, but can be trained and developed.[60]

deductive logic
Also known as top-down logic, a type of logic that generates conclusions by reasoning from one or more theoretical statements (premises). (See also *inductive logic*, *abductive logic*.)

inductive logic
Logic that reaches conclusions by generalising or extrapolating from specific cases in the real world to create general theoretical rules. (See also *deductive logic*.)

abductive logic
A form of logical inference in which you start with an observation and jump to a theoretical explanation which is subsequently tested to see if the explanation fits the observation. Abductive logic leads to a series of hunches or educated guesses about what caused or causes the observations, but these might actually prove false. (See also *inductive logic*, *deductive logic*.)

Here's how the three kinds of logic work. How do we normally decide if something is true or false? Most of us are only familiar with the first two kinds of logic: inductive and deductive. Each of these logics imply something different about how we perceive the relationships between rules (or theories), cases (or the observable data), and the conclusions drawn.[61]

Deductive logic reasons from the top down, or from the general to the specific, by making references to a generally accepted theory or law. 'If all crows are black, and I see a brown bird, it cannot be a crow.' In this example, all crows are black is the rule or theory, the observed data or the case is a brown bird, and therefore the conclusion is that the bird is not a crow. Deductive logic uses a '*rule–case–result*' relationship to validate a finding. **Inductive logic** reasons in the other direction from the bottom up, from the specific to the general. 'Every time I eat peanuts, I get hives. So, I must have a peanut allergy.' Here we see the observed data or case is eating peanuts, the result or conclusion is getting hives and the rule or theory is therefore you have a peanut allergy. Inductive logic follows a '*case–result–rule*' sequence.

The trouble is that most people, including entrepreneurs, do not use either the deductive or inductive logic patterns. New ideas arise when a thinker observes facts that do not fit existing conceptions. This sets off a process of wondering and often you reach a conclusion without a complete case or set of observations. It is a truncated logic of using the relationship of '*rule–partial case–result*'. You have used what the American philosopher Charles S. Pierce calls an 'inference to [your] best explanation'.[62] For example, imagine you enter the living room where the dog has been alone all day and you observe strips of paper all over the place. You know that dogs, especially puppies, are playful and will often tear up paper. You therefore infer that the dog has ripped up the paper. However, it turns out that your roommate has decided to move out and has torn up the paper in preparation for moving out. The dog theory was the likeliest until you had more information. Following this logic sequence with partial case observation data led to the wrong conclusion and the dog was wrongly accused. The logic flow of rule–partial case–result is also called **abductive logic** which, if misused, can cause all sorts of mayhem and confusion, e.g. a wrongly accused dog, but if used well, e.g. checking further information before concluding the result, it can also be a powerful tool for validating, iteratively, new ideas.

Designers use abductive logic as their preferred cognitive style. Recognising the danger of partial facts, designers cycle between possible rules and iteratively gathered case evidence or data that will reliably deliver results. Here we are not testing a true or false case but developing a rule set that most closely fits with a particular intention. Using design thinking means you generate hypotheses using the best information available, which often entails making an educated guess after observing a phenomenon for which there is no clear explanation. Then you repeatedly test your hunches until you have the likeliest possible explanation for the group of observations. Abductive reasoning gives us testable hypotheses for which you then gather facts. It is useful in design thinking because it is the *logic of what could be not what should be*. It complements deductive and inductive reasoning because the designer wants to move from what is known to what could be, to say, 'What is something completely new that would delight us if it existed?' As Martin says, designers use abduction to generate ideas, challenge accepted explanations and infer possible new worlds.[63]

Critical thinking is another important skill used in design thinking. 'Critical thinking is the intellectually disciplined process of actively and skilfully conceptualizing, applying, analyzing, synthesizing and/or evaluating information gathered from, or generated by, observation, experience, reflection, reasoning or communication, as a guide to belief and action'.[64] Critical thinking is especially important when we want to solve wicked problems. A well-cultivated critical thinker:

- raises vital questions and problems, formulating them clearly and precisely;
- gathers and assesses relevant information, interprets it effectively, comes to well-reasoned conclusions and solutions, and tests them against relevant criteria and standards;
- thinks open-mindedly within alternative systems of thought; and
- communicates effectively with others in figuring out solutions to complex problems.[65]

Other cognitive skills include **intuitive thinking** (generating solutions using the power of intuition (what does my gut say?), not logic) and **reflective reframing** (imagining new ways of viewing a problem in the first place). While developing solutions to design problems is a well-recognised design skill, the ability to think up new ways of looking at the problem in the first place is what really matters.[66] Design thinkers are constantly questioning how a problem is represented, and they look 'outside the box' not only at solutions but also to *see if the right question is even being asked in the first place*. The skill needed is to identify, frame and then reframe the problem. This demands a **holistic view**, a 360° perspective that starts with the customer's needs, including social, emotional and cultural factors.[67] A holistic view allows us to visualise the customer's 'pain' as an eco-system, with all its patterns and events, rather than just seeing the isolated picture.

All of this demands **integrative thinking**, which means bringing together competing, even clashing, ideas to form a better model, which might keep the superior parts of each model, all the while seeking a balance in the human and technical dimensions.[68] It also requires divergent and convergent thinking. **Divergent thinking** involves widening your perspective to explore as many ideas and solutions as you can muster, while **convergent thinking** reduces these down to the 'good' or 'best' possible solutions. First, we go wide and explore the multiplicity of possible solutions in a free-flowing, spontaneous manner, where multiple creative ideas are engendered and evaluated. Then we narrow the scope of possibilities using convergent thinking to devise the most effective answer to a problem.[69] Over time, as the funnel narrows, so too do the design possibilities; the designers eliminate unfeasible paths and refine the design, converging upon the best possible solution for implementation. In practice, design thinking involves a constant balance between divergent thinking (creating choices) and convergent thinking (making choices); see Figure 6.2 for a visual representation of this.

critical thinking
Understanding the world through reasoning and creativity. Involves analysing, evaluating, interpreting or synthesising information and applying creative thought to form an argument, solve a problem or reach a conclusion.

intuitive thinking
The ability to acquire knowledge through sensing, pattern recognition or instinct.

reflective reframing
Re-interpretation of solutions through social interaction of 'co-designists' using mindfulness and collective feedback to rewrite the original questions using each individual's contributions.

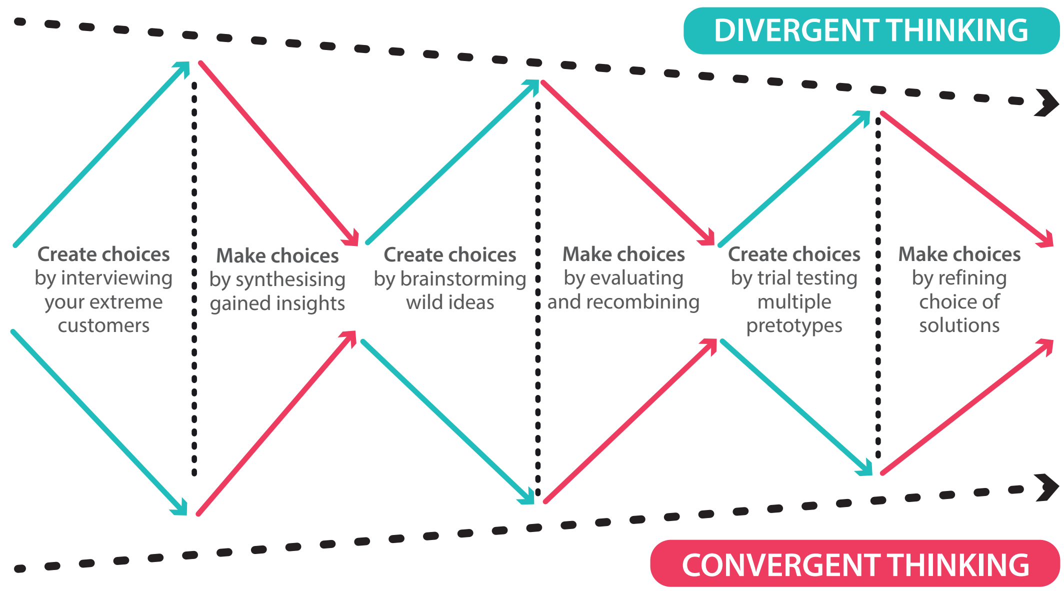
holistic view
Comprehension of the physical, emotional, mental and spiritual needs of customers or stakeholders so that together you can co-create the world.

integrative thinking
The incorporation of two or more opposing ideas to form a new idea that resolves the tension between them and is superior to both.

divergent thinking
Widening perspective to explore as many ideas and solutions as one can muster in order to see a multiplicity of possible solutions.

convergent thinking
Narrowing the scope of possibilities to devise the single best answer to a problem.

FIGURE 6.2 DIVERGENT AND CONVERGENT THINKING



analytical thinking The ability to research, analyse, visualise and articulate a complex decision or problem. Care is needed in relying on analytical thought dependent on historical data to decide on a future course. Analytical thinking can be skewed toward past-dependence and not necessarily indicative of the future or useful in envisioning a different future.

Design thinking is the opposite of **analytical thinking**, where all proof comes from the past and from historical data. Most business schools teach managers to examine what has already happened before deciding on a course of action and to protect the organisation from the 'randomness of intuitive thinking'.[70] This is not to say that analytical thinking is unimportant; it is essential when exploiting an opportunity. Intuitive creativity leads to breakthrough concepts, which analytical implementation can then exploit them.

ENTREPRENEURSHIP IN PRACTICE

DESIGN THINKER JOB DESCRIPTION

We are seeking an awesome Design Thinker to join our Business Design Team.[71] You will have real-world experience blended with theory and be passionate about identifying solutions and bringing them to the marketplace. You should have the following capabilities and attributes:

- You have a curious mind and practise integrated thinking.
- You like to experiment with the design thinking process.
- You are a confident communicator.
- You have experience taking an idea from theory to market.
- You are driven by empathy and have a deep passion for understanding people.
- You know the techniques of interviewing, conducting focus groups and pretotyping.
- You can design and analyse surveys.
- You are comfortable in an ambiguous but team-based work environment.
- You can think of new revenue streams for business and spot growth opportunities.
- You know how to improve the consumer's experiences.
- You can create compelling value propositions and tell captivating stories.
- You can coach other designers and energise the community.
- You understand business models and have skills in market research.
- You can answer the questions: Which business model excites you? Which industry is ripe for disruption? What prototype would you offer as a trial solution?

DESIGN THINKING PROCESS MODELS

Searching the web, you will see a plethora of **design thinking process models** that help explain what happens, when, to what and why in the design process. When we use models, we aim to define steps in the design process. They can be linear, circular or iterative. Over the years, design thinking models have used a variety of terms, and they have differences and similarities in their stages. There is no one 'right' model. You may even be tempted to develop your own to suit a new context. Table 6.1 presents some of the best-known ones.[72] Analysing the stages, despite some differences, the main stages in the design thinking process are similar among all models.[73]

design thinking process model
A multi-stage model that represents the flow of the design thinking process.

TABLE 6.1 VARIETY AND SIMILARITY AMONG DESIGN THINKING PROCESS MODELS

YEAR	SOURCE	COMPONENTS OF THE PROCESS MODEL
2001	IDEO/ Deloitte/ (Deepdive)	Understand and observe > Synthesise > Visualise > Prototype, evaluate, and refine > Implement[74]
2005	British Design Council	Discover > Define > Develop > Deliver[75]
2010	d.school Stanford	Empathise > Define > Ideate > Prototype > Test[76]
2011	d.school Paris	Inspiration (Understand, Observe, POV) > Ideation (Ideate, Prototype, Test) > Implementation (Storytelling, Pilot, Business Model)[77]
2011	Hasso Plattner Institute of Design	Understand > Observe > Point of View > Ideate > Prototype > Test[78]
2011	Kolko	Define > Discover > Synthesise > Construct > Refine > Reflect[79]
2012	HCD - Human Centred Design	Hear > Create > Deliver[80]
2012	IDEO	Discover > Interpret > Ideate > Experiment > Evolve[81]
2013	Google Ventures	Understand > Define > Diverge > Decide > Prototype[82]
2013	PwC	Understand > Observe > Define a Point of View > Ideate and Choose Solutions > Prototype and Test > Implement[83]
2014	Designing for Growth	What is? > What if? > What wows? > What works?[84]
2015	Pontis	Understand > Empathise > Define > Ideate > Prototype > Test
2016	Meinel, Von Thienen	Empathise > Define persona > Ideate > Test prototypes > Bring home[85]

In this book, we have integrated these models, and in Figure 6.3 we present the seven-step 'Etappe Design Thinking Process Model' (*etappe* references the title of this book, *Entrepreneurship Theory Process Practice*, and also means 'step' in French, see page xvi.) with its associated steps, goals and methods.[86]

DESIGN THINKING TOOLS

Each step in the process uses a set of methods to achieve the goals. Researchers and practitioners have compiled these tools in masterworks (see Table 6.2). In this section, we review some of the methods for each step in the process model. These works provide templates for and further examples of the methods described in this book.

FIGURE 6.3 THE ETAPPE DESIGN THINKING PROCESS MODEL

TABLE 6.2 DESIGN THINKING MASTERWORKS

Acumen + HCD (2009). The human-centered design toolkit.	https://goo.gl/wF7w1M
CFC Medialab, & Stein, S. (2017). Design research techniques.	http://designresearchtechniques.com/#/
Hanington, B., & Martin, B. (2012). Universal methods of design: 100 ways to research complex problems.	https://bit.ly/2vcBzG6
Hasso Plattner Institute of Design at Stanford (2010). The bootcamp bootleg.	https://goo.gl/DHUjGe
IDEO LLC (2015). The field guide to human-centered design.	http://www.designkit.org/resources/1
IDEO LLC, & Riverdale Country School (2012). Design thinking for educators toolkit (2nd edn).	https://designthinkingforeducators.com/
Krummeck, K. (n.d.). K12 Lab Network wiki	https://dschool-old.stanford.edu/groups/k12/
Liedtka, J. M., & Ogilvie, T. (2011). Ten tools for design thinking.	https://goo.gl/Rx1WAo
Masood, J. (n.d.). Design thinking [techniques].	https://designthinkingsada.wordpress.com/
Stanford d.school (2016). Design project guide.	https://goo.gl/MWrHSS

PREPARING AND SCOPING TOOLS

Referring to Figure 6.3, let's launch into the preliminary step of the process model, namely Prepare & Scope.

Identify the opportunity

Chapter 5 dove deeply into opportunity identification, so fundamental to entrepreneurship. Finding opportunities for design often comes from noticing problems. An experienced design thinker has a mindset that instinctively reframes problems into opportunities. Remember that **Problem** + **Solution** = **Innovation**.

Research and scoping

Begin with a scoping exercise. Write a statement with action verbs, like 'How can we fashion-advise customers and sell clothes to people with no time for trying on clothes?' Then go broader: 'How can we help people feel and look good in this busy online world?' Now go narrower: 'How can we sell shoes to the fashion-conscious?' Frame the problem or opportunity (with its scope) and name specific customers as well as the outcomes you wish to achieve. You will also need a research plan that outlines, to use Rumsfeld's words, the 'known knowns' (there are things we know we know) and the 'known unknowns' (we know there are some things we do not know, but we could know them). We also need a plan to reveal the 'unknown unknowns' (things we don't know we don't know, but the user may know them).[87]

Ask the experts and observe 'extreme users'

Sketch out a mind map of all the people who can inform you. Topic specialists can be especially helpful. Are there any user associations or web communities about your topic? Seek out 'extreme users', people who are totally familiar with the problem, or others that have no interest in it, or have designed their own solutions to the problem. Take the time to observe (not just ask) 'extreme users'. Sometimes they may not actually realise what they do or how they do it and interviews can be unreliable. Note the workarounds that the extreme users have devised. For example, if you are redesigning the cinema experience, interview people who never go to the movies, who go every day, who view film only in their home theatre and who make their own movies. Extreme users can inspire some wild ideas.[88]

Select your sample

Whom do you want to meet? In Chapter 5, we talked about customer segmentation as it relates to the value proposition. You need a deep understanding of motivations, needs, contexts and history across the various types of customers, clients and stakeholders, however you define them. Consider the broad spectrum of people who will be touched by what you design. Before you immerse yourself and begin the research phases, it is critical to know for whom you're designing. Create trial personas (see Figure 6.4) with the characteristics of people you are looking for. Think about what exactly you want to do with each participant. Where do you want to meet them? How much time will you spend with them? Is there an activity you can do together to enrich the conversation? What will you ask them to show you? Write down your plans for all research activities. You should write a short design brief that clarifies your challenge. Phrase it as if you were asking a design company to do the job for you.

Form your team

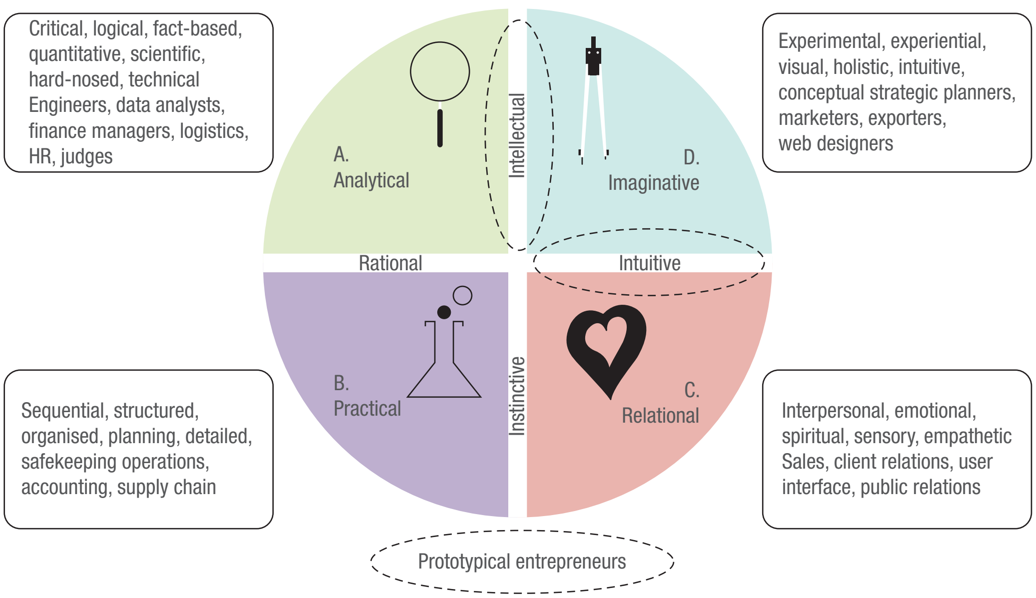
Collaboration is a guiding principle in design thinking. Team members combine capacities and experiences to solve complex problems. To avoid conflict, you need a team with complementary personalities as well as skills. Explore your shared goals. Match skills and passions with what your challenge requires. Post the design challenge where everyone can see it. Choose team members who are respected, articulate and excited about the challenge. Assigning roles will make for a more cooperative relationship.

ENTREPRENEURIAL EDGE

HOW TO FORM YOUR DREAM TEAM

Most of you have seen the 'Dream Team' crew of Captain Kirk and Chief Scientist/ Commander Spock of the Starship Enterprise on the famous TV series *Star Trek*. The crew's mission was 'to go where no one has gone before'. Every entrepreneur at some point needs to put together an innovative team with the perfect combination of talents. Here's one way using the Herrmann Brain Dominance Instrument, one of the most flexible diagnostic tools for starting teams. Herrmann's theory is based on the well-documented specialisations in the brain's cerebral cortex and limbic systems, and the research into left-right brain lateralisation.[89] Have your potential team members take the test at https://www.herrmannsolutions.com/assessment/ or http://www.ipn.at/ipn.asp?BHX. Entrepreneurs are typically one of two types. The D/C entrepreneur is the prototypical, classical start-up: intuitive, relationship-focused and intensely imaginative. A/D entrepreneurs are the archetypal technical entrepreneurs (geeks): intellectual, analytical and imaginative. The leader/entrepreneur should recruit complementary people to create the complete picture of a competent team. The A/D entrepreneur needs team members from B and C. The D/C entrepreneur needs people from A and B.

FIGURE 6.4
HOW TO FORM YOUR 'DREAM TEAM'



Create your project plan

Sketch out a solid project plan in advance with a calendar, assigned tasks, meeting dates, budget and staffing. Are there any resource constraints? Can you get around them? You can always change the plan later, but thinking the project through from beginning to end will save time and increase the likelihood of success.[90]

Build your interview guide

Devise the themes that you want to turn into conversations with your subjects. What do you imagine the customer's motivations and frustrations to be? What do you want to learn about their activities? Use open-ended questions such as: 'Tell me about…', 'In your experience, what are the best and worst aspects of…?', 'Can you help me understand a bit more about…?' Start with questions that everyone can answer with delight and without hesitation. Next, go broader, asking about needs, fears, desires, ambitions and hopes. Then go narrow and delve into the themes you have chosen. Finish up with 'what if…?' scenarios, such as 'What if we offered you a solution that…?' If you have any early concept drawings or other visualisations, bring them out last. Listen and watch for clues that point to a person's values, needs, desires and aspirations.

DISCOVERING AND EMPATHISING TOOLS

The core of design thinking begins now as we explore, discover and empathise with the customer or stakeholder.

Define a challenge

You need a specific and intentional problem to address, almost a dare; this is called a **design challenge**. A good design challenge should be open-ended and actionable, and it should have no right answer. The right challenge question will be broad enough to allow for unexpected possibilities but narrow enough for focus. It is as much an art as a science. Make sure the design challenge seeks high impact and allows for a variety of solutions. Examples: 'Can we build a paper airplane that flies in a straight line so that we get the maximum distance?' 'Can we make a street marker painting device that rolls exactly 20 feet and then stops?' 'How can we drop an egg from three metres without breaking it?'[91]

design challenge
A specific problem to address, expressed as a statement. Getting the problem statement right will organise how you think about your solution. When the going gets ambiguous, the design challenge statement should remind you to focus on the ultimate impact and allow a variety of solutions. And it should be fun!

In the beginning, play the child

We all bring our previous experiences, understanding and expertise to the table. These are extremely valuable, to be sure, but all in their right time. Free your mind of beliefs and prejudices. Just observe, don't judge. Why is the sky blue? Why are there clouds? When explanations come your way, probe further. Like a child, you are seeking causal information actively and you must use specific strategies to obtain it. Don't judge; just observe and ask questions. Question even (and especially) the things you *think* you understand. Try to feel wonder and curiosity, especially in familiar circumstances. Look for patterns, themes and threads.[92]

Embrace an empathic mindset

The ability to be empathic is central to human-centred design. To empathise with your customer/client/stakeholder, you need to step back and observe as well as step into their shoes. You want very much to understand the pains and frustration of a particular group so that you can design solutions for them. To do that, you should put yourself in empathy mode to see how they interact with the problem within a specific context. Yes, you want to record the physical evidence of their experiences – what they do and say. But you also want to uncover the deeper, latent meanings that they may not even grasp themselves. These physical and intangible insights will guide you toward creating innovative solutions. The problem is, as we covered in Chapter 5, as observers and innovators we can easily deceive ourselves through such things as confirmation bias and the sunk cost fallacy. To be a good 'empathiser', you should understand people within the context of your design challenge. You should make an effort to understand the way they do things and why, their physical and emotional needs, how they think about the world and what is meaningful to them.

Plan how you will observe

Try to be invisible during your observation. Use non-obtrusive methods to observe users' behaviours. Choose relevant observation sites such as school drop-off locations, hardware stores, bus stops, sporting venues, crosswalks and airports – anywhere you can observe users performing solutions or having frustrations. Make note of their surprises, frustrations, motivations, decision-making techniques and movement in space. Plan your documentation methods, such as taking pictures, recording diaries or making recordings or videos. Draw sketches, plans and layouts. Consider the 'shadowing' technique, where you accompany the user to see how they use the solution in their natural environment.[93] Let's imagine that you have a novel idea for eco-friendly plastic bottles. Where would you observe the problem? You could wander supermarket aisles, intercept people at convenience stores and go to the recycling centre to observe people throwing their rubbish away. As a group, you can decide how you want to capture and document your observations and interviews using photographs, videos, transcripts, audio and/or notes.

Use 'first person' documentation

Think about employing a 'user camera study' to understand a user's experience through their eyes. Asking participants to use a GoPro to record their own experiences allows you to learn about them over an extended period of time. Guide participants to capture and share their thoughts, decisions and emotions. Informant diaries work in the same way.

Co-create with your user

Another way to immerse yourself in the user's perspective is to incorporate them into your design process. Co-creation puts design teams together with users at the centre of the innovation process. This ensures that products and services are designed not only *for* these users but *with* them. A co-creation session is a great way to get feedback on your ideas and bring people deeper into the process. The purpose is to convene a group of people from the community you're serving and then get them to design alongside you. You're not just hearing their voices; you're empowering them to join the team. You can co-create services, investigate how communities work and understand how to brand your solution.[94]

DEFINING AND SYNTHESISING TOOLS

In this step, you want to uncover new opportunities and confirm that what you have identified is really worth doing.

Define your point of view (POV)

point of view (POV)
A meaningful and actionable problem statement resulting from a successful design challenge, when you are convinced that you have discovered the right problem to address.

The *Define* mode is critical to the design process because it results in your meaningful and actionable problem statement – this is what we call a **point of view (POV)**, where you are sure you have the *right* problem to address. It may sound contrary to what you expect, but narrowing your point of view down to a focused problem statement will generate a greater number of higher-quality solutions when you are generating ideas. A good POV focuses and frames the problem; gives you measuring sticks to evaluate the competition; and captures the hearts and minds of the users. The POV has three components:

[USER – Be very specific] needs to [USER'S NEED] because [SURPRISING INSIGHT].

Define your user through personas, affinity diagrams or empathy maps (see below). Select their most essential needs (these should be verbs). Express the insights you have gained through your research. Here are some examples:

- A drummer needs a portable silent drum kit so he can practise while travelling on business.
- Divers on holiday need to carry ID, credit card and cash for equipment rental but they do not want these items to be damaged by water. They do not want these IDs to be visible to the public, but they should always be available, and should be stored in a way that is stylish.

- A broke smoker who buys single cigarettes needs a wallet that will store three cigarettes, so he can buy only three at once.
- Eco-conscious householders want to reflect light from their roofing tiles to reduce global warming. Surprisingly, the reflector tiles are the same price as the sun-absorbing ones.

Getting the right POV for your design challenge will get you off on the right foot, organise how you think about your solution and, at moments of ambiguity, help clarify where you should push your design.

Frame and reframe your problem

Part of the abduction process (see 'Designerly cognition', above) is reflectively reframing the problem into a 'paradox' that you would like to resolve. A frame is an active perspective that both describes and perceptually changes a given situation.[95] Ask yourself, what makes the problem so hard to solve? Use a 'How might we…?' question. Imagine that Sydney's Darling Quarter (bars and entertainment) sees a marked increase in drunkenness, theft and drugs. Police increase their vigilance with CCTV and foot patrols, and local council imposes stringent regulations. Imagine that design thinkers are invited to study the patrons' behaviour and discover their main desire is just to have a good time. They reframe the problem and ask, 'How might we approach this problem *as if* we were organising a large music festival?' This analogy immediately triggers solutions such as better transportation, crowd control, safety and way-finding. The designers redefine the frame based on the themes that emerged from their investigations.[96] Getting the right frame clarifies where you should push your design and solution.

Empathy map

The empathy map (see Figure 6.5) helps you envision a real or fictitious person to keep in mind as you empathise. Divide the quadrants into sections describing their sensory experiences. As best you can, immerse yourself into that person's experience and understand the context you want to explore. Ask

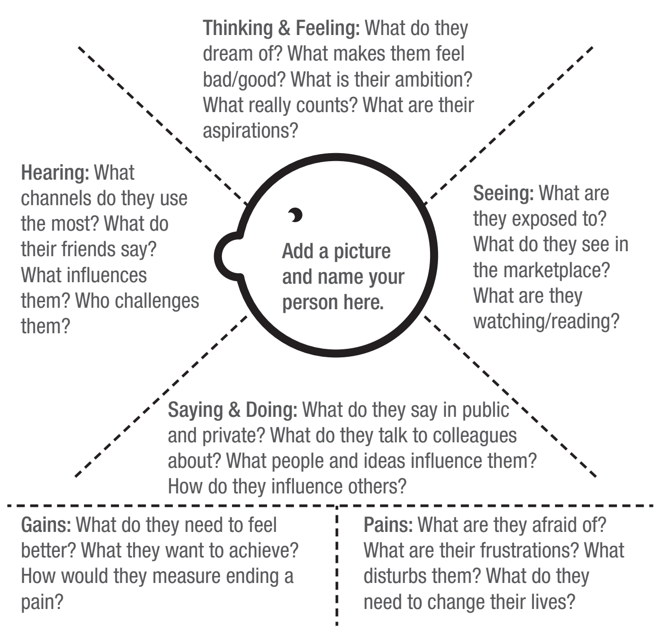


FIGURE 6.5
EMPATHY MAP CANVAS

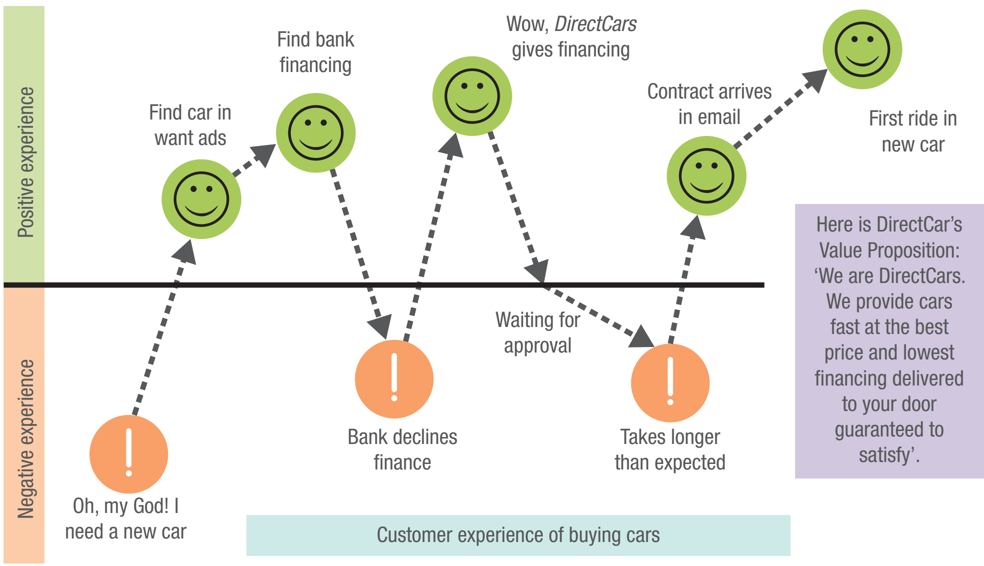
customer journey
A research technique that involves illustrating all of the contact points between the customer and your company, product or service. It relates the story of the customer's experience through the funnel from mystery, to opportunity, to recipe for success (see Figure 6.1).

others to check your impressions. As you did when creating your value proposition in Chapter 5, articulate their pains and gains.

Customer journey mapping

To gain empathy for a user, you can draw the **customer journey** map (see Figure 6.6), which is a roadmap of their journey from mystery to opportunity to a recipe for success (see Figure 6.1). (Remember: We are talking about the customer in the broadest sense, including social stakeholders and service clients.) You can see that each step has a start and a finish, connected by activities that follow a certain chronological order that you can draw. Start with a Post-it® note; use circles, rectangles and arrows. Sometimes there is a branch, or alternative flow.

FIGURE 6.6 CUSTOMER JOURNEY MAP



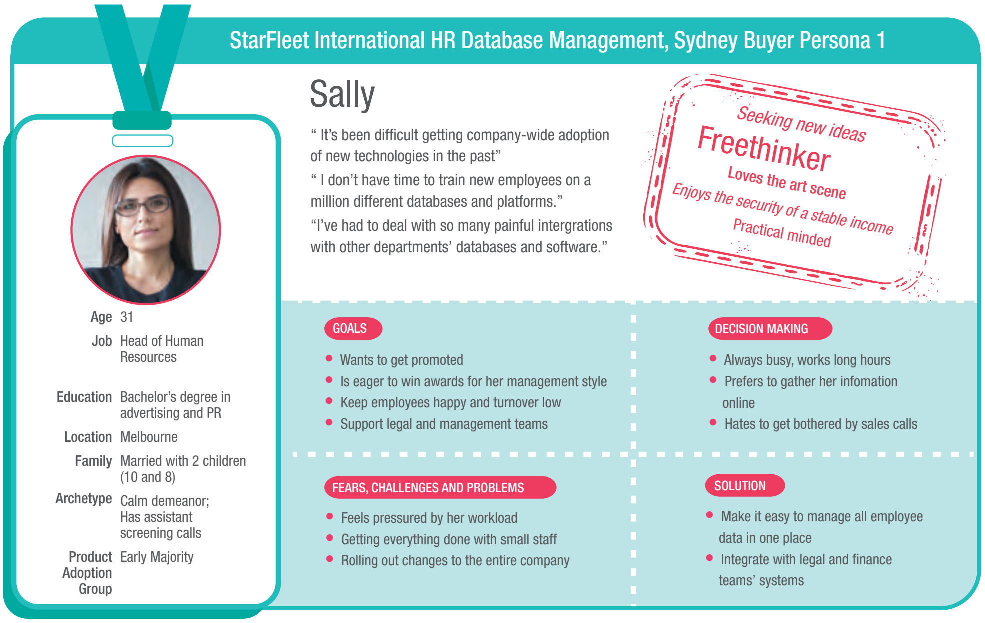
Imagine that you are the customer. You are buying a car because your old one failed. You have positive and negative experiences as you proceed down your journey map. Now imagine you are an entrepreneur aiming to solve this person's pain. You are interested in promoting your clever finance plan as an alternative to bank financing. Your value proposition is 'We are DirectCars. We provide cars fast at the best price and lowest financing delivered to your door with guaranteed to satisfy.'[97]

PERSONA ANALYSIS

persona
A semi-fictional representation of a customer segment in the B2C market.

organisata
The corporate equivalent to persona analysis that looks at the 'personality' of a company. (See also *persona*.)

A **persona** is a fictional character that represents a customer segment in the B2C (business to consumer) market. (If you are B2B, there's an alternative called the **organisata**.) Personas help to understand and visualise your target customers by describing the personality, interests, pains, goals and behaviour of a typical customer. Usually there is a photo, but the persona does not correspond to an actual individual but rather to a general type. Start with the photo and give the person a name. From all your insights from observing and interviewing likely customers, create a personality (age, gender, occupation, marital status); describe the person's pains (why are they unhappy, what is missing); list any goals they might have; describe their interests, lifestyle (leisure activities, interests and attitudes) and buying behaviour (how do they like to buy, where, when). Suppose you are interested in starting a website dedicated to fighting paediatric cancer. There might be three personas: (1) individuals who have had immediate experience of children dying; (2) people interested in supporting the fight against the disease itself, for



Shutterstock.com/sebra

FIGURE 6.7 PERSONA PROFILE OF A TYPICAL BUYER OF HR SOFTWARE

example, through research; (3) people who are driven by status and seek to associate themselves with a successful charity. See Figure 6.7, which is a persona analysis of a typical buyer of HR software.

Mind mapping

A **mind map** is an excellent way to find cohesion among disparate concepts. They help you generate, visualise, structure and classify ideas to look for patterns and insights that provide key design criteria. Using mind-mapping software such as Bloomfire, MindManager, or MindMeister, simply throw ideas at the screen. Then organise them by 'similars' into branches that will eventually form a nodal structure. You will gradually see how ideas or other items are linked to a central idea and to each other. We achieve this by displaying the data and asking people to cluster them in ways that allow themes and patterns to emerge.[98] To succeed, mind mapping must be a team sport.

mind map
A diagram used to visually organise information, showing hierarchical relationships among disparate concepts. Mind maps help generate, visualise, structure and classify ideas to look for patterns and insights that provide key design criteria.

Value chain analysis

Value chain analysis is the business-side equivalent of customer journey mapping. You move backward from value creation to see the capabilities and bargaining power of other key suppliers. Your proposed innovation will always exist within the value chain or network of existing or possibly new suppliers and buyers, some of whom may have the same questions as you. The number of links in the chain, or steps in the channel, represents the complexity of the industry value chain. By analysing the value chain, you can highlight the 'pain points' in the supplier stream. Analysis of the value chain offers ways to create better value for customers along the chain and uncovers important clues about solutions.[99]

value chain analysis
A diagram identifying a company's primary suppliers and support activities that add value to the final product; the corporate version of customer journey mapping. By analysing the value chain, you can highlight the 'pain points' in the supplier stream.

Download, saturate and regroup

Now that you have generated notes, photos, impressions, journey maps, quotes and more, it is time for sense-making, beginning with *sharing* your learnings as a group. Pour everything out of your head and onto a wall where you can start to make connections. This means posting your data as 'findings' to explore what themes and patterns emerge. Saturate your whiteboard with Post-its headlining the findings, and regroup them. The goal is to synthesise your data into interesting findings and create insights useful in creating design solutions.

IDEATION AND SOLUTION GENERATION TOOLS

Moving now beyond the *Explore* phase of the process model, we jump into ideation.

ideation
Literally, the act of forming ideas. In ideation, you combine your conscious and unconscious thoughts, your imagination and your rationality to go wide in terms of concepts and outcomes (see Figure 6.2, 'Divergent and convergent thinking').

Ideation is the process of idea generation, where you move from defining the problem to prototyping the problem.[100] Ideation is where you most diverge or go widest in terms of concepts and outcomes. This wonderful human capacity provides fuel for building prototypes and driving innovative solutions. Ideation helps us harness the collective viewpoints of our team. In ideation, you combine your conscious and unconscious thoughts, your imagination with your rationality.

Use your hypnagogic state of mind

hypnagogia
The state of consciousness between wakefulness and sleep, in which the mind has lucid thoughts and dreaming, hallucinations and deep insights.

Hypnagogia is that state of mind between wakefulness and sleep, that 'threshold consciousness' when someone asks you 'Are you asleep?' and you say 'Yes'. The hypnagogic state can provide insight into a problem. Many artists, writers, scientists and inventors, including Ludwig van Beethoven, Richard Wagner, Salvador Dalí, Nikola Tesla and Isaac Newton, have credited hypnagogia and related states with enhancing their creativity. Thomas Edison used this technique for coming up with creative ideas for new inventions. He would sit in a chair with steel balls in his hands and, as he drifted off and relaxed, the balls would drop, thus waking him, and more often than not he would have a new idea for research.[101]

Bodystorming

bodystorming
A design thinking research method that helps the entrepreneur experience the customer's 'pain' in order to derive new ideas and generate solutions. You design an experiment or an experience where you can enact how people would respond if they had your product or service.

Bodystorming helps us bridge the gap between empathy, ideation and prototyping by allowing us to physically experience the stakeholder's 'pain' in order to derive new ideas and generate solutions. Set up the physical situation of the pain or frustration and act as though the new product exists, using improvised artefacts and physical activities to see how the solution might work. The output will include scenarios, diagrams, sketches and artefacts.[102]

Brainstorming

brainstorming
A technique for creative idea and solution generation through unstructured group discussion. Every member of the group thinks aloud and suggests as many solutions as possible, no matter how eccentric or unusual they might be.

Brainstorming is a group-think creativity activity to generate solutions to a problem by gathering a list of ideas spontaneously contributed by its members. Its principles are 'defer judgement', 'withhold criticism' and 'go for quantity'.[103] The greater the number of ideas, the better the chance of finding a radical and effective solution. Park your criticisms for later stages. Let any wild idea be recorded. Combine ideas to improve them. At the end, cluster your ideas and vote for the favourites. Here are a few ways to brainstorm:

- *Bad idea into good*. Think of really bad solutions to your problem. The ideas should be crazy, funny, out of this world, absolutely impossible or completely impractical; for example, putting advertising on footwear, selling spit or a personal food chewing service. Now turn it on its head. Turn the really bad idea into a good business opportunity. For example, suppose your design challenge is to educate the public about wasteful plastic bottles. The really bad solution is to sell dirty, polluted water. Yes, that's a great educational idea!

- *Frame-storming* means reframing your assumptions. As Einstein once said, 'the mere formulation of a problem is far more essential than its solution.' Start brainstorming solutions to a problem, and spend time exploring different ways to frame the challenge, or what Stanford University's Tina Seelig calls 'frame-storming'. For instance: What is the sum of 5 plus 5? Or, what two numbers add up to 10? The first question has only one right answer, and the second question has an infinite number of solutions, including negative numbers and fractions. These two problems differ only in the way they are framed.[104]
- *'How might we?' (HMW) questions* are short questions that launch brainstorms. HMWs fall out of your value proposition, POV statements, design challenges and other insights. Create a seed question that has a variety of solutions but is narrow enough to provoke team thinking. 'How might we produce an ice cream cone that does not drip?' Stanford d.school listed a brilliant example in one team's brainstorm of how to redesign a mother's ground experience at an international airport:

  POV: Harried mother of three, rushing through the airport only to wait hours at the gate, needs to entertain her playful children because 'annoying little brats' only irritate already frustrated fellow passengers.
  Amp up the good: HMW use the kids' energy to entertain fellow passengers?
  Remove the bad: HMW separate the kids from fellow passengers?
  Explore the opposite: HMW make the wait the most exciting part of the trip?
  Question an assumption: HMW entirely remove the wait time at the airport?
  Go after adjectives: HMW make the rush refreshing instead of harrying?
  ID unexpected resources: HMW leverage the free time of fellow passengers to share the load?
  Create an analogy from need or context: HMW make the airport like a spa? Like a playground?
  Play against the challenge: HMW make the airport a place that kids want to go?
  Change the status quo: HMW make playful, loud kids less annoying?
  Break POV into pieces: HMW entertain kids? HMW slow a mum down? HMW mollify delayed passengers?[105]

- *Provocateur questions* are other stimulating brainstorm questions like: 'Who else wins if we're wildly successful?' 'How could we partner with them?' 'How can we be the best in the world at…?' 'What if…?' 'What might be a better way?' 'In an ideal situation, what…?' 'If you could wave a magic wand, what would you…?' 'If money were no object…?'

Create an idea napkin

Some of the biggest ideas began as doodles on a napkin/serviette. According to legend, the idea for the world's most successful budget airline came about in 1966, when Rollin King, owner of a small Texas commuter carrier, was pitching his plan for a new, low-cost service to his lawyer, Herb Kelleher. He drew the prospective route between Dallas, Houston and San Antonio on a napkin. The following year, the pair launched Southwest Airlines. Access an Idea Napkin template here: https://goo.gl/6cSqFJ.

Mash-ups

A mash-up mixes or fuses totally different design elements. 'What is the car dealer equivalent to a vending machine?', 'What would a farmers' market look like as a cafeteria?', 'What would be the Facebook equivalent to a savings account?' Write a list of features about each one and put them side by side. Connect items that are the same and those that are different. Access a mash-up template here: https://goo.gl/3UB2c8.

PRETOTYPING AND PROTOTYPING TOOLS

Prototyping or **pretotyping** is the stage where we develop virtual, physical, even experiential exercises for the purpose of gaining feedback. A prototype can be anything that a user can interact with. This is so important that we have dedicated an entire section in Chapter 7 to this important step in design thinking.

prototyping
The stage, after pretotyping, where you develop an early version of the product or service for the purpose of testing design and assembly before producing the final marketable product.

pretotyping
The stage, before prototyping, where we develop early, low-cost virtual, physical and experiential artefacts for the purpose of gaining feedback.

TESTING AND INTERPRETING TOOLS

The test mode includes all the hypothesis-based techniques where we place low-resolution artefacts in front of users. Testing is something you should consider as you build your preto- or prototype. What you are trying to test and how you are going to test that aspect are critically important to consider before you create a prototype. Careful thought about what and how to test should inform your prototyping. As you will see in the next chapter, the object is to put your prototype in the user's hands as they interact with it. Show, don't speak. Listen to what they say about it and questions they have. The purposes of testing are to refine our prototypes and solutions, to learn more about the user and to reframe our POV. Ask leading questions about them. What was the most memorable and surprising story? What did this participant care about the most? What motivated them? What frustrated them? What was interesting about the way they interacted with their environment? What questions would you like to explore in your next conversation?

These twin phases – pretotyping and testing – are so important that we have dedicated Chapter 7 and half of Chapter 8 to them.

DELIVERING, IMPLEMENTING AND EVOLVING TOOLS

Having completed the core of design thinking in the process model, we come to the stage where you deliver and implement a solution and prepare to evolve over time. This involves planning the next steps, communicating the idea to your stakeholders, documenting the process and preparing for launch of the product or service. In Chapter 7, you will test concrete measures of success using the *validation board*. In Chapter 8, you will learn about putting your business model into a *lean canvas* and pivoting it as more feedback comes in.

The same research skills you used in the *Discovery* phase can be repeated over time to see if there has been a change in behaviour. Obviously implementing an idea requires a different approach than generating a solution. This is where you start drawing upon deductive (see page 194) and historical logic. You list tasks and assign team members to track progress and identify gaps in service or even new opportunities that may arise. It is time to share your vision with other audiences and pitch your concept to potential partners and investors. This is where you create a compelling narrative to tell the story, and build a community of partners.

SUMMARY

We began by defining design thinking as listening to customer pains and generating solutions using the materials and resources at hand. We saw the human wonder of design all around us and learned to value what Buckminster Fuller called anticipatory design science, which aligns the human species with the design of our environment. Design thinking is the ultimate form of creative enterprise and is a noble calling for entrepreneurs, because it allows them to help satisfy peoples' needs and pains through the introduction of new processes, products and services.

There are different ways of acquiring knowledge today. Science uses experimentation to analyse the natural world. Humanities use metaphor and criticism to describe the human experience. Design, however, uses pattern formation, synthesis and modelling to study the artificial world all around us. Design can address intractable human concerns, also known as wicked problems. These problems are difficult to solve because we do not know enough and the stakeholders involved are too numerous and their opinions too divergent. We see that design thinking is used by non-designers such as entrepreneurs to innovate proactively and create a future. The technique has been used in many interesting areas, such as product development, architectural space, curriculum and even personal problems. Design reduces pain. Design satisfies need. Design creates value. History shows that designers have applied the human-centric creative process to build meaningful and effective solutions that meet the needs of humanity.

Design thinking theory goes back to design literature and management theory. Only in the 1980s did designers and social scientists make the mental leap to 'designerly ways of knowing' to solve the world's wicked problems. The connection between design, management and entrepreneurship occurred relatively late, but now many have realised what a powerful methodology it is in many realms, from new product and service design to personal growth.

We can approach design thinking through mindsets, human sense perception, addressable problems, and cognitive and reasoning perspectives, not to mention tools and practices. We call this 'designerly ways of knowing'. The designerly approach means using enterprising and empathic mindsets. Powerful human perceptions and cognitive abilities affect how we use design and how we interact with end products. We use hypothesis-driven entrepreneurship to test and validate assumptions concerning our proposed solutions to wicked problems. 'Design intelligence' means using reasoning and intuition to frame and reframe alternative solutions. Especially important is abductive reasoning, using the best information available (often making an educated guess) after observing phenomena for which there is no clear explanation; then testing your hunches until you have the *likeliest possible explanation* for the group of observations. Bringing it all together are divergent and convergent thinking, where you widen and then narrow your scope.

There are many design thinking process models that helps us systematise the procedures of our design thinking. In this book, we have integrated these models into the 'Etappe design thinking process model', composed of seven steps: preparation and scoping; discovery and empathy; defining and synthesising; ideation and generation of solutions; preto- and prototyping; testing and interpreting; and finally implementation and launch.

Each of these steps has methods. From the masterworks, we have distilled important methods. We covered opportunity identification in Chapter 5. In this chapter we described how in scoping an idea, we observe and talk to extreme users, select our sample to interview, define our challenge and form our team. For the process of discovering and empathising, we embrace an almost child-like naivety and empathic mindset to make observations. When it comes to defining and synthesising, we define our point of view, and how to frame and reframe our problem. Especially useful are empathy maps, customer journey mapping, persona analysis and mind mapping. When it comes to ideation and tools to generate solutions, we involve techniques as diverse as hypnagogia, bodystorming, brainstorming and mash-ups. The important design thinking process of pretotyping and prototyping is covered extensively in Chapter 7.

KEY TERMS & CONCEPTS

A/B testing
abductive logic
algorithm
analytical thinking
anticipatory design science
bodystorming
brainstorming
convergent thinking
critical thinking
customer journey
deductive logic
design
design challenge
design intelligence
design thinking
design thinking process model
designerly ways of knowing
divergent thinking
empathic mindset
empathy
enterprising mindset
Gaia hypothesis
holistic view
hypnagogia
hypothesis-driven entrepreneurship
ideation
inductive logic
integrative thinking
intuitive thinking
mind map
organisata
persona
point of view (POV)
pretotyping
prototyping
reflective reframing
value chain analysis
wicked problem

REVIEW & DISCUSSION QUESTIONS

1 Recalling Chapter 5, what are customer pains and how do they fit into the design thinking process model?
2 What do you think Buckminster Fuller meant by 'anticipatory design science'?
3 Why do we say that design is a noble calling for entrepreneurs?
4 Consider how designerly ways of knowing contrasts to science and the humanities. Name one problem in your daily life and describe how you would solve it using the methods of each discipline.
5 What are the characteristics of wicked problems?
6 What does mindset mean, and which are the most important mindsets we use in design thinking?
7 When we look at human perception and its relation to design, in your opinion, which are the top three perceptual characteristics of the human mind that most impact design?
8 Give an example of when you have used 'design intelligence' to reframe a problem after initially framing it wrongly.
9 What are the three core factors in the design thinking process model?
10 What are the top five tools you would use in your own design challenge?

EXPERIENCING ENTREPRENEURSHIP

Making toast

This quirky design thinking exercise comes courtesy of Autodesk's Tom Wujec. It reveals how the human mind frames (or re-frames) an idea. It gives us unexpected insights into how we communicate, collaborate and solve problems using systems thinking. Here we focus on finding solutions to something that we all know and love: making toast.

Part one

Distribute felt markers and large-size paper stock to each participant. Tell the group that they are about to take on an important challenge in modelling solutions to a problem. Ask everyone to take *3 minutes* to draw the process of making toast in images and steps. Have everyone share their drawings taped to the wall.

Interpretation: Have the group report on their multi-faceted creations. As diverse as our models are, they all have one thing in common. They can be represented as good, better and best.

Part two

Distribute more paper as well as multi-coloured Post-it notes to the participants. Now the participants must quickly re-draw their solution using Post-its, using as many as they need and re-arranging them as they see fit. Share the changed drawings and have each participant explain whether it is the same model or an altered one.

Interpretation: When we re-draw the solution with Post-its, we actually change the way we represent the solution based upon the materials at hand (Post-its versus large paper stock). Does this improve the process?

Part three

At this stage, talking gets in the way, so limit the group's talking if you can. This time, instead of working individually, participants will form groups of four to six people to jointly and quietly arrange their Post-its on a new piece of paper. Yes, they can overlap! Each group shares its result.

Interpretation: As Wujec says, 'it gets messier […] as people refine the models, [but] the best nodes become more prominent, and with each iteration, the model becomes clearer because people build on top of each other's ideas. What emerges is a unified systems model that integrates the diversity of everyone's individual points of view.'[106] Organisations of all types can use this exercise to crack their wicked problems. You can use this model to think about any business or personal challenge too.

Finally, watch Ted Wujec's TED video: https://www.ted.com/talks/tom_wujec_got_a_wicked_problem_first_tell_me_how_you_make_toast

Sources: Wujec, T. (2015, February 4). Draw toast on TED.com. https://www.tomwujec.com/114/; Wujec, T. (2013). *Got a wicked problem? First, tell me how you make toast*. https://www.ted.com/talks/tom_wujec_got_a_wicked_problem_first_tell_me_how_you_make_toast; Drawtoast.com. (n.d.). Draw how to make toast. http://www.drawtoast.com; Lebowitz, S. (n.d.). There's a simple 8-step exercise that can help you solve your biggest business problems. http://www.businessinsider.com/tom-wujec-and-the-drawtoast-exercise-2015-8; Shuey, J. (2015, May 22). How making toast can make you a problem solver. http://www.personalbrandingblog.com/how-making-toast-can-make-you-a-problem-solver/.

EXPERIENCING ENTREPRENEURSHIP

Design a wallet

This interactive exercise is designed to give you the experience of identifying opportunities, understanding the customer point of view, rapidly prototyping and giving a pitch. 'Design a Wallet' is a highly interactive, experiential learning exercise from Standford's Tina Seelig to help anyone designing a product or service to become more customer- and market-oriented. It helps you develop empathy by focusing on the wants and needs of your customers. In this exercise, you will interview one another about what you like/hate about your wallets. Based upon what you learn, you then build new wallets for your customer.

Instructions: Form several two-member teams (mixing genders is excellent). *Time:* 1½–2 hours.

1 Interview (4 minutes for each participant, switching roles). Take out your wallets. Interview the other person about his or her wallet and write your notes on the sheet. Ask your partner to describe the contents of their wallet. There is a nice worksheet for this exercise located at https://stanford.io/2KjK7zt.
2 Dig deeper (4 minutes for each participant). Ask your partner: What is this wallet to you? A storage container? A photo album? A life organiser? A black hole? What things do you love about your wallet and what do you hate? Why do you have a particular card in there? What do the things in the wallet reveal about your life? Take notes of things you find interesting or surprising.
3 Capture those findings (3 minutes). What things is your partner trying to do with their wallet? Are there any social or emotional aspects to it? What did you learn about your partner's feelings and worldview?
4 Now define the problem (3 minutes), filling in the blanks: [Name of partner] needs a way to [user's needs and desires]. Unexpectedly, I found that in his/her world, [Insight].
5 Quickly sketch at least three radical ways to meet your user's needs (5 minutes).
6 Share your solutions with your partner and capture their feedback (10 minutes).

7 Now, based upon sharing possible solutions and capturing feedback, draw your big idea for a new wallet for your partner (3 minutes).

8 Let each participant build something valuable that the partner can interact with. If time and supplies permit, use your 'Design Thinking Crash Cart' and give everyone 90 minutes to build their solution. For more on putting together the Crash Cart, see https://bit.ly/2LNMnF7.

9 Record your solution and get feedback. What worked and what could be improved?

Concluding the exercise:

1 Ask how many participants would purchase the wallet that their partner created for them.

2 Ask some of the participants who said they would purchase the wallet to explain why.

3 Ask some of the teams to describe the process of designing the new wallet.

More exercises:

1 Organise a *1-minute pitch exercise:* At the end, you may ask each person to give a 1-minute pitch for their new wallet, which helps build presentation skills (critical for potential entrepreneurs).

2 *Show and tell:* You will be surprised by the number of innovative wallets that will be created in the class!

CASE STUDIES

CASE 6.1

CLEAN TEAM: IN-HOME TOILETS FOR GHANA'S URBAN POOR

For the millions of Ghanaians without in-home toilets, there are few good options when it comes to our bodies' most basic functions. Working with Unilever and Water and Sanitation for the Urban Poor (WSUP), the famous San Francisco-based design firm IDEO developed Clean Team, a comprehensive sanitation system that delivers and maintains toilets in the homes of subscribers. Clean Team now serves thousands of people in Kumasi, Ghana, making lives cleaner, healthier and more dignified.[107]

Using design thinking techniques, a team from IDEO conceived a comprehensive sanitation system to serve the needs of low-income Ghanaians. The Clean Team service is a custom-designed standalone rental toilet as well as a waste-removal system, but the design work extended to the entire service ecosystem, including branding, uniforms, a payment model, a business plan and key messaging.

The **Discovery** (see Figure 6.3) phase of the project was intense, with scores of interviews needed to understand all facets of the design challenge. 'Because sanitation is a systems-level challenge we knew that we couldn't just design Clean Team's toilet', says team member and designer Danny Alexander.

After six weeks of talking with sanitation experts, shadowing a toilet operator, digging into the history of sanitation in Ghana and talking to many Ghanaians, key insights about what the toilet should look like and how waste should be collected emerged.

The **Ideation** phase was lightning-fast, one that leapt from learnings to prototypes in seven weeks. After brainstorming with its partners and everyday Ghanaians, the team determined which direction to take and began testing its ideas. What aesthetics did people like? Would a urine-diverting toilet work? Would people allow servicemen into their homes? Where in the home would the toilet go? Can you design a toilet that can only be emptied at a waste management facility?

By building a handful of **prototypes** and modifying existing portable toilets, the team got tangible elements of the service into the hands of Ghanaians. The **test phase** looked at how the service should be positioned and early ideas around marketing and promotion, as well as certain technical limitations, namely that though flush functions appeared popular early on, water scarcity was a major factor to contend with, and nobody relishes disposing of their own waste.

Implementation began with a live prototype. Because tooling for toilet manufacture is so expensive, the team used off-the-shelf cabin toilets, which approximated about 80 per cent of the features that IDEO would design, to test the service.

QUESTIONS

1 How did the design process follow or deviate from the Etappe design thinking process model (Figure 6.3)?
2 Can you imagine which extreme users the team interviewed?
3 Study the videos in the endnote and write down your impressions.

ONLINE STUDY RESOURCES

CourseMateExpress

Visit http://login.cengagebrain.com and use the access code that comes with this book for 12 months' access to the resources and study tools for this chapter.

The CourseMate Express website contains:

- take it further activities
- revision quizzes
- video activities
- and more!

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CHAPTER 7

LEAN ENTREPRENEURSHIP AND IDENTIFYING CUSTOMER NEEDS

Give me six hours to chop down a tree and I will spend the first four sharpening the axe.

Attributed to **Abraham Lincoln**[1]

If you're not embarrassed by the first version of your product, you've launched too late.

Reid Hoffman,
Founder of LinkedIn[2]

To pivot, or not to pivot, that is the question: Whether 'tis nobler in the mind to stay the course and persevere, or to change course against a sea of troubles.

Hamlet, were it set in Silicon Valley.[3]

Doing the right thing is more important than doing the thing right.

Peter Drucker[4]

CHAPTER OBJECTIVES

1. To understand the potential for failure if the business model is misaligned with customer demands
2. To understand pretotyping through historical examples and appreciate the differences between prototyping and pretotyping
3. To be able to build a minimum viable product within the process of pretotyping and appreciate the many types of minimum viable products for start-up entrepreneurs
4. To know how to apply hypothesis testing to developing your start-up
5. To know how to apply the technique of validation to new products and services
6. To know how to apply the concept of pivoting and to understand the various kinds of pivots
7. To be aware of the ethics of pretotyping

BRINGING OPPORTUNITIES TO LIFE

In this chapter, you make the opportunities that you have identified and designed come alive. You will develop and test a 'pretotype' (pretend-prototype) through which the main features and characteristics of your value proposition will take shape. You will 'iterate' it with customers in order to validate their needs. You will develop a minimum viable product (MVP) with cheap available resources. The MVP can be a web landing page, an app, a wireframe, an explainer video, the physical product itself or many other cheap and dirty forms.

lean entrepreneurship Launched in 2008 by Eric Ries, a methodology for developing businesses and products through hypothesis-driven experimentation, iterative product releases and validated learning.

Here is how this chapter fits into the concept of lean entrepreneurship. With **lean entrepreneurship** we write a business plan only after validating our value proposition, testing the idea iteratively, and designing a lean business model (see Figure 7.1). If you go straight to the traditional business plan, as some methods do (including ours in past editions), you cannot help but include untested assumptions in the plan, ones that rarely survive first contact with customers. The lean approach gets you quickly out into the market to test your product. You do not need a business plan for that. Usually, at the end of your product development and customer testing, then you write your business plan as and if required.

Like everyone else, since 2004 this book focused on how to write long-form business plans. It's not that this is unimportant (we return to it in Chapter 11). Long-form business plans are important for some purposes (such as banks or venture capital). The problem is that often these carefully thought-out plans, if prepared too early, sometimes (often!) have not had the benefit of grounded customer insight on the product and sales channels. The reason for this is that start-ups are not just smaller versions of large companies. Successful start-ups go quickly from failure to failure while adapting, testing new iterations and improving ideas with continual feedback from customers. The lean method is driven by '**build-measure-learn**' (see Chapter 5, p. 151). At each stage, we use hypotheses that can easily be tested, roll out series of 'iterative' product releases that address customer needs better and better, and use **validated learning** that help us improve and try again.[5]

build-measure-learn A core component of hypothesis-driven entrepreneurship methodology. First build a minimum viable product, then measure and learn using actionable metrics that feed back into the next iteration.

validated learning Learning whether you have satisfied the customer need or not by testing your idea and measuring it to validate its effect.

PIVOT, PERSEVERE OR PERISH: AN INNOVATION GRAVEYARD

Let's have a short look at some businesses that failed to pivot (change course), and some that successfully pivoted their business models. There are many examples of companies left in the dust because of misalignment between their value proposition (VP) and what the customer was demanding. Their VP simply did not answer a real need anymore; it did not address the evolving problems or jobs of the customer.

Meanwhile, alert and continually learning entrepreneurs see the writing on the wall. They pivot and even sometimes ditch their products. They think, 'our failure was an expensive experiment to find out that customers are telling us to move in another direction'. Here are some examples of companies that paid the price of not validating the value proposition. Some failed and others rose from the dead.

- *Chegg* is the *Gumtree* for college students. When Facebook also decided to do classifieds, Chegg bit the bullet and pivoted to another college student 'pain', textbook rentals. Chegg simply bought books on amazon.com and sent them out, and the renters returned them back to Chegg. Book rentals skyrocketed and Chegg created a model where they could rent out the same book again and again. Then they added on such benefits as homework help, online tutoring, scholarships and internship matching to create end-to-end college student support.

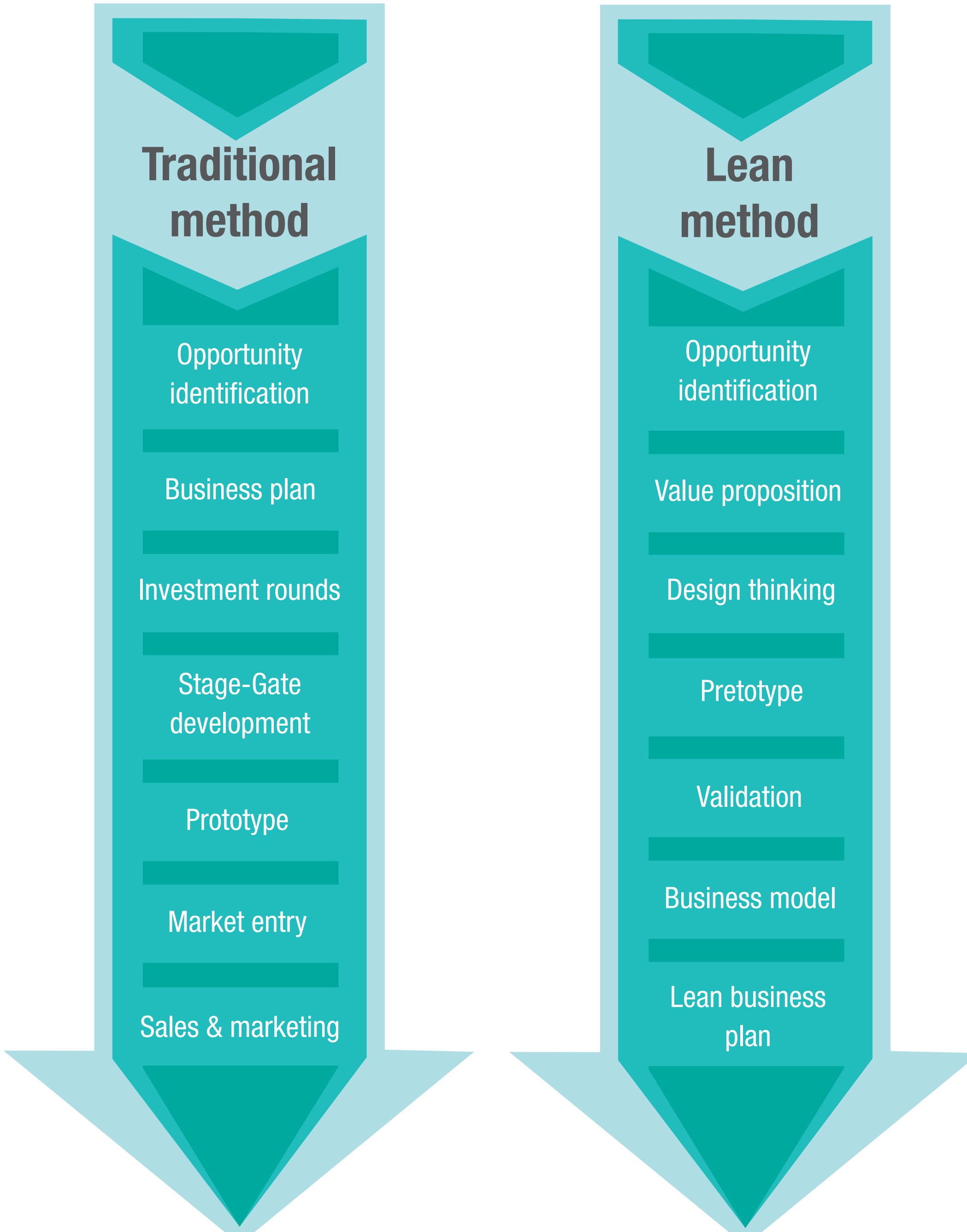


FIGURE 7.1 THE DIFFERENCE BETWEEN LEAN ENTREPRENEURSHIP AND THE TRADITIONAL METHOD OF START-UPS

Sources: Informed by Brinckmann, Jan, Dietmar Grichnik & Kapsa, D. (2010). Should entrepreneurs plan or just storm the castle? A meta-analysis on contextual factors impacting the business planning–performance relationship in small firms. *Journal of Business Venturing* 25(1), 24–40. https://doi.org/10.1016/j.jbusvent.2008.10.007; Blank, S. (2013). Why the lean start-up changes everything. *Harvard Business Review*. https://hbr.org/2013/05/why-the-lean-start-up-changes-everything; Mahdjoubi, D. & Gibson, D. (2015). Formal business plans as myth and ceremony. *World Technopolis Review* 4 (1 December): 222. http://koreascience.or.kr/article/ArticleFullRecord.jsp?cn=SGGHBZ_2015_v4n4_222; Jones, C. & Penaluna, A. (2013). Moving beyond the business plan in enterprise education. *Education + Training* 55(8/9), 804–14. https://doi.org/10.1108/ET-06-2013-0077; Ghezzi, A., Cavallaro, A., Rangone, A. & Balocco, R. (2015). A comparative study on the impact of business model design & lean startup approach versus traditional business plan on mobile startups' performance. In *17th International Conference on Enterprise Information Systems*, 196–203. Barcelona. https://core.ac.uk/download/pdf/74313415.pdf; Folsom, K. (2015). Lean startup model & millennials vs. the traditional business plan & baby boomers. *Hera Herald Resource Center (blog)*, 26 January. https://herahub.com/resources/lean-startup-model-millennials-vs-the-traditional-business-plan-baby-boomers/; Amarsi, N. (2015). Why and how organizations around the world apply the business model canvas. *Strategyzer*. https://blog.strategyzer.com/posts/2015/2/9/why-and-how-organizations-around-the-world-apply-the-business-model-canvas; Sweeney, D. (2018). Traditional business plan vs. lean startup plan: Which is best when starting your new business? AllBusiness.com, 30 January. https://www.allbusiness.com/traditional-business-plan-lean-startup-plan-115661-1.html; Berry, T. (2014). Lean business planning in a nutshell. *Lean Business Planning (blog)*, 2 January. https://leanplan.com/lean-business-planning-process/.

- *PayPal* started life back in the PalmPilot days as a product called Confinity that could 'beam' sums of money between PalmPilots. PayPal discovered that people were not using their 'pay by PDA' feature and dropped it in favour of the wildly successful web payment feature.[6]
- *Odeo* started out as a service where you could find and subscribe to podcasts. Unfortunately for its founders, iTunes Store moved into that space. So the company brainstormed possible new directions. Spotting one, they bought up a quirky little messaging service called Twitter, and the rest is history.[7]
- *Google* is known for its collection of popular products, from search engines to maps to Android. But not everything turns to gold. Google has pivoted countless times. Google first unveiled Google Glass in dramatic fashion in 2012, but the device never made it due to a high price tag, software issues, potential privacy problems and the fact that it generally looked too nerdy!
- *Eastman Kodak*. During most of the twentieth century, Kodak was *the* dominant supplier of photographic film and cameras. Before there was the 'selfie', people used to 'capture a Kodak moment' at birthday parties, sunsets, tourist attractions and the like. Kodak based its growth on film production, but in the early 1980s it made a decision not to move into digital because that would threaten the very high-margin sale of film. Incredibly, it had actually invented digital photography, but to protect their film business model, their strategy was to patent hundreds of innovations related to film processing so that no one else could move into the high-margin film market while Kodak continued to milk it. Refusing to see what the customer really wanted, Kodak fell to bankruptcy in 2012.[8]
- *Blockbuster Video*: Long before there was Netflix, there was Blockbuster. By 2000, customer expectations were changing, and Blockbuster's competitors offered mail delivery and bigger catalogues. Then streaming internet sites arrived and illegal pirating of downloads became mainstream. To fight back, in 2009 Blockbuster pivoted to a video vending machine network to rent movies. Blockbuster's business model had one weakness though: it made enormous profits through late fees, thus penalising its patrons. Netflix came along with a business model more like a health club, with subscriptions. Customers could watch a video for as long or as often as they wanted, or simply switch to a new one. Blockbuster's leadership could not envision changing its business model – that would have hurt its profitability. So the company bit the dust. Its vending machine became its coffin!
- *Iridium*: The 1990s story of satellite communications company Iridium is famous for all the wrong reasons. In an attempt to disrupt the telecommunications sector, Iridium spent $5 billion building a satellite phone system that it believed the market would adopt. In its haste to overcome technical challenges, the company ignored market validation methods (including pretotyping). The idea was to launch low-Earth-orbiting satellites to deliver the same phone services that cell phones and copper wire already did. For customers it would have meant carrying something the size of a brick! The result was billion-dollar losses.[9]

The basic lesson is that companies should pivot their business model when they realise that they are failing. When should you pivot? At the start-up phase, pivoting is cheap and very useful. But for companies who fail to realise or accept that their business model is broken, it becomes progressively more expensive.[10]

ENTREPRENEURIAL EDGE

GREAT BUSINESS PIVOTS

COMPANY	HOW THEY PIVOTED
Berkshire Hathaway	Textiles to private equity
BMW	Aircraft engines to vehicles
Bombardier	Snowmobiles to jet liners and trains
Flickr	Multiplayer online role-playing game to web photo sharing
IBM	Punched card equipment to computers
Living social	Facebook-style app to flash deals
Nintendo	Playing cards to video games
Nokia	Paper and rubber boots to mobile phones
Philips	Light bulbs to consumer electronics
Pinterest	Window-shopping app to app for collecting favourite items
Pixar	Animation tools to animated movies
Shopify	Online snowboards to online shopping cart
Sony	Rice cookers to consumer electronics
Suzuki	Weaving looms to vehicles
Viacom	Drive-in theatres to media conglomerate
Wix	Flash website builder to HTML5-based website developer
Yelp	Email recommendations for friends to one-stop shop for local business reviews
Youtube	Online dating to video streaming service

Source: Bajwa, S. S., Wang, X., Duc, A. N., & Abrahamsson, P. (2017). "Failures" to be celebrated: An analysis of major pivots of software startups. *Empirical Software Engineering*, 22(5), 2373–2408; What's the best pivot in business you've ever heard? (n.d.). Quora. https://www.quora.com/Whats-the-best-pivot-in-business-youve-ever-heard. Nazar, J. (2013). Famous business pivots. *Forbes*. https://www.forbes.com/sites/jasonnazar/2013/10/08/14-famous-business-pivots/#e25361579780; Ghosh, S. & Payton, C. (2016). Anthology: Pivoting the business model. Harvard Business School Press. https://cb.hbsp.harvard.edu/cbmp/product/817066-PDF-ENG; Arteaga, R. & Hyland, J/ (2013). Pivot: How top entrepreneurs adapt and change course to find ultimate success. Hoboken, NJ: John Wiley & Sons, Inc. https://doi.org/10.1002/9781118778852.ch11.

PRETOTYPING

How to avoid these kinds of failures? Memorise these words:

Fail fast, pretotype often, validate relentlessly, and pivot quickly.

Often, entrepreneurs are inclined to go straight to the full-blown business plan prompted by entrepreneurship teachers that use business planning as an instructional device. If you do it this way, you may assume too many things that are untrue – unless and until you have proven/validated them. The best way to test them is by using a three-step process called PVP: pretotype, validate, pivot. This is a set of experiments, tools and metrics that helps you build a solution that people will actually want to use. Remember Savoia's famous phrase: 'Make sure you are building the *right it* before you build it right.'[11] This process makes sure you have found the *right it*. Today we call it hypothesis-driven entrepreneurship (see p. 226 below).

product-solution fit
Perfect intersection between product value and customer needs such that you are sure you are building something that people want, you are making money and a significant portion of customers indicate that they would be 'very disappointed' if they no longer have access to the product or service.

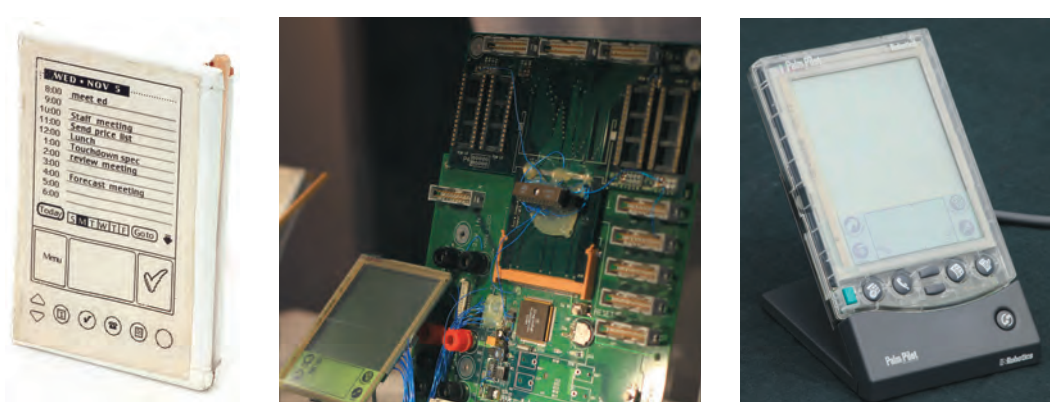
Sometimes called a mock-up, pretotyping (basically 'pretend-prototyping') is how you can cheaply and quickly put your idea into a form to see if it achieves **product-solution fit**. This way, product developers can churn through many ideas at a low cost and with minimum time investment. Basically, you create a series of mock-ups (virtual or physical) that you can use to see if they solve a user's problem. A **pretotype** allows you to simulate the core experience of your idea with the smallest possible investment of time and money to see if customers will use it. Pretotyping helps you to *fail fast enough and cheaply enough* that you have time and resources to try something different.[12]

pretotype
A preliminary version of your product, usually a minimum viable product, that may fail or not even work, but allows feedback to be obtained from potential customers.

HISTORICAL EXAMPLES OF PRETOTYPING

There are a couple of great historical examples that illustrate the process of pretotyping. One is the famous PalmPilot (see Figure 7.2) from the late '90s. It seems so obvious today that it was amazing no one thought of it sooner: a shirt-pocket-sized computer that keeps track of phone numbers, addresses, calendar appointments, a to-do list and memos.

FIGURE 7.2 PRETOTYPE, PROTOTYPE, PRODUCT: THE PALMPILOT[13]



Pretotype | Prototype | Product

Source: © Mark Richards. Courtesy of the Computer History Museum.

Pinocchio test
A method of experimental validation whereby you create a non-working version of your service or product so that customers can imagine that it is actually functional.

To test his concept, entrepreneur Jeff Hawkins first created the device … *out of wood!* Today, we call it the **Pinocchio test** because Jeff was 'telling a lie' and everyone knew it. He brought out his fake wooden PalmPilot at meetings and tapped it with his wooden stylus (a chopstick!), saying 'When can we get together, let me put it into my device.' He used different design interfaces and various button configurations made of paper glued on to the wood, and he carried his pretotype around for months pretending it was a computer. Only much later, after he had identified huge interest, did he build the **prototype**, which actually worked, but was much too big (see Figure 7.2). After much iteration, pivoting, validation and pretotyping, the release version was market-ready in 1997.[14]

Another fascinating historical example of pretotyping is IBM's speech-to-text transcriber.[15] Back in the mid-1980s, engineers had the idea for a speech-to-text computer where you could dictate into a microphone and the text would miraculously appear on the screen. The prototype phase would obviously have cost millions. Before investing huge sums, to see if they had the *right it*, IBM asked focus group customers to try out a pretotype. The trick was that their *words were being transcribed to screen by a typist sitting the next room*. Users were amazed and initially thought it would solve a great pain they had: dictation. But the surprises were equally astounding. IBM learned that even though the customers were astonished, they did not like the solution for reasons that had not even occurred to the IBM team. The customers got sore throats, and they were concerned about privacy (they wanted a sound-proof booth!).[16]

This is now called the **mechanical Turk test** after a fake chess-playing machine constructed for Empress Maria Theresa of Austria.[17] The mechanism appeared to be able to play a strong game of chess against a human opponent, but in truth there was a Turkish chess master hiding inside to operate the machine. It is also called the **Wizard of Oz test** because we 'pay no attention to the man behind the curtain'.[18]

WHAT IS THE DIFFERENCE BETWEEN PRETOTYPING AND PROTOTYPING?

An actual prototype is something you produce right before the release version (see the second image in Figure 7.2). A pretotype is a preliminary version (first image). It may sound counterintuitive, but *you should put an unpolished pretotype in front of potential customers as soon and as often as you can*. If you have truly targeted a real pain, then users will recognise the potential of your idea and want to know more. You need to show it to the real users that you identified in the opportunity identification phase (Chapter 5), whose actual pains you understand and are trying to solve. Even if you are embarrassed by your pretotype's appearance, it is important to engage with the users as soon as possible. Listen to their experiences and problems. Especially important is to find out the minimum number and type of features required to solve their pain points. Get them to answer simple questions:

- Does this solve problems that you have?
- Is it better than alternative solutions?
- Would you and others use it?
- Would you buy it? How much would you pay?

You produce an actual prototype much later in the development process. Entrepreneurs understand pretotypes. Scientists, engineers and project planners understand prototypes. These latter groups divide the prototyping process into time-sequenced stages separated by management decision gates. This is called the **stage-gate process**, in which an engineering-dominated team turns the founder's vision into reality (see Figure 7.3).

Here is the exhaustive and exhausting way to prototype using the stage-gate process so that you can see the difference with quick and dirty pretotyping. At Gate 1 you get a flickering green light from the bosses. Stage 1 is a preliminary in-house assessment. Gate 2 subjects the product and the appraisal to reactions from the sales force, who presumably have contact with the customers. Stage 2 is the stage before heavy development spending and includes market research studies, concept testing, competitor analysis, technical appraisal, operations plans, legal/patent/copyright issues and financial analysis. At Gate 3, management decides on the business case to spend heavily (last chance to kill the project). In Stage 3, the product goes into development along with marketing and operations planning. Gate 4 is

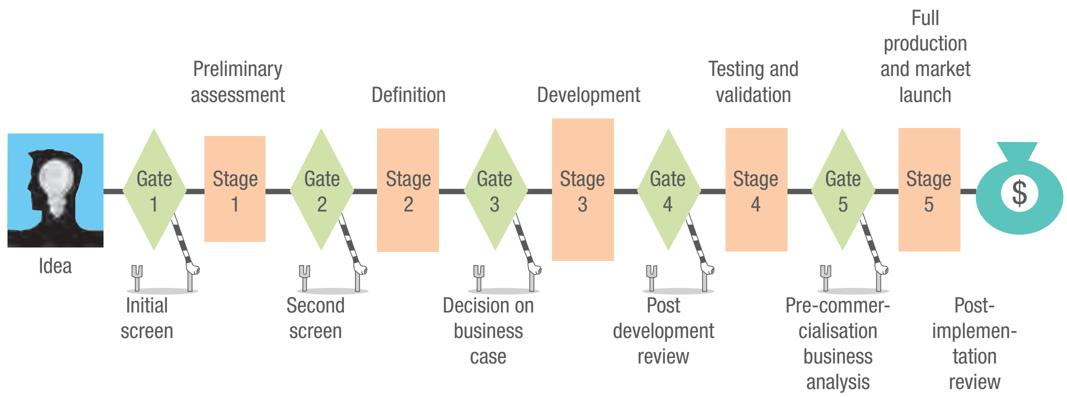
prototype
In contrast to a pretotype, a preliminary version of a product that costs a lot of money and is produced as a final step before producing the actual product. In the prototype you want to show all the features the product will have. (See also *prototyping*.)

mechanical Turk test
A method of experimental validation that uses a hidden human to simulate a technology in order to deliver potential customers the same experience with a fraction of the cost, thus postponing development until you prove market interest. Also known as Wizard of Oz test

Wizard of Oz test
See *mechanical Turk test*.

stage-gate process
A new product development technique divided into distinct stages, separated by decision points (known as gates).

FIGURE 7.3 THE STAGE-GATE PROCESS



commercialisation The process of introducing a new product into the market; sequence of actions necessary to achieve market entry and general market competitiveness of new innovative technologies, processes and products.

the post-development review. Stage 4 is testing and validation of the product, the production process, likely customer acceptance and the economics of the project. Gate 5 is the pre-commercialisation decision. Stage 5 is full commercialisation.[19]

Whew! Entrepreneurs can do without that! Table 7.1 provides a list of the differences between pretotypes and prototypes.

TABLE 7.1 PRETOTYPES AND PROTOTYPES ANSWER DIFFERENT QUESTIONS

PRETOTYPES	PROTOTYPES
Is this the right thing to build? Should we build it at all?	Can we build it?
Would people be interested in it?	Will it work as expected?
Will people use it as expected?	Will it continue to work and not fail?
Will people continue to use it?	How will people use it?
Can we build a stripped-down mock-up?	How fast can we make it?
Will people pay for it?	Can we create a version as close as possible to the final product?
What are the minimum features that solve the customer's pain?	Can we show all the features the product will have?
How can we design it to fail fast and cheaply?	Can we produce it fast or cheaply enough?
Many, many iterations before the final product	Functional and close to the final product
Cost and timeframe very low	Takes months or years and can cost millions
Will people use it at all?	What will people use it for?

AGILE DEVELOPMENT

Our lean entrepreneurship approach is basically the **agile development** of 'minimum viable products', reframing the problem until a satisfactory solution is generated. In contrast, Stage-gate is a lock-step linear process that can last for months. Agile development builds products iteratively and incrementally in short, repeated cycles.[20] Use the core factors of design thinking to develop your minimum viable product (MVP), which contains only the critical features; gather feedback from customers; then reframe and revise the minimum viable product over and over based on what you learned. The basic principles of agile development are: Satisfy the customer early and continuously; embrace changing requirements, even late in development; harness change for the customer's competitive advantage; and deliver working pretotypes frequently.[21] Figure 7.4 shows *agile development* in action. It is iterative and recursive.

agile development
A method of product development in which the product is developed iteratively and incrementally while continuously seeking customer feedback using successive minimum viable products.

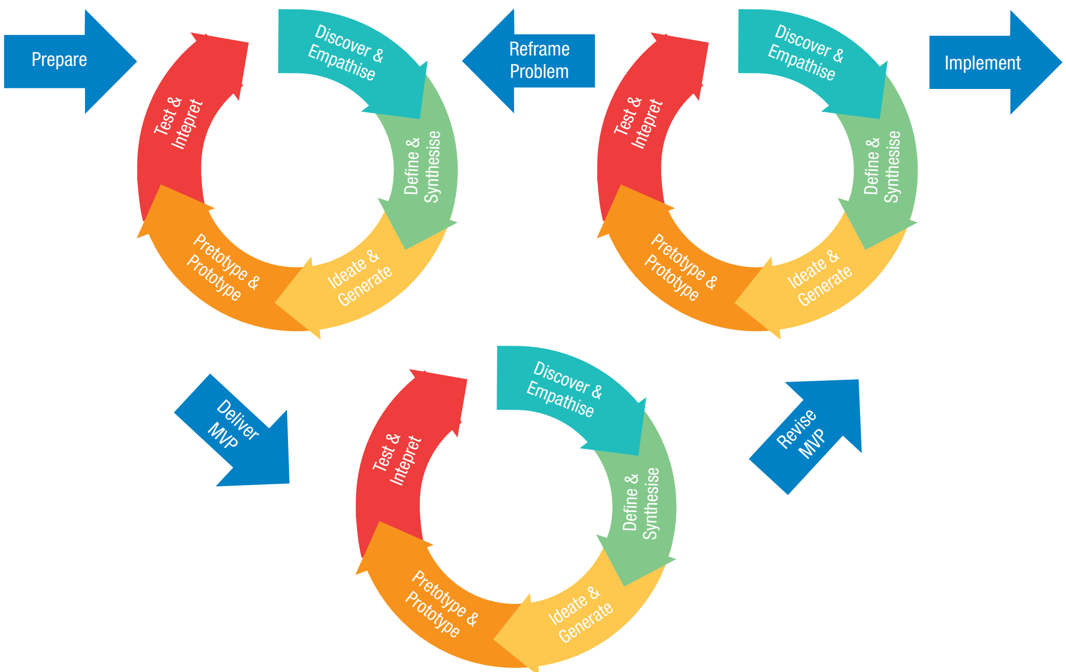


FIGURE 7.4
AGILE DEVELOPMENT[22]

DEVELOPING MINIMUM VIABLE PRODUCTS

Pretotyping is a process that leads to **minimum viable product**, one that delights the customer and has *just enough functionality*, with emphasis on 'just enough'. Don't misunderstand the word minimum. It does not mean an incomplete MVP with too little functionality. It is not a substandard user experience or a product that is clunky or buggy. It does not (necessarily) mean a cheap product. It means a product (or service) with a minimum set of 'core' functionalities that makes it *useful enough* to be able to test customer needs. Ignore the 'nice to have' features. It should be *functional enough* to test in front of live

minimum viable product (MVP)
A temporary product with just enough functionality to satisfy early adopters; solicits early feedback to be fed into future development with which you are able to test a product hypothesis

customers. The MVP's primary purpose is to accelerate the build-measure-learn feedback loop as soon as possible. With MVPs, we test hypotheses, and we *validate or invalidate* our assumption that people actually want it. There are many kinds of MVPs. Use your imagination and creativity to pick the types that best suit your particular project.

PREPARING PHYSICAL MVPs

For a physical MVP, use the most basic materials first and work your way up to the complexity you require as the build is tested with the customer so as you can learn. Your pretotype, starts with hand sketches/wireframes, paper, cardboard, foam, wood, Lego, lookalike products, basic fabricated parts or 3D prints. Remember the PalmPilot example – Hawkins used a chopstick for a stylus. The prototype (see Figure 7.2) proved the configuration of the technology would work and could be tested by a few customers with the barest minimum functionality. If it is a new kind of wind turbine blade, make it out of balsa wood to illustrate the design principles and demonstrate improved performance with customers using experimental results. The first launch of the product should be not over-engineered and over-featured but be the simplest and most minimal design that satisfies the customer, solves their problem and gets the job done. No more, no less.

ENTREPRENEURIAL EDGE

MAKE YOUR MINIMUM VIABLE PRODUCT INTO YOUR MOST VALUABLE PLAYER

Your minimum viable product is an important milestone. Done correctly it can be the most powerful and important milestone of all. All businesses start out as 'billion-dollar ideas' (at least in the mind of the founder). A lean marketing plan and a business plan are developed; charts, graphs and tables are drawn up. The founder works furiously in formulating the business and moves a lot of dust. They start talking to friends and ask for money (after they run through their own) to keep their baby in business. Soon they hit the point where it is either going to work or it is not. After all of the late nights and panic, they must decide what they are actually launching.

Your first product offered to the trial customers (not family or friends) is a difficult thing to create. It must be useful and desirable, but you will never have enough time or money to make it all that you want it to be. This is the point where many businesses run out of money by over-engineering the launch. Your MVP is just that: the minimum you can do to attract interest and feedback. Your minimum viable product has to accomplish two major things that will make or break the business. First, it has to get customers to say 'I like it and I'd buy it, but . . .' It has to demonstrate that strangers will buy this thing, hire you or go to your store. This is achieved by communicating your idea and showing people how to give you money in exchange for something. It doesn't need to be pretty. The reason that this step is so important is that it is designed to *attract consumer interest and have a compelling value proposition*!

Second, your MVP needs to show that you have turned the corner with a viable business. Up until now you were spending the most expensive money there is, early round funding and personal or family savings. Now, for the first time, you will be able to talk to real investors with leverage on your side. You have a *proven idea*! (Not a pretty, polished or fully developed business.) That's why we say your MVP is now your Most Valuable Player!

BUILDING VIRTUAL MVPs

Virtual MVPs use software and images that appear to be functional. Sometimes they are clickable demo apps or screenshots. You can use photoshopped images, PDFs or PowerPoints that act like software/apps. Using rapid app prototyping software (see **Table 7.2**) you can create clickable/interactive environments that represent complex systems reacting to events in real time, and customising themselves for each user and each device individually. You can use no-code and low-code mobile development tools and application simulators using existing content and social networking feeds to produce a variety of different test approaches for your app.

Infographics

One virtual MVP that many entrepreneurs use for testing a business idea or product is an infographic. It is something you can post on the wall and talk about, pointing to different elements and ascertaining the customer's interest. In its two dimensions you can put phrases, images and explanatory text that make up your value proposition. The purpose of the infographic is to draw the customer's attention through colour, images and design. Using PowerPoint, Illustrator or Photoshop, you can design an infographic with the dimensions of a large poster and convert it to a smaller format to post online or send to potential customers, thus possibly boosting your reputation and online presence.

Explainer video

One video is worth 48 billion words … er, dollars. That is the value that Dropbox built upon one explainer video. Explainers are short, informative videos usually 2–3 minutes long. Explainer videos are used when you want to teach, inform and inspire. Take difficult-to-understand Cloud computing. Dropbox in 2009 paid $50 000 for a 2-minute explainer about why customers needed Dropbox even if they did not realise it: How it would allow them to share files across multiple devices. Dropbox was not even ready! It used the video to get people to click on a waiting list icon. To see the actual video, go to https://youtu.be/w4eTR7tci6A.

Landing page

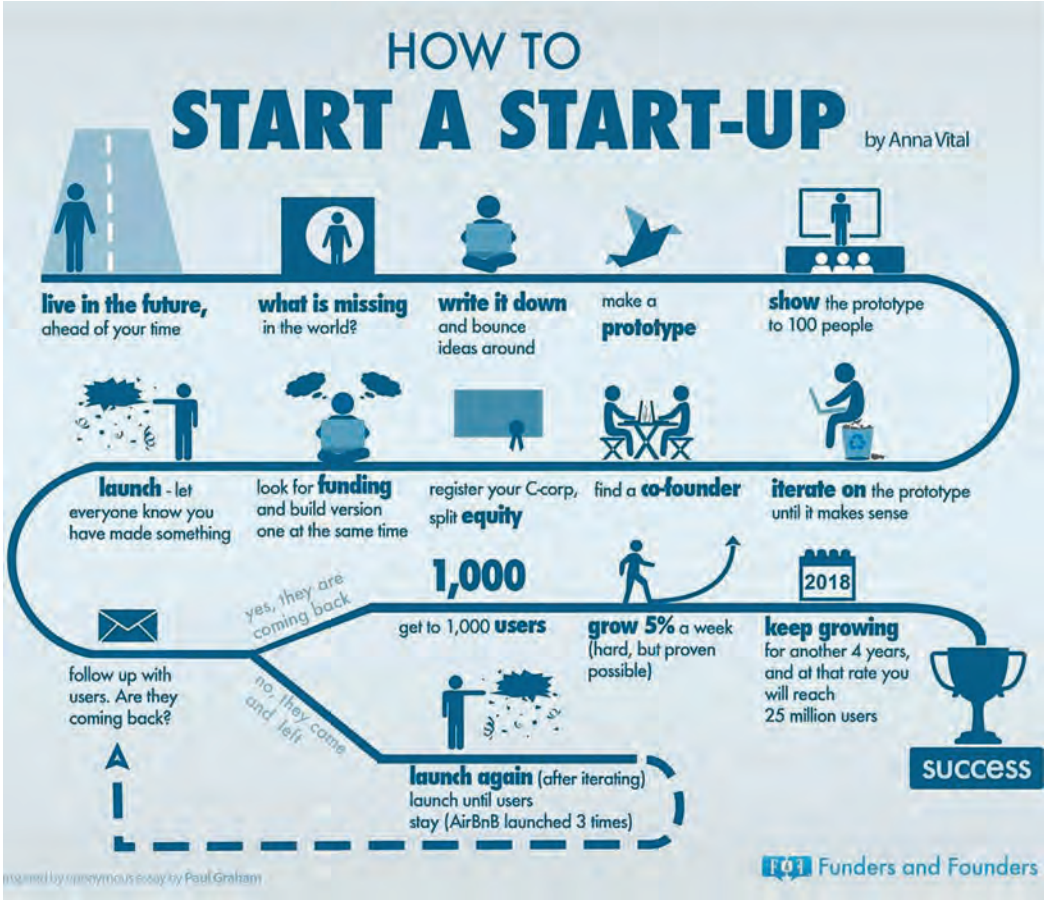
In online marketing, a **landing page** is a web page that captures customers who have a pain your product or service can satisfy. This is not the same as a homepage for general surfers. A landing page is usually connected to a Google or Facebook ad. Using landing pages, you want to convert specific customers into sales leads. The page must have a big Call to Action (CTA), such as 'leave your email here'; 'contact me by phone'; 'buy now'; 'click here for free information'; 'download your free e-book'. It is a form of *inbound marketing* (see Chapter 8). You can also use the Google Keyword Tool to see how many monthly searches are performed for various related keywords. Using Google Trends, you can search for a product idea and view the search volume throughout the years. Test various keyword combinations, and then set up an ad using Google AdWords Express. See the ethics section below, but if payment is not involved, you might be able to use this test with vapourware too. Obviously, the more honest you can be with the test audience, the better.

landing page
A specially designed web page used in ad campaigns that a visitor 'lands' on, for example, a lead-generation landing page to capture user data would contain a form along with a description of what the user will get in return for submitting their personal data.

Crowdfunding

Crowdfunding platforms like Indiegogo and Kickstarter can be an effective way to measure interest in your product and to quantify demand. If you have a product idea and need to raise funds to complete the design or first manufacturing run, why not create a Kickstarter project? You are testing whether the project generates buzz. You could also use it simply to gauge market response. To protect yourself from

FIGURE 7.5
INFOGRAPHIC 101



Source: Walter Lim, 'How to Start a Start-up' https://www.flickr.com/photos/coolinsights/19385257202. Attribution 2.0 Generic (CC BY 2.0). https://creativecommons.org/licenses/by/2.0/.

ethical objections, you could set the goal impossibly high. You can also contact Kickstarter and cancel your campaign before it funds by letting them know you will not be able to make/produce/accomplish your goal. This kind of market testing is technically not illegal. One group raised millions in pledges for a 'Star Wars Death Star' before cancelling the project.[25]

FROM LOW TO HIGH FIDELITY

One tried-and-tested way of testing your MVP is the **live product test** with actual consumers. This is especially good after you have iterated your pretotype several times by testing it with increasingly **higher fidelity** (closeness to the final product). As you develop it, you will know when it is time to let your customers eat, feel, touch, smell, play with and use your product. Live testing is the goal of pretotype testing and equates to a launch of the MVP when you will discover things from customers that did not occur to you (or them) during **lower fidelity** tests. You can test your live product in front of a focus group, at the check-out counter, in a country market, on Facebook or just about anywhere you run into live customers.

At the low-fidelity level are hand sketches, which are a great way to start visualising your ideas and to share them with teammates and stakeholders. While whiteboarding is a particularly good way to pretotype, be sure you take photos of each state. For websites, a **wireframe** lets you design the information hierarchy of your site and plan the layout. Usually they are without visual details such as colours and images at the start. From here you can do a web mock-up using Wix or Weebly.

live product test
The highest level of pretotype testing, in which you let your customers eat, feel, touch, smell, play with and use your live product. Can be undertaken anywhere you run into live customers.

high fidelity
Describes a prototype that is quite close to being the final product or service. (See also *low fidelity*.)

low fidelity
Describes a low cost prototype, usually an illustrated design or concept sketched on paper or created as flat images. (See also *high fidelity*.)

wireframe
Visual representation of the skeletal framework of a website to help designers in arranging elements.

ENTREPRENEURSHIP IN PRACTICE

McSPAGHETTI

Imagine that you work for McDonald's and you believe selling spaghetti (McSpaghetti) could be a great idea. You submit your idea and management are sceptical at first, saying it would be too risky and take too much money to build new equipment for a pilot. Now imagine you are a McDonald's intrapreneur. How could you test your idea using pretotyping?

TABLE 7.2 PRETOTYPING TOOLS

Paper prototyping: Paper prototyping uses sketches, mock-ups and designs to save time and money by enabling developers to test interfaces before beginning development.	
Paper prototyping: A primer	https://bit.ly/2KnkaPv
Five paper prototyping tips	https://articles.uie.com/prototyping_tips/
A guide to paper prototyping	https://goo.gl/DhjKJd
Physical shapes maker: Make physical shapes easily for prototypes, customised solutions, jewellery, LifeHacks or repairs	
AnyShape – Think it! Shape it!	https://makeanyshape.com/
InstaMorph mouldable plastic	https://www.instamorph.com/
3D image generation: 3D printing, animation, gaming, architecture and industrial design. 3D models are crucial components of digital production.	
Tinkercad	https://www.tinkercad.com/
Ponoko	https://www.ponoko.com/
Best free CAD software	https://goo.gl/tXbVjk
Generative and immersive design: You tell the computer what you want to do and it gives you optimal ways to resolve these problems.	
NodeBox	https://www.nodebox.net/
Project Dreamcatcher	https://autodeskresearch.com/projects/dreamcatcher
Grasshopper algorithmic modelling	http://www.grasshopper3d.com/
Mock-ups: Emulate real applications with buttons, controls, and graphics and action areas (hover, click etc.).	
What are mock-ups?	https://goo.gl/WT3Qu5
Top prototyping tools	https://goo.gl/GzwK3L
Balsamiq	https://balsamiq.com/
Infographics: An infographic simplifies your value proposition into a captivating experience that you can use with customers.	
Infographic cheat sheet	https://goo.gl/abRDaU
30 tools to create your own infographics	http://www.hongkiat.com/blog/infographic-tools/
Infographic creator	https://www.canva.com/create/infographics/

continue

continue

Explainer video: An explainer video is an animated short video to quickly express your value proposition in a way that potential customers can easily comprehend.	
The 10 best startup explainer videos . . . ever	https://goo.gl/hqLxgj
5 best explainer videos (& how to make your own)	https://goo.gl/ck1XVH
IFTTT: 'If this, then that' allows you to create chains of simple conditional statements, called applets, e.g. 'send an e-mail message if the user tweets using a specific hashtag'	
9 easy IFTTT DO button tricks	https://goo.gl/7FGBfo
A beginner's guide to the wonderful world of IFTTT	https://goo.gl/VG8xaB
Learn how IFTTT works	https://ifttt.com/
DIY usability tools: If finding participants for your usability study is a problem, there's a handful products that will assist you in conducting usability tests more easily.	
Usability Studio	http://www.sketchman-studio.com/usability-studio/
Usability testing from start to finish	https://uxmastery.com/beginners-guide-to-usability-testing/
Usability testing	https://www.techsmith.com/morae.html
Customer analytics: Helps you make decisions on market segmentation and predict customer behaviour. Analytics tell you how to grow your business.	
Customer journey analytics	https://www.woopra.com/
Product analytics for web and mobile	https://amplitude.com/
Product analytics for mobile, web and beyond	https://mixpanel.com/
Fake door technique: A measure of initial interest using a landing page or advertising to see if anyone clicks on it, and apologising that the product is not yet available.	
Set up viral contests	https://kickofflabs.com/
Launchrock – The fastest way to acquire customers	https://www.launchrock.com/
Ignite – Lean start-up – Polyvore (talk)	https://vimeo.com/24744647
A/B testing: Split testing compares two versions of a web page	
Optimizely experimentation platform	https://www.optimizely.com/
A/B and split testing software	https://vwo.com/
Experiments – Google Analytics	https://goo.gl/sqDkoS
Design communities: Feedback from peers, providing constructive criticism that will move your project forward.	
Dribbble	https://dribbble.com/
Interaction Design Foundation community	https://www.interaction-design.org/community
UX Mastery community	http://community.uxmastery.com/
Design feedback tools: Feedback on your prototype or mock-up, from the first sketch to full working prototypes.	
Comprehensive review of UX tools for your website	https://goo.gl/C9FWF5
Design surveys with Verify	https://verifyapp.com/
Fast user testing: Settle design debates with data	https://usabilityhub.com/

continue

continue

Remote usability: Conduct usability studies using test participants matching demographic guidelines you provide.	
Prototyping and user experience testing tool	https://www.canvasflip.com/
Website usability testing	https://www.trymyui.com/
Usability and user testing	https://www.whatusersdo.com/
Landing pages: A landing page is any page that the user lands on after clicking on an online marketing call to action.	
Landing page conversion course	https://goo.gl/D8auD1
Landing page platform for teams	https://instapage.com/
Landing page creator	https://goo.gl/vZzk9Y
Customer feedback tools: Real-life users give feedback on the experience you provide.	
Tools for getting user feedback and data	https://www.userreport.com/
The standard in user feedback	https://usabilla.com/
User feedback widgets	http://www.feedbacklite.com/
Heatmap and user recordings: Record user actions and generate heatmaps for web interaction analysis.	
User experience research platform	https://www.usertesting.com/
Website heatmaps, session recording, form analytics	http://www.inspectlet.com/
Heatmaps, visitor recordings, conversion funnels	https://www.hotjar.com/
Social search: Find users or tests on a social searching engine that mainly searches Facebook, LinkedIn, Twitter, Instagram and Flickr.	
Real-time search	http://socialmention.com/
Google Social Search	https://www.social-searcher.com/google-social-search/
Social Searcher	https://www.social-searcher.com/
Twitter advanced search	https://twitter.com/search-advanced
App developer suites: Development tools for app developers	
Mobile app development tools comparison	https://buildfire.com/mobile-app-development-tools/
How to create an app for free	http://www.appypie.com/
Build native apps and progressive web apps	http://ionicframework.com/
Page speed tools: Page speed tools optimise the speed of your site.	
Website speed and performance optimisation	http://gtmetrix.com/
Page speed insights	https://developers.google.com/speed/pagespeed/insights/
Website speed test	https://tools.pingdom.com/
SEO tools: Search engine optimisation is a must to appear in the top organic Google listings	
Google Analytics	https://analytics.google.com/analytics/web/
Moz	https://moz.com/
SEO tools: The complete list	http://backlinko.com/seo-tools
Spyfu	https://www.spyfu.com/

continue

VALIDATION & HYPOTHESIS-DRIVEN ENTREPRENEURSHIP

Now that you have your minimum viable product, how do you validate it? Most start-ups fail, we know that. Movies and books often portray a successful start-up as one based on intellect, determination and hard work against insurmountable odds. This has led many start-up entrepreneurs to use the 'seat-of-the-pants' approach rather than a more structured methodology, one, as portrayed here, focused on learning, construction of knowledge and reduction of uncertainty.

In this book, we use Ries' terms **build-measure-learn** (see Chapter 5, p. 151). Ries suggested that entrepreneurs could validate their learning scientifically by running experiments and testing different elements of their product or service. The concept of validated learning goes back to the early 1980s. Peters and Waterman's *In Search of Excellence* called it 'ready, fire, aim'. Byers et al. modified this into 'Act, Review and learn, Fix and adjust'.[26]

Starting a new business is essentially experimental. Implicit in the experiment are a number of hypotheses (commonly called assumptions) that can be tested only by getting out of the building and into the user/customer community. You can launch the enterprise and simultaneously validate or invalidate the assumptions. Because some hypotheses will be dead wrong and others partially wrong, an important goal of planning the launch of a new venture must be to continually produce and build on new knowledge.[27] This comes from a mid-nineties management concept known as **discovery-driven planning**, which says that course correction would take place *as new information was revealed*. You have to reduce the 'assumption to knowledge ratio' through experimentation and pivoting. You can reduce the number of assumptions you make relative to the amount of knowledge you have.[28] Too many untested assumptions = potential for failure. To counteract this, you need 'critical assumptions planning'. Major uncertainties are isolated as assumptions, which are then tested to reduce uncertainty. At each iteration, the business model can be revised to reflect what has been learned. Decisions to persevere, stop or redirect ventures can be taken earlier and often.[29]

discovery-driven planning
While conventional planning extrapolates the future from the past, discovery-driven planning can envision the unknown and uncertain future to learn as much as possible as cheaply as possible.

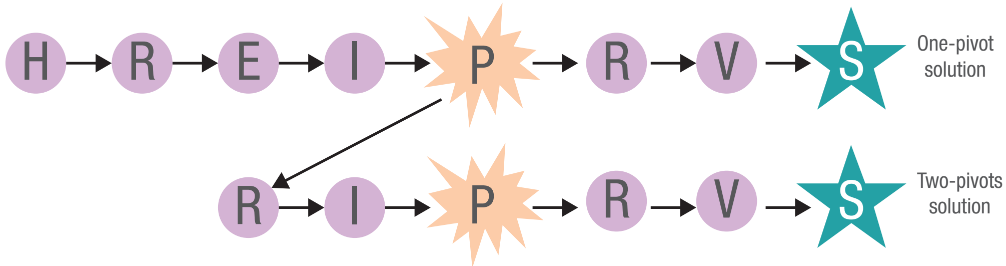
What is remarkable is that it has taken more than 20 years for entrepreneurs to catch up with the literature on what we now call hypothesis-driven entrepreneurship.[30] The idea is to translate the entrepreneur's idea or identified opportunity into **falsifiable hypotheses** that are tested using a series of cheap but well-thought-out pretotypes, leading to minimum viable products through experimental methods. The uniqueness of the methodology consists in its ability to explicitly consider and test the numerous uncertainties regarding the suitability of a given solution for a specific customer problem. This is the opposite of the traditional 'build it and they will come' approach.[31] Entrepreneurs must combat the urge to build a product to completion without engaging customers for vital feedback and guidance. You should be asking yourself continually, 'Whom are we building this product for?' Using the hypothesis-driven method, we explicitly investigate and hopefully disprove various uncertainties about how suitable a given solution is for a specific customer problem. This helps the entrepreneur decide experimentally whether to *pivot* or to *persevere* with the business model and product. After several of these tests, using slightly different assumptions and hypotheses, you can achieve a good measure of product-solution and product-market fit.

falsifiable hypothesis
A statement or assumption that can be proven false (invalidated) through observation.

The validation board (VB) is one of the key instruments or canvases to come out of Ries' hypothesis-driven method. Through creating a validation board, entrepreneurs can make better decisions as to whether to pivot (change some elements in their business model), accept the original vision or abandon the start-up altogether. The VB is a research tool that tests the unproven assumptions about our ideas, value propositions and pretotypes. Using the scientific method, the validation board takes a hypothesis-driven approach that helps entrepreneurs test a product idea without wasting money. The tool uses a seven-part approach (see Figure 7.6).

validation board
A key canvas used in lean entrepreneurship to test unproven assumptions about our idea, value proposition and pretotype using testable assumptions that can be invalidated or validated.

FIGURE 7.6 THE VALIDATION METHOD



Hypothesis (H)–Riskiest Assumption (R)–Experiment (E)–Invalidated (I)–Pivot (P)–Validated (V)–Solution (S)

riskiest assumption
The riskiest of the assumptions used in creating hypotheses to validate your business idea, which is the one you should start with.

You have your minimum viable product, or better yet an iterating series of MVPs, plus an idea of who your potential customers are. You start with a testable hypothesis, about which you make assumptions. You first select the riskiest assumption (one whose invalidation will kill the business or idea) to test using an experiment. If it is invalidated, you pivot (make a course correction) and select another risky assumption. You validate and pivot several times until you have reached a satisfactory solution.

The complete step-by-step process is found below in 'Experiencing entrepreneurship: Validation board group exercise'.

METHODS OF EXPERIMENTAL VALIDATION

In the validation board, the most important step is the experiment. Which experimental method should you use? There are a variety of methods. The one thing they have in common is that they all test hypotheses. Here are some suggested methods to test for your hypothesis-driven validations. Be sure to keep a detailed record of your experiments so that you can constantly sharpen your hypotheses and assumptions.

EXPLORATION METHOD

The exploration method is like a survey. It is an ethnographic tool to observe and understand users, their actions and their habits within their cultural context. This means obtaining knowledge about user needs by observing them. This is an especially good way of tapping into their tacit knowledge (knowledge they can show you but not articulate well). Some common exploration tools are mall intercepts, interviewing strangers on the street, fast-motion video observations, web surveys, Facebook invites and likes, user diaries, LinkedIn, cold calls and even shadowing of users. Most entrepreneurs also use personal interviews, but beware that people often say one thing, but mean something else. You will also need to observe customer behaviour. Another method is 're-enactment', where you re-enact the situation that causes the problem using the customer journey map.

exploration method
Method of surveying to observe and understand your users, their actions and their habits, using such techniques as re-enactments (simulating the problem), interviews, video observations, web surveys, and Facebook invites and likes.

tacit knowledge
As opposed to formal knowledge, knowledge that is difficult to transfer to another person through books or talking, which must be shown (*tacit* comes from the Latin 'to touch') in order to understand, for example, how to knead bread dough.

mall intercepts
A method of experimental validation in which people are intercepted while shopping in malls and asked to respond to a survey.

cold call
An unsolicited visit or telephone call made by someone trying to sell goods or services.

PITCH METHOD

pitch method
Method of experimental validation whereby you essentially 'sell' your value proposition to see if it will 'earn' some form of currency, such as email addresses, tweets, cash or anything your customer gives up.

After validating your customers' pain and potential solutions through exploration, you can move on to the pitch. In the **pitch method**, you essentially 'pitch' your value proposition to see if you can 'earn' some form of currency. Currency here is broadly defined as something with exchange value, something the customer pays. It can be an email address, tweet, cash or anything your customer gives up to receive a solution to their problem. The goal is to collect as much currency as you can to see if there is real interest in your idea. You can pitch online through a landing page, at public events, through cold calls or emails, even on a T-shirt. The point is you want customers to demonstrate some intention to purchase or use the product or service.

CONCIERGE METHOD

concierge method
Manual delivery of a product to a customer with as little technology as possible before the automated or software-driven process is available, performed to quickly see if the product solves the customer's problems.

After you have demonstrated customer interest through exploration or pitching, the next step is the **concierge method**. A hotel concierge provides whatever delight the customer wants, be it restaurant reservations, theatre tickets or nightlife. The concierge method of validation involves delivering your product through manual service or by handholding the customer. The Wizard of Oz test and the mechanical Turk test are examples of the concierge method. The goal is to make a customer ecstatic with the proposed product before you actually deliver it. The concierge method is about delivering the product to a few customers with as little technology as possible, which quickly helps you to learn how to solve the customer's problems. In the Chegg example above and the CarsDirect example below, the entrepreneurs went to the extent of supplying the product manually before the actual service took over to perform the tasks automatically.

A/B TESTING

freemium
strategy for pricing in which a product or service (e.g. games or web services) is offered for free, but money (premium) is charged for higher functionality and more advanced or additional features.

Now we look at more advanced ways to validate or invalidate your idea. What is A/B testing? With A/B you can compare two versions of the same design or value proposition to see which one customers prefer. The tests are run by randomly assigning your customers to either the 'A' test or the 'B' test until you get a good sample size. For a website, for example, which version of the homepage gets you closer to your customers? Which tagline works best? Let's say you have a **freemium** music site. You set yourself the challenge to try different ad campaign to see which one resonates most with the consumer. What stops them from signing up? Is it the complex form? Is it the terms and conditions? Is it the price? You can find out the answer to each of these questions by making small modifications to the interface, and then running an A/B test to see whether the new or the old version prompts more people to register. Note that A/B testing is not a replacement for qualitative methods that assess why your customer prefers one value proposition to another. For that you need focus groups and interviews.[32]

PRE-ORDERING

pre-orders
A pretotype test that lets you offer your product to potential customers before you even build it.

Another way to research the demand for your product or service is to take **pre-orders**, maybe even offering a discount for early buyers. You do not take payments, but rather pledges for products before you are ready to ship them. By taking pre-orders, you can set up a website and drive traffic to it to test the viability of a product before you spend money. Your website will truthfully tell people that the product is not ready to ship yet, but you should give them an estimated date for when it will be ready. Or if you decide to take a customers' money, you can guarantee a refund – this will provide cash to fund manufacturing or purchasing of inventory. Pre-orders also generate buzz about your product, especially if you make a special offer for pre-orders (20% off if you pre-order by X date, for example).

FAKE DOOR, FAÇADE AND SMOKE TESTS

Predicting product demand is difficult; people react better to what already exists (or pretends to exist). So entrepreneurs build the important bits and fake the rest. In geek-speak this is called a '404 error', when the server could not find what was requested. It's also called the **fake door test**.[33] By creating a landing page and putting a big 'call-to-action' button on it, you can validate demand for a new feature or product and see how many customers click on it. Customers usually get a page thanking them for their interest and explaining the petite deception. This is also known as an **initial level of interest (ILI) test**. Sometimes we call it a **smoke test** because there is no real product there; it is all 'smoke and mirrors'. The smoke test directs web traffic to a landing page that has a big 'call-to-action' (CTA) button like 'sign-up now' or 'click here for more information'. The page tells the surfer about your product and asks them to give you some form of 'payment', usually an email address. Then it usually just says something like 'Coming soon' or 'First 100 get a discount coupon', or it just thanks the potential customer for their interest. The key metric is the conversion rate, which is the number of customers who landed on your page and then clicked on the CTA. The best way to measure ILI is using Google AdWords.

Another ILI test is the **façade test**, also known as the **vapour test** or **fake inventory test**. Have you ever gotten an 'out of stock' message on a website? In all likelihood, the product never existed. E-commerce retailers are famous for posting plausible product descriptions and images to gauge buying interest. Why spend all that money to design, source, build, distribute and sell a product for which there is no credible evidence of demand? Entrepreneurs can flip the dreamy 'if you build it, they will come' philosophy into the hard-nosed 'if they come, you should build it'. ILI tests help answer the question 'Does anyone want it?' You could even start listing 'fake inventory' from other online retailers.

Here is an example. Founded in 1998, CarsDirect started a façade website selling vehicles online directly to consumers. Using their website, they first tested if people would buy used cars online. They bought some newspaper ads pointing people to the website. They had no car inventory, so when people clicked on the 'Buy' button, CarsDirect went right out, bought the car at full retail price and delivered it to the customer, even at a loss, thus fully validating that there was customer demand for this idea.

The creator of pretotyping, Alberto Savoia, tells the story of how he used the smoke test to see if there was the demand for his unwritten book *Pretotyping* before he even wrote it. Savoia created a Google AdWords ad (see **Figure 7.7**) for the book and then ran pay-per-click ads sending traffic to this page. Rather than collecting payments, however, when someone tried to buy the book Savoia simply collected their email address and then said that servers were down and the book was currently unavailable. This allowed him to get an idea of the percentage of people that visited his sales page who would likely purchase the book if he were actually selling it. He waited for 1000 people to click before he ever took pen to hand.

fake door test
A method of testing an idea in which you build the important bits and fake the rest, for example by creating a landing page and putting a big call-to-action button on it.

initial level of interest (ILI) test
A test of the customer's starting interest level, usually measured by asking for an email or a download.

smoke test
A method of experimental validation whereby there is no real product there; it is still all 'smoke and mirrors', for example fake inventory or e-books not yet published.

façade test
See *fake inventory*.

vapour test
See *fake inventory test*.

fake inventory test
An initial-level-of-interest test in which an e-commerce site lists 'fake inventory' from other online retailers. Also known as vapour test.

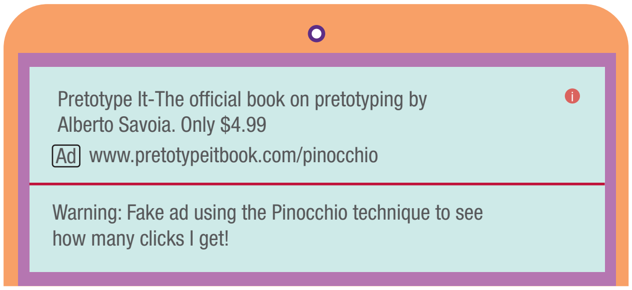


FIGURE 7.7 FAKE AD FOR ALBERT SAVOIA'S BOOK, *PRETOTYPING*[34]

POP-UP OR ONE-NIGHT-STAND TEST

provinces test
See *one-night-stand test*.

pop-up test
See *one-night stand test*.

one-night-stand test
A method of experimental validation whereby you offer an early pretotype version of your service or product for a very limited time to a limited customer base to see if there is any interest. Also known as pop-up test.

Sometimes called the '**provinces test**', the concept of the **pop-up** or **one-night-stand test** is to test your product or service in the outback or boondocks before committing to launch it on a large scale. Pitch a tent, or the equivalent, and see what happens. This is what thrift label Fruit of the Loom (mens' underwear) were doing when they rented a high-class pop-up retail space to test luxury underwear.[35] Airbnb had the ultimate one-night stand. Wondering whether homeowners were willing to rent their spare bedroom to strangers, they created a testing site. The site simply tested the assumption of 'Hey, can we rent air mattresses on the floor and serve breakfast?' They designed airbedandbreakfast.com and made $240 on the first night.[36] The rest is history.

THE IMPERSONATOR/IMPOSTOR/RELABEL TEST

impersonator test
A method of testing an idea in which you impersonate the new product you have in mind. For example, take a Lotus Roadster, rip out the fossil fuel and install all-electric (along with slightly different body). This is the actual test Elon Musk used in building the Tesla.

This is where you give an existing product or service a new wrapping to see if there is demand for the new variant. Most of the time you do not have to build a prototype from scratch. You can leverage, modify or combine existing products or services to 'impersonate' the product you have in mind in order to validate some hypotheses while saving yourself a lot of time and money. You can also repackage or 're-skin' an existing product so that it can masquerade as another product. Put a different label on an existing product that looks like the product you want to create. The **impersonator test** is good for testing the initial level of interest in an as-yet unbuilt product or service. For example, you might show a customer a can of Diet Coke and ask, 'How would you like Diet Coke with Bacon?' Note: This can be a questionable technique from an ethical standpoint. See 'The ethics of hypothesis-driven entrepreneurship' below.

TYPES OF PIVOTS

After validating or invalidating your idea, pivoting is that magical 'aha' moment in the 'Learn' stage where you realise you should take a different course to better satisfy the customer's needs. All sorts of discoveries can prompt the decision to pivot. What are some top triggering factors for pivoting?

- *Negative customer reaction*: You experience slow customer acquisition, slow customer retention or negative (or no) response from customers.
- *Inability to compete*. Your competitors outplay you by working on the same idea more effectively.
- *Technology challenge*: You reach limitations in existing technologies or disruptive technologies emerge.
- *Investor/mentor/partner dissuasion*: You receive pressure from investors, mentors or partners to change the direction.
- *Flawed business model*: The cost of customer acquisition is high, or your revenue model is not working.
- *Unscalable business*: You discover that you are solving a problem that not many people have, resulting in unscalable business.[37]

What to do when you reach these conclusions? You could just persevere because you are stubborn, or you could abandon the idea. But you could also pivot and find a new direction. Ries lists types of pivots:

- *Zoom-in pivot*. This is where you discover that a single feature of the product is so successful that it becomes the whole product. Examples: Flickr, Shopify, Pinterest, Instagram.
- *Zoom-out pivot*. Just the opposite, sometimes customers say that a single feature is just not enough to satisfy their pain, so you pivot the feature to be part of a much larger product. Example: Yelp's start-up idea was to create an email service with recommendations but it pivoted to become a web portal with user reviews and ratings of local companies.

- *Customer-segment pivot*. Maybe you attract customers but not the ones that you originally thought. This means you have to reposition and optimise the product for a more favourable customer segment. Example: IMVU shifted away from its virtual world roots to social games and entertainment.
- *Customer-needs pivot*. What happens if you find out that the problem you solve is not as important as you thought, or the customer does not have the money to buy? This requires repositioning, finding a different customer segment, or creating a completely new product, to find a problem worth solving. Example: Pinterest originally wanted to create a replacement for paper shopping catalogues, but when it turned out people were more interested in 'clipping' product descriptions and sending them to friends, young Pinterest pivoted to being a 'catalogue of ideas'.
- *App to platform pivot*, or vice versa. Some start-ups confuse an app with a multi-app platform. Most customers buy solutions, not platforms. Example: PayPal emerged when Confinity decided to stop supporting PalmPilot's money exchange function and instead focused on the web platform.
- *Business model pivot*. At the end of the day, you can change your business model (see Chapter 8), for example from freemium to subscription. The famous Finnish business Nokia originally made paper products before shifting in 1992 to mobile phones.
- *Channel pivot*. Changing how you deliver your product may permit new pricing and competitive positioning, for example, an auto company pivoting from dealership sales to direct sales.
- *Technology pivot*. The chances of success can be improved by delivering the same solution using a different technology with cheaper price and/or performance. Example: Wix, Instagram, PayPal.[38]

Of course, pretotyping, validation and minimum viable product do not take into consideration other aspects of the business model (Chapter 8) such as partners, revenue and cost, and so forth. Some research shows that the validation of a greater number of hypotheses does not generate a commensurate increase in the likelihood of venture success. However, it is useful when evaluating customer segments, value proposition and channel.[39]

As well, sometimes young companies operate in environments where the market will not tolerate mistakes well or where the 'launch early and often' approach raises ethical issues. You should not pretend-test aeroplanes, medications or interplanetary space travel! Another situation where this approach may not be appropriate is when the unmet demand is so enormous that there is little or no need to seek feedback about the customer's needs. Here we could mention green energy solutions, vaccinations for Ebola or Zika viruses, or even computer operating systems. (Microsoft was once famous for releasing OSs that were 80 per cent complete.) The lean development approach is also limited when product development cycles are extremely long.

THE ETHICS OF HYPOTHESIS-DRIVEN ENTREPRENEURSHIP

Savoia warns that 'not all pretotyping techniques are suitable, ethical or legal for all companies and products' (for example, never use the fake door technique for medical or safety products).[40] Be concerned about the ethical implications of your pretotypes and experimentation. As well, entrepreneurs need to be aware of 'idea theft', whereby competitors can steal the concept that you are testing. However, the value of powerful early feedback usually outweighs the risk of idea theft. There are also possible reputational risks of launching an incomplete product. Again, the limited exposure to customers generates feedback whose value exceeds these risks.

On the other side, though, Savoia also points out the great advantages:

> Wrong *its* are responsible for a huge amount of waste. They squander the time of smart people who develop them and divert the money and natural resources that should have been used to build something more useful and more successful. Time, money and resources invested in wrong *its* are time, money and resources stolen from right *its*. … Pretotyping can save you and your potential customers from wasting a lot of time and money on the wrong *its*.[41]

Always follow the law and apply judgement and ethics when pretotyping. A good test is whether you would be comfortable if the actions, decisions, and implied motives were exposed on the front page of your local or national newspaper. Called the 'Front Page Test' think and consider your actions carefully. As a guide, how comfortable are you with the description of actions in the above pretotyping cases. If these decsions were yours, would you be comfortable in defending your own actions and decisions after exposed in front page news?

SUMMARY

This is a core chapter in the entrepreneur's journey. We focused on product development and testing through the use of pretotyping and minimum viable products. This is all part of lean, hypothesis-driven entrepreneurship.

We started by reviewing the many interesting examples of companies that perished because they could not pivot to change their business model, as well as of those that pivoted away from previous models to achieve more success.

We studied the concept of pretotyping (pretend-prototyping) to see how it could be used to achieve product-market fit. The key is to: 'Fail fast, pretotype often, validate relentlessly and pivot quickly.' Especially interesting are the historical examples of pretotyping, such as the PalmPilot and IBM Speech-to-Text.

We learned about the importance (and the limitations) of putting an unpolished pretotype in front of your customers as soon and as often as possible in order to see if this minimum viable product satisfies the pains that the customer has.

Prototyping is the traditional method of innovation. We learned about the difference between lean entrepreneurship and the traditional method of start-ups at the beginning of this chapter. We studied how the exhaustive process of prototyping differs dramatically from the speedy process of pretotyping.

There are many kinds of minimum viable products (MVPs) depending on the service or product being developed. These range from physical pretotypes using paper, mock-ups, physical shapes and infographics to virtual forms such as explainer videos, landing pages, heat maps, usability images and 3D images.

Hypothesis-driven entrepreneurship is how entrepreneurs validate their learning scientifically by running experiments and testing different elements of their vision through falsifiable hypotheses. Based on the results of these experimental tests, the entrepreneur can decide whether to pivot or persevere with the business model and product to achieve product-solution fit.

The validation board is the tool we use to carry out this scientific validation process. It involves coming up with testable questions, risky assumptions to be tested and an experimental method that can invalidate or validate the hypotheses. It can take as little as one day to validate the entire product or service concept.

A variety of experimental methods can be used with the validation board. The exploration method involves physical or virtual surveys. The pitch method allows the experimenter to tell if the customer is willing to pay 'currency', be it emails, money or tweets, in order to measure the initial level of interest. The concierge method sees the entrepreneur providing the product or service 'manually' before the complete automatic product is ready. We also examined other very interesting experimental methods, such as A/B testing, fake door and smoke tests, ad campaigns and pre-ordering.

At the end of the process, the entrepreneur can persevere or pivot; that is, change course to better satisfy the customer's needs. Throughout the process an entrepreneur needs to be aware of the risks of poor judgement and suspect ethics that can impact reputation. The 'Front Page Test' is a quick an easy way to guide choices and decisions.

KEY TERMS & CONCEPTS

agile development
build-measure-learn
cold call
commercialisation
concierge method
discovery-driven planning
exploration method
façade test
fake door test
fake inventory test
falsifiable hypothesis
freemium
high fidelity
impersonator test
initial level of interest (ILI) test
landing page
lean entrepreneurship
live product test
low fidelity
mall intercepts
mechanical Turk test
minimum viable product (MVP)
one-night-stand test
Pinocchio test
pitch method
pop-up test
pre-orders
pretotype
product-solution fit
prototype
provinces test
riskiest assumption
smoke test
stage-gate process
tacit knowledge
validated learning
validation board
vapour test
wireframe
Wizard of Oz test

REVIEW & DISCUSSION QUESTIONS

1. What does the phrase 'Pivot, persevere or perish' mean? Can you give an example of (1) a company that perished; and (2) one that changed its business mode?
2. Is there really any difference between minimum viable product and the process of pretotyping?
3. What is the difference between pretotyping and prototyping?
4. In what way is the stage-gate process the antithesis of pretotyping?
5. When would you use physical pretotypes and when virtual pretotypes?
6. For your project, which of the following would fit: infographic, explainer video or landing page? Which would you pick for your pretotype and why?
7. What is the difference between high-fidelity and low-fidelity pretotypes?
8. Can you name a situation (not mentioned in the book) where pretotyping might have ethical implications?
9. What is the difference between hypotheses-driven entrepreneurship and 'build it and they will come' entrepreneurship?
10. Give two examples of falsifiable hypotheses in one of the projects in 'Entrepreneurial edge: Solving the world's wicked problems', Chapter 5, page 161.
11. How many times can you repeat the cycle in Figure 7.6, 'The validation method'?
12. What is the importance of the riskiest assumption in the validation board?
13. Which of the methods of experimental validation is most interesting to you, or would you like to use in your venture?
14. Give clear examples of three types of pivots.

EXPERIENCING ENTREPRENEURSHIP

Pretotype project

You have identified your opportunity, interviewed potential customers and written the value proposition. Now it is time to give your idea some real form, even if it does not quite work yet! Your assignment is to develop a pretotype and to test it with early adopters or first clients. In this process you can identify errors, mistakes and false assumptions. Then you can search for options to adjust your value proposition, if needed, and get ready for the validation process. This is a two-part assignment. You will present your pretotype as (1) an infographic plus (2) any one of the other types of pretotypes mentioned in this chapter.

EXPERIENCING ENTREPRENEURSHIP

Rubric

	0 POINTS	10 POINTS	20 POINTS
Pretotype represents the value proposition	No pretotype is handed in in the expected form.	Only handed in one type of pretotype. It is not obvious how this relates to the value proposition.	Handed in the infographic plus one other type of pretotype. They are good representations of the value proposition.
Description of the market opportunity	There is no mention of the market opportunity.	A clear market opportunity is apparent, but it is not convincing.	The pretotype convinces us that a concrete market opportunity exists.
Value proposition is defined	No value proposition is apparent.	The value proposition is an obvious solution to the market opportunity.	The value proposition is a unique solution to a market opportunity and a better solution is not obvious.
Innovative use of technology	None presented.	The solution uses standard technology.	The solution uses the most advanced technology within the particular field.
Feasibility	Not presented.	From the provided information, I am not convinced that it is technically possible to produce the solution with the described features.	From the provided information, I am convinced that it is technically possible to produce the solution with the described features.

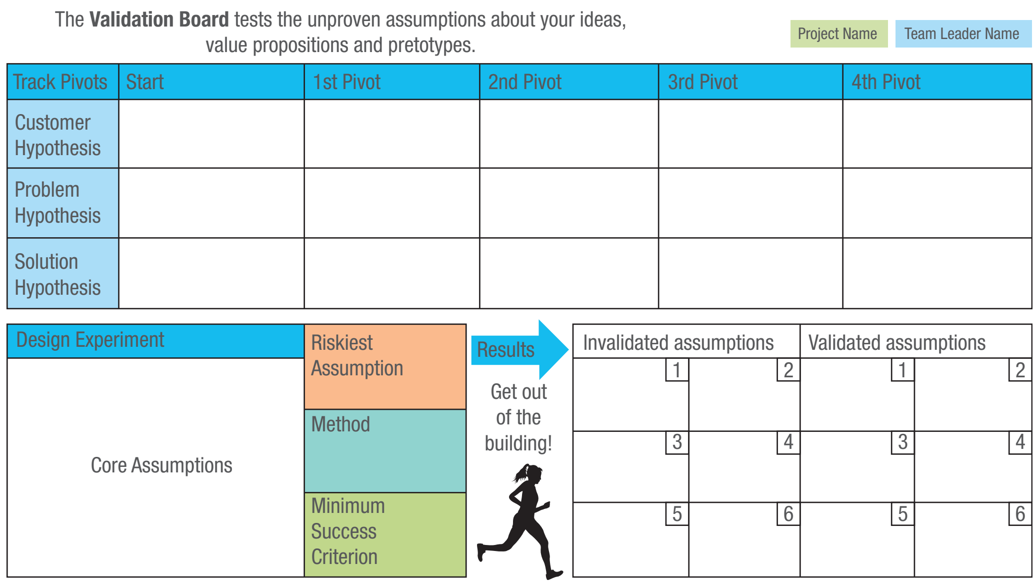
EXPERIENCING ENTREPRENEURSHIP

Validation board group project

The **validation board** (VB) is an excellent additional one-pager for validating your minimal viable product and customer interest in it (see Figure 7.8). Usually any new project will go through at least 2–3 pivots before settling on a validated solution. Based upon your research conclusions, at each point you decide whether to persevere or pivot, that is, change course. A pivot is a structured course correction designed to test a new hypothesis. The decision whether to pivot or persevere should be evaluated after each build-measure-learn feedback loop for the hypotheses tested during that cycle.

- Study the 'Quick review of pretotyping techniques' at https://goo.gl/5bMY96.
- Working in your group, watch the following videos:
  - Lean Start-up Machine (2012). How to use the Validation Board to test your start-up idea. https://youtu.be/HhoducyStMw
  - Lean Start-up Machine (2015). Starting a Scooter Business with the Experiment Board. https://youtu.be/U03KwQa7a0o.
- Discuss and fill out your validation board using the online form at https://www.leanstartupmachine.com/validationboard or the Google template at https://goo.gl/h8MtZX. Your final product should look like the samples of finished exercises at https://goo.gl/Q5TV4b.

FIGURE 7.8 A VALIDATION BOARD



Work through the board using Post-its and experiments (see 'Methods of experimental validation' above).

EXPERIENCING ENTREPRENEURSHIP

Rubric

	0 POINTS	15 POINTS	33 POINTS
Your validation's objective	Your objectives are not clear. There is no way to make decisions based upon the hypotheses.	It presents clear hypotheses that are specific enough to be measurable.	Customer and problem hypotheses are given. They are clear and testable. They are phrased in a way that permits you to take hard decisions relevant to the project.
Experimental method	There is no information about the methodology.	The research includes two or three of the full-credit elements	The research you carry out contains all of the following: description of the tested customer segments; detailed description of the method(s) chosen; detailed description of the tools and types used; a timeline of activities, including dates and team members responsible.

continue

continue

	0 POINTS	15 POINTS	33 POINTS
Results and analysis	Results or conclusions are insufficient to make decisions.	Your analysis includes two or three of the full-credit elements	Your analysis contains all of the following: it is organised by objectives and by experiments; it presents quantitative results such as tables and graphs; it contains qualitative results such as interviews; it has a coherent conclusion explaining the logic behind the pivots and the change(s) in customer and/or problem hypotheses.

CASE STUDIES

CASE 7.1

NORDSTROM VALIDATES SUNGLASSES APP IN A 'FLASH BUILD'

Be sure to watch the videos about 'rapid experimentation' and 'validated learning'. Watch 'Nordstrom Innovation Lab: About the Lab' at https://vimeo.com/99292434; and 'Nordstrom Innovation Lab: Sunglass iPad App Case Study' at https://youtu.be/szr0ezLyQHY.

Nordstrom is an American chain of luxury department stores ranked 188th in the Fortune 500, with annual revenues of USD$18 billion. From 2011 to 2014, Nordstrom's Innovation Lab acted as an intrapreneurial tech start-up within the huge retailer. Its impact extended into the entire company when in 2015 it pivoted to make innovation 'everyone's job'.

During its heyday, the Innovation Lab undertook a 'flash build', using lean methodology to create a new iPad app to help customers buy sunglasses (see videos). Occupying the sunglasses department of the Seattle flagship store, the team erected a sign saying 'Innovation Testing in Progress' and gave itself a week to construct the idea, build the feature and launch it. They walked into the store not knowing what the features were or what would be most useful to build. The team 'wanted to get to the point where we had something that was *good enough*'. The team was composed of a human factors designer, a design thinking catalyst, an open innovation specialist and an iOS developer.

The first thing they did was create a 'user story' map by interviewing actual customers and putting Post-its on a whiteboard to depict the customer's journey toward purchase. They first designed an easily changeable *paper pretotype*, including simulated buttons and actions. Within minutes they had feedback from real customers. The team brought their user experience to the task, saying to customers, 'I've created a paper version of an app, and I'd like you to use it like you would normally use the app.' Using the results of the paper version, on day two they had the first working software pretotype. On day three they had the first version where customers could look at images of themselves with different sunglasses side-by-side. On day four the corporate buyers came down to test out the system. These specialists immediately noticed a polarisation problem, where the glasses appeared black on the iPad image because the video cancelled out the polarisation. By day five, with all the feedback, they launched a counter-top version with animation, titling and zoom, and which recorded metrics.

The outcome was an iPad app that allowed customers to view side-by-side pictures of themselves wearing different pairs of glasses. The team was able to build (and multiply iterate) a full-featured iPad app in a week.

They left the department with the app running as an experiment. When they returned, they found that the experiment had not caught on. After more interviews and observations, they discovered that it was not because the *customers* did not like it; it was the *salespeople* who had to be convinced. Eventually they rolled it out to sunglasses departments across Nordstrom.[42]

QUESTIONS

1 What would you do for a one-week experiment?
2 Do you think it would be hard to have a design lab inside of a large corporation?
3 What lean methods did the Nordstrom Innovation Lab use?
4 Can intrapreneurs in large companies benefit from lean methods?
5 At 38″ in https://goo.gl/UJMRyD, what does he mean by having something that is 'good enough'?
6 At 1′10″ in https://goo.gl/UJMRyD, is the 'user story map' the speaker mentions the same as the 'customer journey map'?

CASE 7.2

UPS AND DOWNS OF AUSTRALIAN START-UP PIVOTING

Many Australian start-ups have pivoted into successful companies. But how do you know it is the right time to change the direction of your company, or the product or service it provides?

Founded in 2012, Elto discovered the customer pain that small-business owners were often struggling to find qualified and verified web developers who could create websites, update them with new functionality or otherwise generally make improvements and changes on their behalf. On Elto's Marketplace, the company would carefully vet developers who applied, and then help connect them with small-business clients. When they hit 25 000 users, the knock on the door came. They were acquired by GoDaddy, who intended to transition the business to become a key piece of GoDaddy Pro. Ned Dwyer, founder of Elto, says it is important to take into account whether you as the founder – as well as your team – have enough energy to see the pivot through. 'It's the right time to pivot when you know that you've exhausted your current line of pursuing product-market fit with your current product or market, but you still have enough gas in the tank to keep going.'[43]

Pioneering Australian start-up incubator and consultancy Pollenizer shut down after conceding that it had failed to find a sustainable business model for its operations. Australia's first real incubator, founded in 2007, could not find a sustainable business model in that space, so it became a consultant to larger organisations – but that didn't work out either. Though they have helped hundreds of Australian start-ups succeed, their own business model was not sustainable. Now they are rolling with the punches again. Pollenizer still has a portfolio of start-ups under its wing and said it was cutting out its other operations in order to retain enough capital to be able to assist these start-ups to their next stages as previously planned.[44]

After investing millions in their mobile information start-up Pop!, the founders decided to pivot away from the idea and instead launched Fillr. Pop! focused on the customer pain of filling out forms on mobile devices. It required companies to install it on their own sites. But these companies wanted to see how users would respond before investing. Classic chicken and egg. No matter how many additional features they added to the app, they just could not find a workaround. To attract media attention, the founder even swallowed a small computer as a stunt at the launch. Reflecting on the customer pain, they realised that the core problem still was unsolved: Shopping on your mobile sucks. So they pivoted their business to an app called Fillr, which eliminated pinching and zooming your tiny smartphone screen to fill out information forms.[45]

QUESTIONS

1 Review the section 'Pivot, persevere or perish'. Now search for the phrase 'Google Graveyard'. Do any of the products in the Graveyard have pivot potential?
2 What is the value proposition of an 'incubator' and how can it build a sustainable business model?
3 Research Pollenizer and explain why it shut down.

CASE 7.3

IPOD TOILET ROLL HOLDER

The iPod toilet roll holder was one of the hot gadgets from bimbambanana.com during the 2006 Christmas season. 'Now you can bring your iPod everywhere – and we mean everywhere!' It was actually a high-tech toilet paper dispenser with a built-in iPod docking station. 'Listen to your favourite music on your iPod while brushing your teeth, in the shower, in the spa or when you are on the Throne.' Features included high-performance moisture-free speakers, charger, audio selector and an integrated toilet paper holder that can be easily folded into a stereo dock. It even has tweeters and woofers!

QUESTIONS

1 What customer needs does this product satisfy?

2 How would you validate the market need for this product?

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ONLINE STUDY RESOURCES

Visit http://login.cengagebrain.com and use the access code that comes with this book for 12 months' access to the resources and study tools for this chapter.

CourseMateExpress

The CourseMate Express website contains:

- take it further activities
- revision quizzes
- video activities
- and more!

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CHAPTER 8

LEAN MARKETING AND BUSINESS MODEL DESIGN

Perfection is not attainable, but if we chase perfection we can catch excellence.

Vince Lombardi,
NFL coach[1]

There are no facts inside your building, so get the hell outside.

Steve Blank[2]

It is not the customer's job to know what they want.

Steve Jobs[3]

CHAPTER OBJECTIVES

1. To gain an understanding of the lean marketing process
2. To understand how to develop a lean business model
3. To understand the logic of value creation through different business models
4. To understand how to use the lean canvas and differentiate it from the business model canvas
5. To know how to describe the external forces outside your lean canvas

EXPERIMENTING WITH MARKETING AND MODELLING

The goal of this chapter is two-fold. First, following on from Chapter 7's focus on experimental validation, we cover another important part of hypothesis-driven experimentation, namely lean marketing. With **lean marketing** experimental tools, we can continue with testing, tracking and scaling our product or service. We do this with unconventional marketing techniques such as inbound marketing, guerrilla marketing, growth hacking and viral marketing in a process of customer discovery.

Moving on in this chapter, we focus on the concept of business model design both theoretically and practically. Start-up entrepreneurs will find business model design especially useful and powerful in making more informed decisions, thus increasing their chances of success. **Business model design** visualises your project using colour, position, texture and form.[4] At the end of this business model design process, you will have a one-page summary of your entrepreneurial project which can serve as the basis for your lean business plan (Chapter 11).

LEAN MARKETING

Lean marketing is a concept that follows on from lean start-up and hypothesis-based entrepreneurship. Lean marketers throw out the old 'push' playbook and replace it with 'pull' tools that are *testable, trackable and scalable*. They use new tools to feed marketing information from customers back into product or service development until they have generated explosive results.[5] We define lean marketing as hypothesis testing using marketing techniques that speed up customer feedback into the offered product or service.[6]

Lean marketing fits squarely into the hypothesis-driven approach as an extension of **entrepreneurial marketing**. A commonly cited definition of entrepreneurial marketing is 'the proactive identification and exploitation of opportunities for acquiring and retaining profitable customers through innovative approaches to risk management, resource leveraging and value creation'.[7] A basic premise of entrepreneurial marketing is that it achieves **durable competitive advantage** through value-creating innovation. Lean entrepreneurs care more about using experimental marketing techniques to show demand, test assumptions and especially discover customers (see Figure 8.1). Without much money to spend, what matters is using these experimental marketing techniques to validate your hypotheses. In essence, it means learning how to test your concepts constantly and to use possible misjudgements to guide course corrections – to pivot or persevere. Increasingly, entrepreneurs must be prepared to explore markets through **co-creation** or **co-marketing** strategies with customers, suppliers and even investors. Rather than focusing on expected return, you focus on hypothesis testing and **affordable loss**. The key skills are agility, speed and willingness to change course. You need the broad thinking of a generalist and the readiness to tolerate ambiguity. You should be part marketer and part coding geek, all within **zero-budget marketing**. Speed of execution and decision making is the number one reason why companies applying lean marketing are outsmarting and outrunning their competition.

Lean marketing comes from Eric Ries' *The Lean Startup*. Based on lean thinking and lean manufacturing, lean marketing fits perfectly into iterative product design, minimum viable products, value propositions and validation. What matters is 'build–measure–learn' in marketing. Run experimental ads, even overnight stunts. Again, the motto is: Fail fast and fail often. Lean marketing is about being agile, about viewing each campaign or marketing activity as one more step toward customer discovery and ultimately customer satisfaction.[8]

lean marketing
Marketing focused on agility, viewing each campaign or marketing activity as one step in the ever-improving progress toward customer acquisition and ultimately customer satisfaction.

business model design
The architecture of how we exploit a new opportunity, product or service. It describes the logic of value creation by depicting how an enterprise works.

entrepreneurial marketing
The proactive identification and exploitation of opportunities for acquiring and retaining profitable customers through innovative approaches to risk management, resource leveraging and value creation.

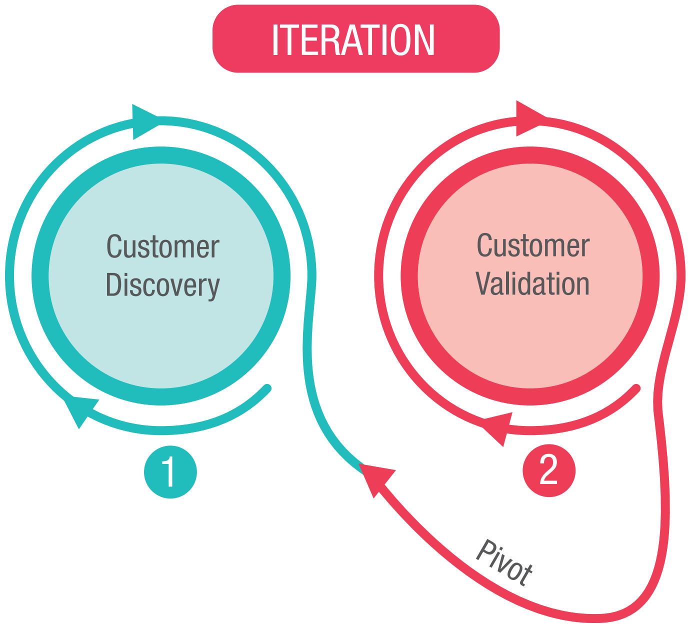
durable competitive advantage
In marketing and strategic management, an advantage that one company has relative to its competitors.

co-creation
Collaboration between two or more parties to produce a product, service or other outcome that has shared benefit. Usually involves the customer as one party in a marketing sense but other co-creators may be suppliers or investors.

co-marketing
Also known as co-promotion, cooperation of two or more companies to market or promote each other's products.

affordable loss
The level of loss that can be endured by an entrepreneur or a business that can be reasoned to be affordable in order to explore the potential of an opportunity.

FIGURE 8.1
HOW CUSTOMER DISCOVERY RELATES TO CUSTOMER VALIDATION[9]



zero-budget marketing
Entrepreneurial marketing techniques that require few or no resources.

customer discovery
This first step in the customer development process, in which you identify your customers by turning your assumptions into testable hypotheses.

customer development
A process of discovering, validating, recruiting, even creating customers that don't yet exist.

customer validation
A process which uses hypotheses and experimentation, you find out whether your assumptions are correct in respect to identifying actual customers who will buy your product.

Lean marketing is all about **customer discovery**, **customer development**, and **customer validation** following hypothesis-based techniques.[10] The goal is to reach a situation where the entrepreneur and the customers *agree that there is a problem that needs to be solved.* If the idea fails the validation test, then you need to pivot, and the process begins again. Using the validation board (see Chapter 7, pp. 237, 245 and especially Figure 7.8) we tested our assumptions about customers, product features, channels to use and strategies. It is the same thing with marketing. As the validation board says, 'Get out of the building!' by designing and testing an experiment. Don't make the mistake of developing your product without testing it constantly with potential customers. Let's extend our hypothesis-based method into marketing.

ENTREPRENEURIAL EDGE

LEAN MARKETING SKILLS

- Lean marketers identify and solve problems that others do not even recognise.
- Lean marketers have great overall contextual insight, which they use to spot opportunities that others overlook or view as problems.
- Lean marketers develop new marketing strategies to validate or invalidate assumptions, which they continually use to modify their products and business models.
- Lean marketers take calculated risks based upon tested and validated hypotheses and lean experimentation.
- Lean marketers screen their assumptions against validated knowledge of how the market functions.
- Lean marketers are not afraid to pivot a business based on their insights.
- Lean marketers are always in search of new lean marketing advantages in quality and cost reduction.
- Lean marketers develop unique experimental validation techniques using lean marketing.

Inspired by: Dickson, P. R. (1994). *Marketing management.* 1st ed. ©1994 Cengage Learning.
This was taken from Kuratko 10e, p. 225.

Of course, the underlying principles of entrepreneurial marketing are grounded in the age-old marketing fundamentals referred to as the **marketing mix**, traditionally called the **four Ps**: product, price, promotion and place. The internet age brought about a change from product-centred to customer-centred marketing, and the parlance changed to the **four Cs**: customer solution, customer convenience, customer communication and customer cost.[11] The four Cs revolution was a paradigm shift away from the customer being merely the *object* of marketing to *the customer being involved in shaping the marketing mix*.[12] Through active participation, the customer plays a part in co-creating and then testing both the product/service and the experience they want. Customers now form communities that are integral to promotion. Even price is determined by customer customisation and satisfaction rather than by some shop-floor pricing model. The **new four Cs** have evolved in the social media era to include co-creation, communities, customisation and choice. Some say this is the era of **Generation C marketing**, where the C stands for *content*. This generation is connected, creative, collaborative and contextual. Entrepreneurs must realise that the customer is now at the centre of all effective marketing activity.[13]

If you remember nothing else here, remember it's all about the Big C for Content! This is because customers face a dilemma. In the modern era, there are so many choices that customers feel overwhelmed. They have even learned how to isolate themselves and ignore the cacophony of advertising noise. Customers now choose the right time and place to connect with the market. Through their own online research, they are making more and more informed decisions. Entrepreneurs must create a knowledge-intensive and content-rich environment that delights and draws in the participation of the customer. Consumers are hungry for knowledge and are constantly looking for value. IT enables them to specify their own desired content and services. They are more easily influenced by their peers and they are supremely informed, but time-pressed and difficult to impress.[14]

Lean marketers need to appeal to the deeper needs of the customer using the 'Cone of Experience' (see Figure 8.2). It follows the principles of the old Chinese proverb: 'What I hear, I forget; What I see, I remember; What I do, I understand.' But lean marketers offer to *pull customers into 'experiences'* rather than push out advertising about products that can be ignored. The deeper you engage the audience, the more information they retain, and the more likely they are to delight in your offering.

marketing mix
Actions a marketer can take to promote a brand or product. Usually referred to as the four Ps: price, product, promotion and place, but could today be replaced with the four Cs: co-creation, communities, customisation and choice.

four Ps
The marketing mix of product, price, promotion and place. (See also *marketing mix*, *four Cs*, *new four Cs*.)

four Cs
The marketing mix of co-creation, communities, customisation and choice, all of which means content is king. (See also *marketing mix*, *four Ps*, *new four Cs*.)

new four Cs
In the marketing mix for social media, co-creation, communities, customisation and choice. (See also *four Cs*, *four Ps*, *marketing mix*.)

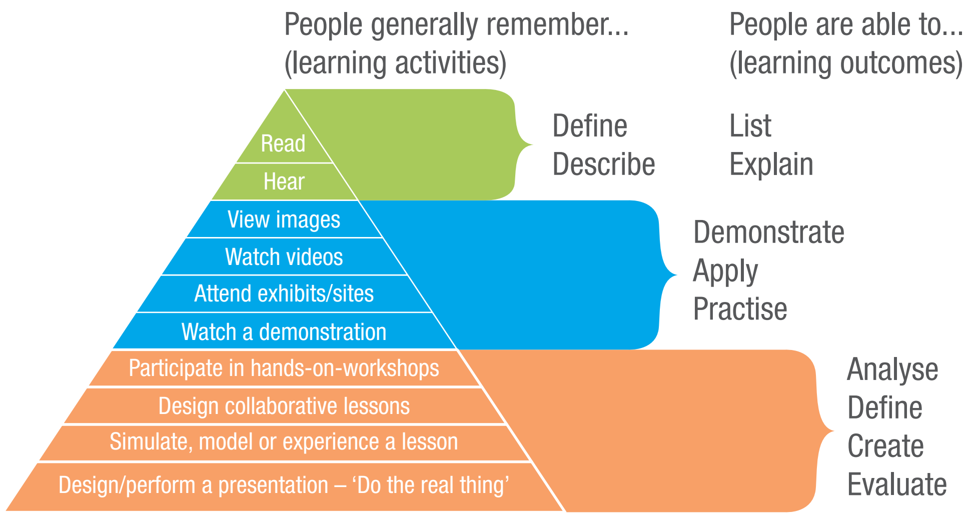


FIGURE 8.2 DALE'S 'CONE OF EXPERIENCE' AND ITS RELATION TO LEAN MARKETING[15]

Adapted from Edgar Dale's cone of learning.png. https://en.wikipedia.org/wiki/Edgar_Dale#/media/File:Edgar_Dale%27s_cone_of_learning.png. CC BY-SA 3.0. https://creativecommons.org/licenses/by-sa/3.0/deed.en.

Generation C marketing Generation C (for content) is a social media demographic that includes all the new four C's: creation, curation, connection, and community. (See also *new four Cs*, *marketing mix*.)

Here's the hierarchy of user involvement that is central to inbound marketing. Here we're talking about those colorful 'Call to Action' (CTA) buttons and bars on websites begging us to 'Click Here'.

- People remember what they read. The call to action (CTA) should be 'Read our blog'.
- People remember what they hear. The CTA should be 'Listen to our podcast'.
- People remember what they view. The CTA should be 'Download our SlideShare PDF'.
- People remember what they attend. The CTA should be 'Sign up for our event/webinar'.
- People remember the demonstration they watch. The CTA should be 'Attend our training'.
- People remember what they design. The CTA should be 'Help us co-create the product for you'.
- People remember what they evaluate. The CTA should be 'Join our focus group'.

PLANNING YOUR LEAN MARKETING CANVAS

A lean marketing Canvas is the modern, hypothesis-based and experimental version of a guerrilla marketing plan, which forces you to specify how marketing validates customer value creation. A lean marketing canvas has nine spaces (see Figure 8.3). You can follow them in order:

1 List one page with your top three marketing campaign *objectives*. What impact do you want to have on a potential customer? What do you want the customer to do? Quantify your overarching goal so that it is measurable.

customer segment A targeted group of customers that fit a certain profile. Customer segments aid decisions on where and how a product or service will be marketed. May be defined in many ways, including geographic, demographic, psychographic and combinations of these, or in any other way that narrows the focus toward a group of potential purchasers, either individuals or businesses.

2 Who is your *target audience*? List your top three **customer segments** and corresponding customer personas.

3 What communication *channels*, tactics, strategies and weapons will you use to carry out your marketing? What will you do to surprise and delight your customers?

4 *Where are you now?* What is your niche? What do customers most associate with you? Is it speed, value, variety or any number of other characteristics? A mini-SWOT (strengths, weaknesses, opportunities and threats analysis) would suffice.

5 What is your *core brand value*? State your compelling value proposition. (see Chapter 5, pp. 167–170, and 174–175).

6 Who are your *competition*? Research your top three competitors, all the while keeping the customer in focus.

7 What's your *timeline*? Write brief outlines of your one-week, one-month, three-month, six-month and one-year marketing campaigns.

8 What's your *marketing budget*? What percentage of projected gross sales are you willing to earmark as your marketing budget?

9 How are you going to *measure your success* or failure? What key marketing metrics are you going to use?[16]

As an example, here we fill the nine spaces for *Australian Outback Flashpackers: The hostel for the high-tech backpacker*. Read the list while looking at the figure on the next page.

1 Our objective is to be the number one 'flashpacker hostel' in Melbourne for budget-conscious, tech-savvy travellers who carry electronics like laptops, cameras, smartphones, tablets and DSLRs.

2 Our affluent social media customers can afford to spend more on accommodation and appreciate our one-stop-shop approach.

3 We link-build with our customers' social media outputs and use word of mouth to find new business. Our referral program encourages them to refer fellow travellers to us. We surprise and delight them with an environment they never thought they could find at that price.

4 Trendy and high-tech. Low-cost and broadband. Tech support/repair and great working spaces.

5 We offer our high-tech backpackers the broadband, editing tools and workspaces they desire at a cost they can afford.

6 We are unique in Melbourne. We are the Ibis of flashpackers.
7 We start off with Facebook and referrals, develop our email mailing list and boost our visibility with outside links all in the first three months.
8 We will spend 10 per cent of gross revenues on marketing until we attain sustainable growth, and then reduce to 4 per cent.
9 We will grow our mailing list from 300 to 3000. We will have a 5 per cent return on each advertising dollar in Google Adwords.

FIGURE 8.3 LEAN MARKETING CANVAS

Source: Adapted from Varghese, J. (2015, November 23). One page digital marketing plan to grow your small business. http://jacobv.com/technology/the-one-page-digital-marketing-plan-to-grow-your-small-business/.

ANOTHER WAY TO WRITE YOUR LEAN MARKETING PLAN

If you have no patience for the canvas above, sketch out your plan this way. It requires lean writing too. You should be able to write this in 10 minutes in seven sentences that fit on one page!

1 Repeat your venture's unique value proposition (see Chapter 5). Make sure it has quantifiable key metrics. The point is to envision exactly what you want your ideal customer to do, and then to establish a goal for ensuring that customers will act in that way.
2 Expand on your unfair advantage (unique qualities or offerings). What makes you uniquely positioned to offer value? Outline the venture's strengths that you intend to use as your marketing materials.
3 Describe your customer segmentation. To which segments will you expose which messages? Note: If you have more than one customer segment you can use one sentence for each.
4 List your marketing arsenal. Specify only those tools that you can afford and know how to use.

5 Specify your venture's market niche. What characteristics or features do customers most associate with your venture (e.g. speed, value, variety)? Say what your company is, but also what it is not.
6 Now describe the identity of your company. Usually you can take this from your Mission and Values statements.
7 Finally, tell us how much of your gross sales you are willing and able to throw at your marketing budget. Think of the expensive research and high-quality collateral that you will have to generate.[17]

LEAN MARKETING TECHNIQUES

Lean marketing is accomplished in a variety of ways. Over the years, marketing literature has identified more and more concepts and instruments of unconventional advertisement techniques. This includes inbound marketing, buzz marketing, ambient marketing, ambush marketing, celebrity marketing, shock marketing, mosquito marketing, sensation marketing, stealth marketing and viral marketing.[18] What makes the various techniques fall under the lean-marketing umbrella is the ability to quickly measure their effects, validate the concept, validate the value proposition and contribute to business modelling. In this chapter, we will cover four important techniques: inbound marketing, guerrilla marketing, growth hacking and viral marketing.

Inbound marketing

outbound marketing
Marketing that uses traditional tools such as cold calling, email blasts or television ads, whether or not the customer wants it.

inbound marketing
Capture of users/seekers by pulling them into a sales relationship through website, social media, email, content, blogging and other techniques rather than by pushing ads out to them.

conversion funnel
A visual representation of the journey that buyers take, from visitors to customers to brand ambassadors for your company.

lead scoring
A technique of assigning scores to contacts to indicate how likely it is to close a deal with that customer, usually based on that contact's engagement, persona or demographics.

Rather than invading their spaces, inbound marketers draw in customers and 'earn the customer's awareness'. In so doing, they reverse the typical company-customer relationship. Whereas **outbound marketing** pushes the product or service where it may not be wanted, even resisted, **inbound marketing** generates leads and draws the customer in.[19] Figure 8.4 shows the four stages of inbound marketing in the shape of a **conversion funnel**.

- *Attract*: The first challenge is to attract eyeballs! This is done with the big C: content. You can create content using what you already know your customers are craving from the previous chapters' exercises. An effective inbound marketing campaign is built around blogging, e-books, coupons, chats and offering information. Set up a blogging schedule to feed social media channels. Make sure you have done your keyword search and that your site is search-optimised. Web visitors are thirsting for information and your goal is to convert strangers into visitors, and ultimately followers.
- *Convert*: Once customers have expressed an interest in your product or service, you need to convert them into leads using a call to action (CTA). Typically, you use a landing page to entice them to give up something of value, such as their personal information, email address or telephone number, in exchange for something they want, such as a white paper or webinar.
- *Close*: Then comes the 'closing dance', where you can retouch your lead several more times in order to achieve a sale. Rank your incoming leads using **lead scoring**, for example, based on number of downloads, email opens and clicks; industry segment; or geographic location. Lately, lean marketers have been using the visitor's 'social score', for example, whether they tweet about your product, comment on a blog, ask a question on LinkedIn or take part in any other conversation happening online. Then you bring them in using a series of targeted emails.[20]
- *Delight*: Of course, your relationship with the customer should never be finished. Now you need to nurture the customer, providing after-sales support and reassuring them they made the right decision. Use social media channels and email to continue to engage with them. Delighting them is how you can upsell them, make them loyal and, most importantly, make them into evangelists who will spread the word about your concepts.

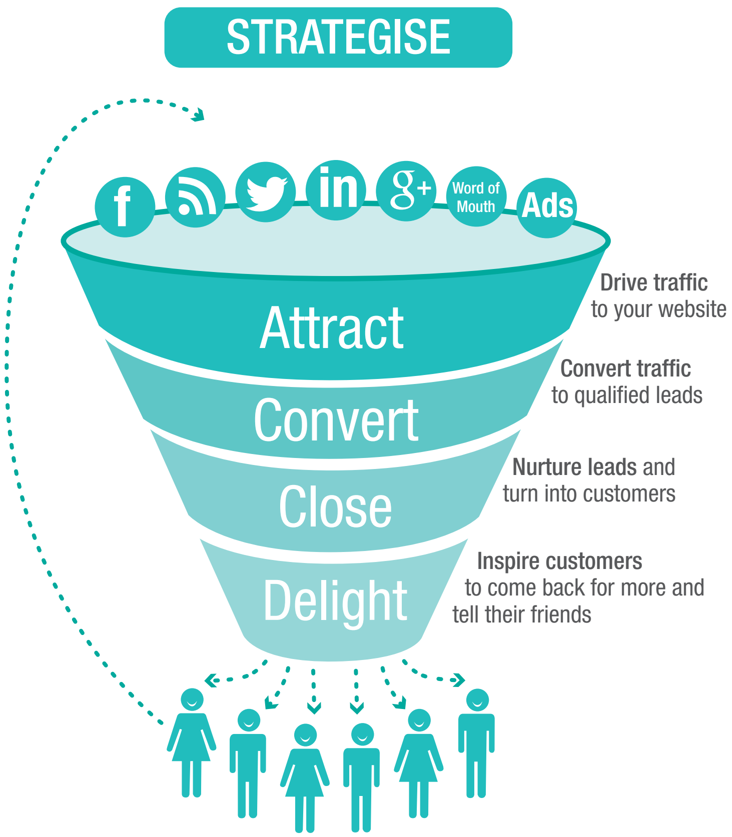


FIGURE 8.4
FOUR STAGES OF INBOUND MARKETING

Adapted from https://www.flickr.com/photos/coolinsights/16202148999. CC BY 4.0. Generic https://creativecommons.org/licenses/by-sa/4.0/.

ENTREPRENEURIAL EDGE

INBOUND MARKETING WORKFLOW

- Audit your website using Google Webmaster tools and Google Analytics.
- Be sure you are well-SEOed and have done your keyword planning.
- Complete your customer persona profiles.
- Be sure you have a compelling value proposition that has been validated.
- Set up your landing page with proper CTA and web forms.
- Create email triggers using Mailchimp.
- Launch a pilot campaign that focuses on one feature only.
- Measure results. Iterate landing page with learnings.
- Create landing page variations with experimental A/B testing.
- Launch pilot campaign with two testing variations.
- Launch your blog with content-based experimentation (e.g. e-books).
- Measure results. Iterate landing pages.
- Launch premium gated content to match customer journey, and measure.
- Launch aggressive social media campaign.
- Launch your third pilot campaign. Focus on two or more features.
- Perform A/B testing of top-level website pages.
- Record visitors in a database and convert them into leads.
- Redesign based on discoveries.
- Renovate your web architectures with new components.[21]

customer persona
See *persona*.

Guerrilla marketing

guerrilla marketing
An unconventional way of performing marketing activities (primarily promotion) on a very low budget.

As we mentioned above, potential customers now tend to isolate themselves away from media and ignore messages. **Guerrilla marketing**, or what we now call 'surprising ambient media'[22], creates awareness at a time and place at which customers may least expect it. It is an unconventional form of inbound marketing in that it raises brand awareness among large audiences *without annoying them* (it's called the 'stumble upon' effect). As the godfather of the topic, Jay Levinson said many years ago, 'Guerrilla marketing is the truth made fascinating. It's going after conventional goals using unconventional means. Your prime investments in guerrilla marketing don't have to be money – they should be time, energy, imagination and information.'[23]

The element of surprise is important here. The purpose is to surprise consumers with unexpected activities or experiences. Surprise is a result of the divergence of perceptions and expectations. Unusual stimuli are processed more deeply than those considered commonplace.[24] Think of innovative ways to surprise: absurdity, humour, shock, location. Examples of guerrilla marketing campaigns are:

- Shark-bitten surfboards exhibit to promote Shark Week
- Light projections onto the Sydney Opera House
- Using huge paper towels to clean up huge messes
- Promoting a hair strengthener by having acrobats climb oversized ponytails

Here is just one example of a creative guerrilla campaign from Coca Cola: http://www.huffingtonpost.com.au/entry/coca-cola-atm-free-money-video_n_2766268.

ENTREPRENEURSHIP IN PRACTICE

THE SEVEN-SENTENCE GUERRILLA MARKETING PLAN

A business plan is essential for any entrepreneur planning to start a venture; however, by the time you include your market research results, pro forma statements and critical risks, your business plan will become a dense packet of information to be used to guide your entire business – a document that few will read in its entirety. Entrepreneurs should therefore be able to quickly articulate the key aspects of their venture in a matter of minutes. One tool that can be used for this purpose is what is known as a guerrilla marketing plan.

A guerrilla marketing plan forces an entrepreneur to specify the seven most important marketing issues that face their company. Of course, there will most certainly be more than seven key areas to address; however, by going through the exercise of consolidating the marketing topics that require the most focus, an entrepreneur will be better prepared to get to the heart of their concept, both when presenting to potential investors and when managing the business.

The key is to address each area using no more than a sentence. Guerrilla marketing plans give people a quick understanding of exactly what is of the utmost concern to your business by eliminating much of the detail provided in your full business plan. Large companies make use of such plans by developing different ones for different products. For instance, Procter & Gamble develops a guerrilla marketing plan for each individual product.

Although some companies choose to attach several pages of documentation to their plans, the key is to get the seven sentences right. Following are guidelines for developing a guerrilla marketing plan. We covered these steps above in 'Another take on the lean marketing canvas', but here we go into a little more detail.

- You should begin your guerrilla marketing plan with a sentence that describes the purpose of your marketing. This sentence should be very specific and should address what impact your marketing initiative should have on a potential customer. Goals such as 'to be more successful than my competitors' or 'to be more profitable' are not useful. This sentence should quantify your overarching goal so that it is measurable. The point is to envision exactly what you want your customer to ideally do, and then to establish a goal for ensuring that customers will act in that way.

continue

continue

- The next sentence should address the competitive advantages of the enterprise; in other words, what are the characteristics of the business that make it uniquely positioned to offer value to the public? The objective of this sentence is to outline your business' most unique strengths so that you can emphasise them in your marketing materials.
- In the third sentence, you should address your target audience. By specifying exactly who will be exposed to a marketing campaign, you will make the process of engineering an effective plan much more straightforward. Companies often have more than one target audience, so guerrilla marketing plans should be written to address all potential customers in order to avoid losing sales to competitors.
- For the fourth point, you should create a list of the marketing weapons that you will use. The important idea of this section is to include only those tools that the company can understand, afford and use properly. Countless tools are now readily available to entrepreneurs, so filtering out those that do not meet these three criteria will help you avoid making poorly directed investments.
- Fifth, you should discuss the company's market niche. Now that you have addressed the purpose, benefits and target market, understanding your marketing niche is the logical next step. The market niche should capture what customers most readily associate with your company. It could be speed, value, variety or any number of other characteristics. You will not be able to please everyone, so defining what your company is and what it is not will help to narrow your focus when promoting it to potential customers.
- The sixth sentence is where you will establish the identity of your company. An entrepreneur should ensure that the marketing image they broadcast to the world is supported by the identity of their company, which means that the company's operating procedures need to reinforce that identity.
- The final sentence in your guerrilla marketing plan should explicitly state what percentage of projected gross sales you are willing to earmark as your marketing budget. The quality of your marketing materials will clearly reflect on your business, so this step requires a significant amount of research to ensure that the amount you have allotted will be sufficient for supporting all previous steps.

When developing your guerrilla marketing plan, all subsequent steps should be framed by the first sentence you write, which is meant to define the purpose of your plan. Entrepreneurs should theoretically be able to write a plan of this nature within 5 minutes, given its brevity. The more practice you get at articulating your business objectives, the easier you will find using tools – such as the guerrilla marketing plan – to communicate your business goals.

Source: Adapted from Levinson, J. C., & Levinson, J. (2008, February). Here's the plan. *Entrepreneur*. http://www.entrepreneur.com/magazine/entrepreneur/2008/february/188842.html

Growth hacking

This concept goes back to 2010 with Sean Ellis' work on lean marketing.[25] Growth hacking extends hypothesis-driven entrepreneurship into the sphere of marketing, and it unites previously disparate concepts under one umbrella as a different way to attack the market. **Growth hacking** is the marketing extension of the experimental methods that we introduced in Chapter 7. It is a process of hypothesis-based experimentation across marketing channels and product iterations that measures and tracks results so you can identify bottlenecks in the conversion funnel and strategise effective ways to pivot a business toward growth. (See Table 7.2, 'Pretotyping tools' and Table 8.1, 'Lean marketing resources'.)

growth hacking A process of experimentation to identify the best way to grow the business that combines the skills of marketers, user interface designers and product managers.

Growth hackers are 'geek strategists' because they combine the skills of marketers, user interface designers and product managers – and they can code using Adwords, CSS and HTML. Their focus is to build a user base through marketing trials, and even stunts, that further validate the product or service concept, or perhaps lend themselves to a pivot decision. Growth hackers start with sketches and wireframes, then iterate and validate their ideas quickly, even overnight. In the jerky start-up world where a new competitor can arise overnight, where loyalty of customers can shift with the wind and where disruption is more constant than change, growth hackers give the project a leg up in discovering new customers and strategies. Here are some of the tools in the so-called **growth stack**.

growth stack A set of tools to market, sell and communicate with customers, including such tools as Mailchimp, Hootsuite and Google Analytics.

search engine optimisation (SEO)
Maximisation of the number of visitors to a particular website by ensuring that the site appears high on the list of 'organic' results returned by a search engine through index crawlers, sitemaps and cross-linking.

search engine marketing (SEM)
Internet marketing that promotes website visibility using tools such as keyword research, web analytics, HTML validators, spiders and website checkers.

user experience
The experience a visitor has on a website; the goal of an entrepreneur should be to give the user a positive experience through look and feel, design, navigation and content.

remarketing
Positioning of targeted ads to a defined audience that have previously visited a particular website as they browse elsewhere around the internet.

email capture
The collection of leads to encourage consumers down the conversion funnel.

web scraping
Harvesting or extraction of data from websites using a bot or web crawler.

influencer marketing
Marketing focused on key individuals or customer segments who can influence potential buyers, rather than the market as a whole.

click-through rate (CTR)
the proportion of people who view an ad who then click on a link. Useful metric for measuring effectiveness of a call-to-action or pay-per-click ad.

conversion rate
In an online advertising campaign, the average number of sales, enquiries or subscriptions per ad click, shown as a percentage.

- **Search engine optimisation (SEO)**: From the start, build your website so that it appears at the top of search results. There are online courses to learn how to include popular search terms in your page copy; tag and meta-tag all assets (especially images) on your page; and include hyperlinks to other even more recognisable sites.
- **Search engine marketing (SEM)**: Use Google AdWords to identify the best search terms for your enterprise. Use landing pages and A/B testing to further improve your ranking.
- **User experience** management: Here you analyse how users interact with your technology and your business model. You need to closely monitor your users' experience/behaviour, and course-correct the business model and the technology in response. Google Analytics is the most accessible product management tool.
- *Facebook/Instagram ads*: Facebook allows you to drill down to specific demographics. You can ask questions like 'Will educated females in Melbourne who like to travel be open to chocolate-themed hens' parties?' Facebook can also track activity across multiple devices (phone, computer, tablet) so that you can target individual devices.
- **Remarketing**: This is a way to continue contact with potential customers who have not reached the bottom of your funnel yet by placing targeted ads in front of people who previously visited your website as they browse elsewhere on the internet.
- **Email capture**: Use a capture form to acquire mailing lists. A monthly email newsletter can greatly increase your customer base. You can deepen customer loyalty through surveys, relevant content and calls to action that drive them back to your site, or convert them into paying customers. Beyond this, **web scraping** is a method of extracting data from a website.
- **Influencer marketing**: Focus on specific key individuals (or types of individual) rather than the target market as a whole. Identify the people who influence potential adopters of your product or service. Also, collaborate with high-profile brands to tap into their audience.

Using the tools for leaning marketing, here are some of the metrics you can track.[26]

- *Active users or repeat customers*: a measure of how engaged your customers are with your site or product.
- **Click-through rate (CTR)**: the percentage of people that view an add that click on it. A useful metric for measuring the effectiveness of a call to action or a pay-per-click ad.
- **Conversion rate**: the number of people who actually take action, divided by the number of people who see an offer, and multiplied by 100 to give a percentage.
- **Customer acquisition cost (CAC)**: average amount of money you spend to acquire a single customer.
- **Customer lifetime value (LTV)**: The potential revenue that you'll receive from a given user. In an SaaS (software as a service) business, this is calculated based on churn (the rate at which customers stop subscribing to a service). For e-commerce, this is based on transaction size, commission and chances of the user returning.
- **Average revenue per user (ARPU)**: average amount of money you receive per customer.
- *Referrals*: the number of people referring your product and sharing why they think it's great
- *Sources of traffic or customers*: how your customers are finding your product

ENTREPRENEURIAL EDGE

GROWTH HACKER JOB DESCRIPTION

Looking for growth hackers is like looking for a needle in a haystack. The broad skills needed to run successful data-driven experiments across the entire funnel means you have to build growth-hacking teams with T-shaped profiles (deep expertise in a single field but with the ability to cross silos and tap into other people's knowledge and skills).

Responsibilities:

- Conduct paid search marketing
- Work on website link structure and titles and meta descriptions.
- Edit and optimise content for SEO purposes
- Perform in-depth SEO research using multiple tools
- Develop recommendations and off-page tactics
- Monitor performance to improve campaign
- Inspect and resolve HTML code and content, link architecture and navigation issues.

Qualifications:

- Bachelor's degree or equivalent experience in online marketing, including experience managing paid search engine marketing campaigns
- Google Adwords certification and Google Analytics certification are a plus
- Expert in on-page and off-page SEO
- Expert user of Google Analytics, Google Webmaster Tools, link research tools, crawling tools and keyword research tools
- Familiarity with recent algorithm changes
- Experience in mobile and local SEO.

Viral marketing

Viral marketing is a technique wherein the producer/supplier inspires users/customers to spread the message to other users. The product is usually 'free' and easily accessible. The message, or meme, must be short and easily transferrable through email, WhatsApp, networking websites and so on. The message should also be interesting and intelligently positioned in media space. It is even better if an influential person recommends it on their own social media space. Here are the components of viral marketing:

- **Buzz marketing** sends out online and offline messages via 'buzz agents' (influencers/brand ambassadors) to 'buzz targets' (receivers) and then harvests market research information from the buzz agents. 'Buzz agencies' sometimes pay **thought leaders** or **influencers** – individuals who influence potential buyers – to diffuse a marketing message from behind a wall of peer respectability. In communication theory this is called the **two-step flow of communication**, where compelling messages flow from opinion leaders to a wider population.[27] For example,
  - Personal: 'I was running with a friend and I started having foot pain. My friend told me about a new runner's clinic she had heard of and emailed me the info.'
  - Organisational: 'I heard about the runner's clinic through the sports store newsletter.'
- **Word-of-mouth marketing (WOM)** diffuses messages about products, services and brands for commercial gain through words (oral or written), pictures, videos and so on in order to 'infect' target audiences with 'memes', which are ideas imprinted in the mind of an individual who then acts as a host to transfer the content like a virus. 'Infection' is usually achieved through entertainment, amusement and emotional reactions, delivering a positive image that the recipient is keen on spreading through social networks, blogs, chats, newsletters and web communities.

customer acquisition costs (CAC)
The ratio of all costs spent on acquiring customers (marketing expenses) divided by the number of customers acquired.

customer lifetime value (CLV)
An estimate of the net profit from one customer over their lifetime; an element in calculating payback of advertising.

average revenue per user (ARPU)
Total revenue divided by number of subscribers. Used widely by consumer and digital companies.

buzz marketing
A technique of viral marketing that aims to generate 'buzz' or word-of-mouth communication leading to conversations about products and services among family, friends and larger social forums. (See also *word of mouth*.)

thought leader
Similar to an influencer, an individual whom other customers recognise as an authority and who can influence others' adoption of a product or service.

influencer
A person who influences other people in a market, particularly their buying behaviour. (See also *thought leader*.)

two-step flow of communication
A model that posits that most people form their opinions under the influence of influencers or thought leaders.

word of mouth (WOM)
Form of message transmission, formerly limited to oral communication, that now involves passing information through all means of communication, including electronic media such as websites and social networks.

online marketing Advertising and marketing efforts using web and email to drive direct sales.

- **Online marketing**: This includes everything from website banner ads to sponsored email newsletters, Facebook, Twitter and YouTube.[28]

Before the internet, WOM primarily involved people talking face-to-face (which of course still happens today), but it has expanded to become digital WOM, a byproduct of successful online viral marketing. Word of mouth, now *largely facilitated by the internet*, can be a rapid and exponential marketing force and is now called 'word-of-mouse marketing'.

TABLE 8.1 LEAN MARKETING RESOURCES (SEE ALSO TABLE 7.2, 'PRETOTYPING TOOLS')

AdWords and keywords	https://adwords.google.com/home/resources http://evergreendm.com/getting-started-with-google-adwords
Blogging	https://theblogstylist.com/tools https://www.bloggingbasics101.com/blogging-resources-recommendations https://problogger.com/recommended-blogging-resources
Growth hacking	https://growthhackers.com/articles/a-comprehensive-guide-to-growth-hacking-resources https://www.entrepreneur.com/article/282515
Guerrilla marketing	https://blog.hubspot.com/marketing/guerilla-marketing-examples https://www.feedough.com/guerrilla-marketing-strategies-examples
Inbound marketing	https://inbound.org https://www.inboundo.co/resources/inbound-marketing-strategy-complete-resource
Measurement	http://www.demographicspro.com
Search engine optimisation	https://www.e-marketingassociates.com/blog/beginners-resources-for-seo https://blog.hubspot.com/marketing/resources-to-learn-seo
Social listening and social media monitoring tools	https://www.brandwatch.com https://mention.com/en/media-monitoring/social-media-monitoring-tools
Viral marketing	http://www.bluleadz.com/blog/best-viral-marketing-campaigns-weve-seen https://minipakr.com/2017/04/14/viral-marketing-how-meme-culture-is-making-sales
Web scraping tools	https://www.import.io/post/13-ways-use-web-scraping-tools/

WHAT RESEARCH DOES THE LEAN MARKETER NEED?

The purpose of marketing research is to identify customers – target markets – and to fulfil their desires. For marketing research to be effective for the growing venture, the following areas warrant consideration:

- *The company's major strengths and weaknesses*: These factors offer insights into profitable opportunities and potential problems and provide the basis for effective decision making.
- *Market profile*: A market profile helps a company identify its current market and service needs. How profitable are existing company services? Which of these services offer the most potential? Which (if any) are inappropriate? Which will customers cease to need in the future?
- *Current and best customers*: Identifying the company's current clients allows management to determine where to allocate resources. Defining the best customers enables management to more directly segment this market niche.
- *Potential customers*: By identifying potential customers, either geographically or with an industry-wide analysis of its marketing area, a company increases its ability to target this group, thus turning potential customers into current customers.

- *Competition*: By identifying the competition, a company can determine which businesses are most willing to pursue the same basic market niche. By examining the competitor's products, an entrepreneur can establish how different their own product offering will be and pre-empt competitor response.
- *Outside factors*: This analysis focuses on changing trends in demographics, economics, technology, cultural attitudes and governmental policy. These factors may have substantial impact on customer needs and, consequently, expected services.
- *Legal changes*: Marketing research performs the important role of keeping management abreast of significant changes in governmental rates, standards and tax laws.[29]

Customer segmentation

Customer segmentation is the process of identifying a specific set of characteristics (subgroups) that differentiates groups of consumers. The total market is often made up of submarkets (called segments).[30] (You will recall this concept from our discussion of the value proposition in Chapter 5 and our discussion of persona analysis in Chapter 6.) Here's are two interesting examples of customer segmentation. Let's create customer segments among wine drinkers and ecotourists. Wine-related lifestyle segments in the wine market have been classified as: ritual-oriented conspicuous wine enthusiasts, purposeful inconspicuous premium wine drinkers, fashion/image-oriented wine drinkers, basic wine drinkers, and enjoyment-oriented social wine drinkers.[31] Yet another example can be drawn from the ecotourism market in the outback of Australia, which has such segments as: 'harder' ecotourists, who reflect a high level of environmental commitment and affinities with wilderness-type experiences; 'softer' ecotourists, who are much less committed on either dimension; and 'structured' ecotourists, who are generally highly committed but vary in their level of desire for the guides, escorted tours and services/facilities usually more associated with mass tourism.[32]

The key to customer segmentation is to distinguish the groups of customers that share the same notion of what is valuable in a product or service offering; and to then satisfy these customers by designing their customer experiences to match.[33] Some individuals may prefer high quality in some product categories but be indifferent to quality dimensions in other categories. The price and profit margin may be higher for high-quality offerings but the market niche may also be smaller than for lower-priced competitors. The process of segmenting the market can be critical for new ventures with very limited resources.

To identify specific customer segments, entrepreneurs need to analyse demographic variables and benefit variables. **Demographic variables** include age, marital status, sex, occupation, income, location and the like. These characteristics are used to determine a geographic and demographic profile of customers and their purchasing potential. **Benefit variables** help to identify unsatisfied needs that customers are seeking. Examples may include convenience, cost, style, trends and the like, depending on the nature of the particular new venture. Whatever the product or service, it is extremely valuable to ascertain the benefits or value a customer segment is seeking in the product or service in order to further differentiate a particular target group.

Psychographics is a term that has gained traction in defining of customer segments. Psychographics looks at psychological characteristics of individuals that influence their buying behaviour. Just think 'soccer mom': a middle-class suburban mother who drives an SUV, wears a tennis outfit, and takes her children to sports. What motivates her psychologically? Table 8.2 shows **segmentation variables** for

customer segmentation
The process of identifying a specific set of characteristics that differentiate one group of consumers from the rest.

demographic variables
Statistical information about the customer or beneficiary, such as income, gender, education, location, ethnicity, race and family size. (See also *psychographics*.)

benefit variables
Benefit variables are when you divide up your customer base according to their perceptions of benefits or advantages that they receive from a product or service. Some customers highly value quality, others performance, customer service or special features.

psychographics
Attributes relating to personality, values, attitudes, interests or lifestyles, as opposed to demographic variables such as age and gender.

segmentation variables
Variables used to categorise consumers by geography, demographics, psychographics and behaviour in order to target specific types of people and not just people in a certain geographic area. (See also *customer segmentation*.)

TABLE 8.2 CUSTOMER SEGMENTATION VARIABLES FOR CONSUMERS AND BUSINESS MARKETS

SEGMENTATION VARIABLES: CONSUMER MARKETS	SEGMENTATION VARIABLES: BUSINESS MARKETS
Demographics: age group (e.g. teens, retirees, young adults), gender, education level, ethnicity, income, occupation, social class, marital status Geographics: location (e.g. national, regional, urban/suburban/rural, international), climate	Demographics: type (e.g. manufacturer, retailer, wholesaler), industry, size (e.g. sales volume, number of retail outlets), age (e.g. new, young growth, established growth, mature) Geographics: location (e.g. national, regional, urban/suburban/rural, international), climate Business arrangement: ownership (e.g. private versus public, independent versus chain), financial condition (e.g. credit rating, income growth, stock price, cash flow)
Current purchasing situation: brands used, purchase frequency, current suppliers Purchase readiness: necessary equipment, property, knowledge, skill sets Local environment: cultural, political, legal	Current purchasing situation: brands used, purchase frequency, current suppliers Purchase readiness: necessary equipment, property, knowledge, skill sets Local environment: cultural, political, legal Customers served by the business – the business' market Business' perceived image – how they are perceived by their customers
Benefits sought: price, overall value, specific features, ease of use, service Product usage: how used, situation when used Purchase conditions: time of day/month/year when purchased, credit terms, trade-in option Characteristics of individual buyer: purchase experience, how purchase is made, influencers on purchase decision, importance of purchase Psychographics: personality, attitudes and lifestyle combined with demographics	Benefits sought: price, overall value, specific features, services, profit margins, promotional assistance Product usage: how used (e.g. raw material, component product, major selling item at retail level), situation when used Purchase conditions: length of sales cycle, set product specifications, bid pricing, credit terms, trade-in option, product handling Characteristics of buying centre: purchase experience, number of members, key influencers, willingness to assume risk

Source: Stage 1 Segmentation variables (2018). https://www.knowthis.com/targeting-markets/stage-1-segmentation-variables. Copyright KnowThis LLC. Used by permission.

consumers and business markets. At the end of the chapter you can develop your ability to identify customer types with the 'Experiencing entrepreneurship: Marketing your product or service' exercise.

Consumer behaviour

Consumer behaviour is defined by the many types and patterns of consumer characteristics. However, entrepreneurs should focus their attention on only two considerations: personal characteristics and psychological characteristics. Traditionally some marketing experts have tied these characteristics to the five types of consumers: innovators, early adopters, early majority, late majority, and laggards.[34]

The differences in social class, income, occupation, education, housing, family influence and time orientation are all possible personal characteristics, while the psychological characteristics are needs, perceptions, self-concept, aspiration groups and reference groups. This type of breakdown can provide an entrepreneur with a visual picture of the type of consumer to target for the sales effort.

The next step is to link the characteristic makeup of potential consumers with buying trends in the marketplace. Table 8.3 shows the changing priorities that have shaped buying decisions. Each of these factors relates to consumer attitudes and behaviours based on education, the economy, the environment and/or societal changes. By interpreting common consumer characteristics in light of the information in Table 8.3, the entrepreneur can begin to examine consumer behaviour more closely.

TABLE 8.3 CHANGING PRIORITIES AND PURCHASES IN THE FAMILY LIFE CYCLE

STAGE	PRIORITIES	MAJOR PURCHASES
Fledgling – teens and early 20s	Self, socialising, education	Appearance products, clothing, cars, recreation, hobbies, travel
Courting – 20s	Self and other, pair bonding, career	Furniture and furnishings, entertainment and entertaining, savings
Nest building – 20s and early 30s	Babies and career	Home, garden, do-it-yourself, baby care, insurance
Full nest – 30 to 50	Children and others, career, mid-life crisis	Children's food, clothing, education, transportation, orthodontics, career and life counselling
Empty nest – 50 to 75	Self and others, relaxation	Furniture and furnishings, entertainment, travel, hobbies, luxury cars, boats, investments
Sole survivor – 70 to 90	Self, health, loneliness	Healthcare services, diet, security and comfort, TV and books

Source: Dickson, P. R. (1994). *Marketing management*. 1st ed. © 1994 Cengage Learning
This was taken from Kuratko 10e, p. 225.

LEAN BUSINESS MODELLING

Take a deep breath and let's turn the corner to the last half of this chapter as well as the last 'canvas' that we'll consider, the business model canvas. In Chapter 7 and the first part of this chapter we have outlined the various hypothesis-based ways to validate your business idea. This has included pretotyping, minimum viable products, pivoting, experimental methods and hypothesis-driven marketing techniques. All of these contribute to your ability to determine whether a given business model could be viable or not. Every venture has a business model, articulated or not, successful or not, and entrepreneurs are increasingly asked by investors, judges, mentors and teachers to describe their business models. So what are business models?

business model
How a venture is designed to make money, demonstrating a clear method of getting to the market for sales.

Business models are, at their core, stories that explain how new ventures work.[35] Business models are also personal stories about entrepreneurs because they can show us the life trajectory and passions of the individual entrepreneur or entrepreneurial team. Entrepreneurs usually try out multiple business models at the same time or in succession. Obviously, the opportunity that you have identified is central, as are the value proposition, validation and minimum viable product. At its root, a business model describes the benefits and gains for the customer, but also the entrepreneur's course of action. The business model canvas is a conceptual tool with nine elements (see Figure 8.5) that allows us to depict the business logic of a specific venture. *Miraculously, it can be sketched on one single sheet!* It has become one of the great buzzwords of today's economy. You will have the chance to run through the nine elements and create your own business model canvas in the 'Experiencing entrepreneurship: Lean canvas business model' exercise.

The roots of describing a business model go back to the 1950s, when Peter Drucker began asking entrepreneurs not 'what is your product' but 'who is your customer' and 'what does your customer value'?[36] Despite its popularity, defining a business model has been a bit difficult. Teece in 2010 claimed that the concept of a business model had not yet appeared in a single scientific paper in the mainstream economics journals. His explanation was that economists have no need for the concept of a business model: If value is delivered, customers will pay for it. To economists, Teece said, the concept of business model is superfluous because producers/suppliers create and capture value simply by 'disposing of their outputs' at competitive market prices. If no one buys it at a certain price, *they just lower the price*, no matter what kind of business model they have.[37] Who needs a business model, say the economists? It's just about supply and demand. Well, the economists, with this view, only see a small part of the business model story.

business model ontology
A way to visually depict the logic of a venture's value creation through such instruments as value proposition, target customer, revenue and cost structures, unfair advantage, etc. (See also *ontology*.)

ontology
An way of explaining the nature of things that have existence and the relationships among them, usually depicted in some graphic form. (See also *business model ontology*.)

business model canvas (BMC)
A one-page visualisation or depiction of how you create customer value in terms of content, structure and operation.

lean canvas (LC)
Created by Ash Maurya, a one-page visualisation or depiction of the content, structure and operation of how you create customer value. The LC focuses more on start-up businesses and entrepreneurs, while the BMC can be used by investors, consultants, advisors and larger businesses.

Outside the economics journals, the literature on **business model ontology** is enormous. We use the concept of **ontology** (from the Greek meaning the 'study of being') to describe a way that researchers identify, compare and classify different frameworks or models. Ontologies are ways to visualise or create mental models helpful in theory-building.[38] In 2001, Amit and Zott described the business model as an analytical tool that shows how entrepreneurs create value from multiple sources.[39] Many articles started to emerge that described how business models could explain value and predict success.[40] It is not surprising that there have been a variety of definitions of what exactly a business model is. There are several complementary schools of thought. A business model can be:

- a representation of a particular kind of value creation logic (e.g. freemium business model)
- the value creation logic of a particular real company (e.g. the Dell business model)
- the core logic about how to do business as a whole system (e.g. the insurance industry).[41]

In this book, we define a business model as an analytical tool that visualises (depicts) the content, structure and operation of the entrepreneur's choices of how to create customer value – what was the innovation and what is the strategy to bring it to the users? We visualise this using the **business model canvas (BMC)** or the **lean canvas (LC)** and their building blocks. Every box in the canvas can be filled in to show the choices you can make in strategy and innovation and the consequences of those choices.[42] The canvas is a dynamic tool that generates feedback loops and validation opportunities.[43] It focuses the entrepreneur's attention on essential questions: How do we create value? For whom do we create value? What is our source of competitive advantage? How do we differentiate ourselves competitively? How do we make money?[44]

First devised by Alexander Osterwalder in 2004, and now variously modified and used around the world, the business model canvas gives entrepreneurs a common language and a visual framework of how to create new businesses and develop new products and services, as well as how to revive and renew existing business models.[45] (See curated bibliography on business modelling.[46]) Again, a business plan is much more comprehensive than a business model. But once you have the business model you can go straight to the business plan (which we will deal with in Chapter 11). With the BMC, you can define the relevance and power of the market, its viability and feasibility, the cash engine and cost structure, and many other things that will tell you when it is time to go on to the full business plan.

THE LOGIC OF VALUE CREATION

How does one actually 'create value'? Let us start by cataloguing some business models into a simple typology. Here is a list of some standard and disruptive business models, so that you can see each as following a particular kind of value creation logic.

STANDARD BUSINESS MODELS

bricks, clicks and flips
Describes an entrepreneurial venture that combines presences offline (bricks) and online (clicks), sometimes with the third extra, flips (physical catalogues).

Franchise
Any arrangement in which the owner of a trademark, trade name or copyright has licensed others to use it to sell goods or services.

- *Advertising*: Online businesses and media companies often look to advertisers for most or all of their revenue. Google and Facebook depend on ad revenue because they cannot get users to pay for content.
- *Auction*: On eBay, sellers offer products in an online auction and buyers bid on what they want to buy.
- **Bricks, clicks and flips**: Apple and Amazon integrate both offline (bricks) and online (clicks) presences, sometimes with a third extra, 'flips' (physical catalogues).
- **Franchise**: At franchises such as Battery World and Baker's Delight, the master franchisor sells the rights to use a brand and a tried-and-tested business model.

- *Freemium*: You can build a huge user base when the marginal cost of producing another unit is very low. At Dropbox and LinkedIn, most users use the product for free, while only a minority pay for a 'premium' version of the product.
- *Low-cost*: Budget airlines such as Jetstar and Tiger drive in significant volumes of customers at a low customer acquisition cost by charging a very low price, and adding charges for extras.
- **Razor and blades**: The first product (razor) is sold at a low price (or given away for free) in anticipation of people buying the higher-margin paired product (blades), for example, game consoles and games, printers and ink cartridges.
- *Subscription*: Pioneered by magazines and newspapers; now companies like Netflix require the customer to pay a subscription price to have access to their product or service.

SOCIAL BUSINESS MODELS

- *Consumer co-ops*: In a **cooperative business model**, the beneficiaries are all members of the cooperative enterprise and they share access to services such as technology, markets, marketing services, and bulk purchase discounts. The members combine their resources (revenue) to pay for the services.
- *Donation funding*: This business model relies on member or charitable donations and must abide by legal and tax regimes.
- **Hybrid**: Hybrids are social organisations that combine public, private and voluntary sectors, for example, non-profits with for-profit business models, and for-profits with social missions.
- **Mutuals**: Mutuals provide common services to all members of the organisation or society. Profits made will usually be reinvested in the mutual for the benefit of the members.
- *Selling services*: These are organisations that are business oriented and sell services for revenue, while still relying on donations and other sources of funding.
- *Social business*: A social business addresses a social problem and does not distribute dividends. It is financially self-sustainable and profits are reinvested in the business itself.

DISRUPTIVE BUSINESS MODELS

One of the most profitable and daring things you can do is to disrupt an entire market (think Uber!). Blow things up and you'll make money. Here are some of the better known disruptive business models:

- **Access over ownership**: Ownership has lost its cachet value. To many people, owning something is a burden and an expense. Zipcar is a membership-based car sharing company with a fleet of expensive cars reserved by the hour or day.
- **Hypermarkets**: Some companies can offer a product or service at *below cost price* because of their volume and market share. Walmart and Amazon have implemented this business model.
- *Delight and experience*: Companies such as Apple sell the experience of their products. Users get a special delight when interacting with this kind of company that competitors cannot match.
- **Long-tail marketing**: Some entrepreneurs sell to tiny niche markets that they find on Google. For example, an Indigenous entrepreneur in Southern Mexico sells 'traditional red spider dyes from Oaxaca' to the 50 people or so per month who search for that term online.
- **Free and open**: In this model, companies do not charge their customers directly, although they may license the product. But they make money from the data collected and user eyeballs (advertising). Examples: Wikipedia and Opendesk.
- **Platform**: A business acts as an intermediary between buyers and sellers, providing a platform that enables easy exchange. eBay has successfully implemented this model. They have a network of sellers who access customers through the eBay online platform.

razor and blades
A business model where the introductory item is sold at a low or no price so that the consumer must buy complementary products later, for example, razors and razorblades, or printers and cartridges.

cooperative business model
A social business model, a non-profit association of people coming together voluntarily to meet some common need through a jointly owned and democratically controlled venture.

hybrid business model
A business model adopted by social organisations that combine public, private and voluntary sectors; includes non-profits with for-profit business models, and for-profits with social missions.

mutuals business model
Business model of a private company in which the customers are also the owners, and receive profits and benefits.

access over ownership
A disruptive business model that allows customers to use a product or service without buying it.

hypermarket
A business model focusing on high-volume, low-margin sales, offering a product or service at a price lower than cost. Walmart and Amazon have implemented this business model.

long-tail marketing
Marketing to the long tail based on the Google Search phenomenon that while some keywords are searched relatively infrequently, they can be aggregated into profitable markets. For example, 500 people search each month for the niche market 'cocoa beans from Samoa'.

free and open business model
Making money not from the product but from data collected and user eyeballs (advertising).

platform business model
A business model whereby the business acts as an intermediary between buyers and sellers, providing a platform that enables easy exchange. eBay has successfully implemented this model, with a network of sellers who access customers through the eBay online platform.

sharing economy
Also known as the peer-to-peer economy, an economic system in which assets and services are shared; the system's thesis is that goods that are shared (typically via an online marketplace) gain value. For example, expert networks, crowdfunding and open data. Also encompasses the monetisation of idle or unused products, services and talents, for example, spare seats in one's car (Uber) or an unused spare bedroom (AirBnB).

- **Sharing economy**: Everyone can share something. People share what 'excess capacity' they have, be it a spare bedroom (Airbnb), seats in their car (Uber), or seats around the dinner table (EatWith). See also 'Experiencing entrepreneurship: Uberisation as a business model' below.
- *Need it now!* People highly value their time. Speed and convenience matter. People like to 'pay as they go' or pay a monthly subscription fee, as for services such as Netflix. These customers want it all done now.
- **Unbundling**: This is when a company separates into different parts to avoid undesirable duplication, for example, splitting into a customer relationship business, a product innovation business and an infrastructure business. Many telcos have done this to great profit.
- **Product ecosystem**: Like Nespresso and Apple, some companies can lock their customers into a product ecosystem.

An important concluding thought here about how business models create value: *Most start-up entrepreneurs have only a vague idea of which business model will work.* After identifying your opportunity, validating it and creating a value proposition, building a pretotype, and then testing it experimentally (that is what Part II is all about), now comes the need to test your business model scientifically to verify the key components, such as customer segments, creating a value proposition, product features and communication channels.

TWO CANVASES THAT WE USE FOR BUSINESS MODELLING

For business modelling, there are two canvases that have widespread acceptance: the business model canvas (BMC) and the lean canvas (LC). We compare these in Table 8.4. Both are excellent alternatives to the standard 40-page detailed business plan. Many standard business plans are filled with unproven and untested assumptions. Start-ups need a variety of tools to plan their future in their early stages. This was the aim of Alex Osterwalder's original business model canvas, which was later modified by Ash Maurya into the lean canvas, a tool that shows entrepreneurs how to make first contact with real

TABLE 8.4 COMPARING THE BUSINESS MODEL CANVAS WITH THE LEAN CANVAS[50]

ELEMENT	BUSINESS MODEL CANVAS	LEAN CANVAS
Target	New and existing larger businesses	Start-up businesses
Focus	Customers, investors, entrepreneurs, consultants, advisors	Entrepreneurs
Customers	Lays emphasis on customer segments, channels and customer relationships for all businesses	Does not lay much emphasis on customer segments because start-ups have no known or tested products to sell
Approach	Describes the infrastructure, lists the nature and sources of financing and the anticipated revenue streams of the business	Begins with the problem, a proposed solution, the channels to achieving the solution, costs involved and the anticipated revenue streams
Competition	Focuses on value proposition in quantitative and qualitative terms as a way to stay smart in the market	Assesses whether the business has an unfair advantage over the rest and how to exploit it
Application	Fosters candid understanding, creativity, discussion and constructive analysis	A simple problem-solution oriented approach which enables the entrepreneur to develop step by step – but fast and furiously

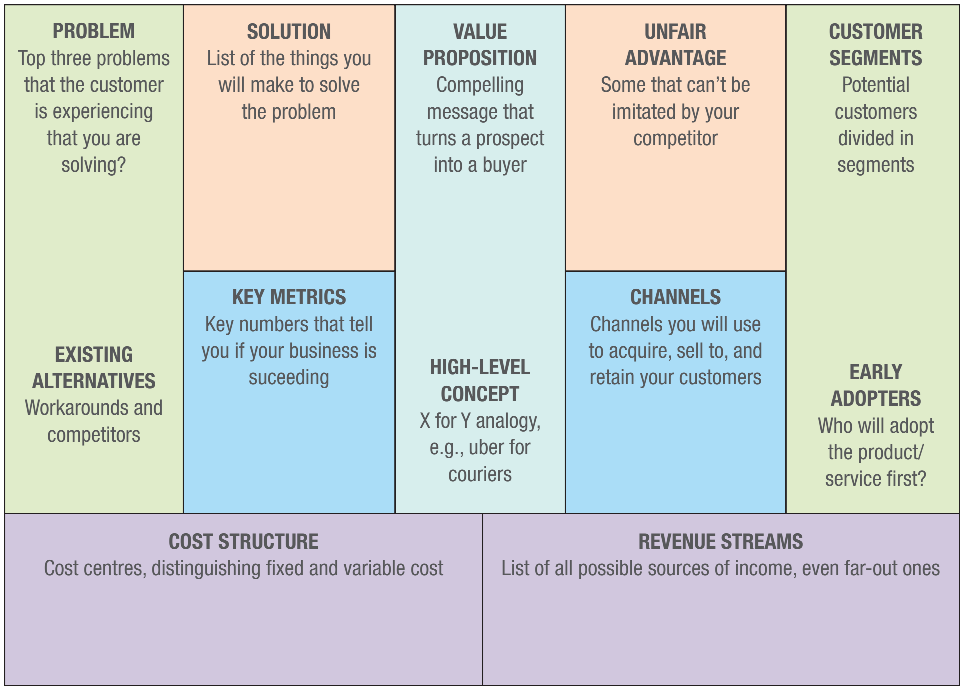


FIGURE 8.5 THE LEAN CANVAS FOR BUSINESS MODELLING

customers, and allows the team to generate the minimum viable product.[47] While the BMC enables both new and existing businesses to focus on operational as well as strategic management and marketing plans, the LC takes a more problem-focused approach and targets start-up entrepreneurs.[48] *We will use the LC in this book* because the lean canvas is more customer problem–solution focused.[49] For more resources on business modelling, see Table 8.5.

DO YOU HAVE AN UNFAIR ADVANTAGE IN YOUR BUSINESS MODEL?

Let's look especially at the 'Unfair Advantage' block in the LC. Genuine unfair advantage is what investors are looking for. It enables start-ups to become icons. Just think Genentech, Dell, eBay, Amazon and Google. An **unfair advantage** is a unique difference that survives over time and is next to impossible to duplicate or acquire. Ask yourself: Is there another product or service that is similar? Can it be copied? Can others manoeuvre around it? Here are some examples of unfair advantages:

- *IP protected components*: Features, technologies and business processes protected by patents, trade secrets, exclusivity contracts or non-compete agreements.
- *Information and knowledge:* Knowing more than your competition through advanced education or research. Is your product understood by only three scientists in the world – two of which are co-founders with equity?
- *Trusted brand:* People know and trust you and seek your 'objective of desire'.
- *Speed:* People seek you because you speed up the process or customer job that they must do.
- *Cost:* Do you have ruthlessly low costs, like AirAsia or JB Hi-Fi?[51]

unbundling business model
A business model whereby the parts of a company are divided up to maximise their earning potential, for example, telecommunications companies that unbundle their cable, internet and phone networks into separate entities.

product ecosystem
A cluster of products and services that complement each other and work symbiotically to generate value for each other, for example, Nespresso, Apple, or Jamie Oliver.

unfair advantage
An advantage that cannot easily be copied or bought.

TABLE 8.5 RESOURCES FOR BUSINESS MODELLING

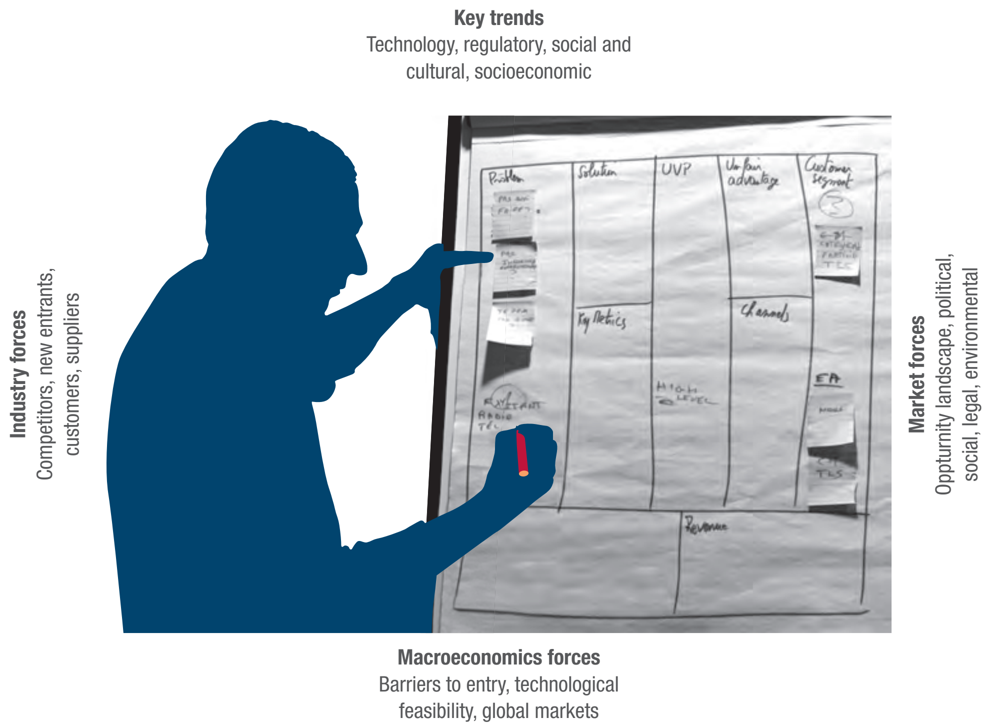
Ash Maurya's blog on the lean canvas https://blog.leanstack.com/
Ash Maurya videos https://www.youtube.com/channel/UCimRGeoiwUPmIddym-HdaCg
Video capture your business model in 20 minutes – Lean canvas https://youtu.be/7o8uYdUaFR4
The Lean Startup – Eric Ries – Animated book review https://youtu.be/9bPgNEDdX3E
Udemy videos https://www.udemy.com/how-to-guide-on-lean-startup-crash-course/
Videos Field at Aspen Institute https://www.youtube.com/user/AspenFIELDUS
Entcounsel videos https://www.youtube.com/channel/UCF3_q2gmT_heF1EvudyRQ7Q
Design a better business toolbox http://www.designabetterbusiness.com/toolbox/#/search
Canvanizer https://canvanizer.com/
Lean Stack https://leanstack.com/is-best-in-class-training
Strategyzer videos on business model canvas https://www.youtube.com/user/businessmodeltv
Alex Osterwalder's business model alchemist http://businessmodelalchemist.com/
Pollenizer's start-up science toolkit http://Start-upscience.com/Start-up-science-toolkit/
Using the business model canvas for social enterprise design (for social entrepreneurship projects) https://csialtd.com.au/news/article/blg-14/using-the-business-model-canvas-for-social-enterprise-design
Development impact & you http://diytoolkit.org/tools/business-model-canvas/

FORCES OUTSIDE YOUR LEAN CANVAS

Many entrepreneurs make good use of the focused 'lean canvas'. But the smart ones also look at the forces *just outside* the lean canvas. Your business or social business is never created in a vacuum. A critical task when starting a new business enterprise is to evaluate the external environment before launching your tested, validated, and modelled idea. Few businesses are immune to external elements resulting from government, political, economic, social and technological forces. Small businesses are perhaps more vulnerable to these external elements than larger businesses as they often have little capacity in the way of resources and diversity of operation to cope with the impact of rapid change. Let us now look through some of the ways to analyse forces that are external to your business model.[53]

- *Market forces*: Key customer issues in your area, such as growing or shrinking segments; customer switching costs; changing jobs, pains and gains; and more.
- *Key trends*: Key trends shaping your arena, such as technology innovations, regulatory constraints, social trends and more.

FIGURE 8.6 APPLYING A FIVE FORCES INDUSTRY ANALYSIS



Source: https://commons.wikimedia.org/wiki/File:Lean_canvas.jpg. CC BY-SA 4.0. https://creativecommons.org/licenses/by-sa/4.0/deed.en.

- *Industry forces*: Key actors in your space, such as competitors; rising value chain actors; new or fading technology providers; and more.
- *Macroeconomic forces*: Macro trends, such as global market conditions; access to resources; high or low commodities prices; and more.

WHAT ARE THE KEY TRENDS IN YOUR BUSINESS?

Review Chapter 5 'Sources of opportunity' for trend analysis. Also, make a list of the wicked problems in your field and estimate where your business will be in three years and in five years. Using the Trendwatching 'Consumer Trend Canvas' (http://trendwatching.com/trends/consumertrendcanvas/), you can analyse the three fundamental elements that drive all trends: (1) basic human needs, such as identity, love, social interaction, connection, and excitement; (2) drivers of change, such as shifts in energy sources, transportation and communications; and (3) innovations in such areas as technology and foods. The consumer trend canvas helps you to see how these three elements react with each other.[54]

WHAT ARE THE MARKET FORCES?

Conducting an *opportunity landscape analysis* systematically examines the external conditions that both shape and influence your opportunity. The opportunity landscape analysis helps the entrepreneur to:

- Locate the source of the opportunity or the changing conditions that present the opportunity
- Identify the size of the likely market needs that may arise from these changing conditions and the extent of change or momentum
- Identify the likely duration of the need and how the conditions will influence the timing of the opportunity

- Locate the trends that create new needs and may show how the need will increase or decrease over time
- Indicate the emerging issues, values, or lifestyles that uncover emerging needs.

This is based fundamentally on the well-known Political, Economic, Social and Technology (PEST) factors and trend analysis, which has become more sophisticated over the years. It has evolved into a STEEP analysis (Social, Technological, Environmental, Economic and Political), and some have even labelled it the PESTLE analysis (Political, Economic, Sociocultural, Technological, Legal and Environmental). The 'environment' factor refers to the ecological soundness and impact of the opportunity features, while the 'legal' factor refers to the specific legal or regulatory influences on the opportunity.[55]

This type of market forces analysis sets out the major proposition as to *why* a business proposal exists. Conducted well, it will provide and reveal verified sources of data to prove underlying assumptions about market size and customer need. It will help to validate to others that the opportunity is real and exists. The best opportunities have the political, regulatory, social, environmental and technological winds of change blowing in the same direction.

WHAT ARE THE INDUSTRY FORCES?

The third 'outside the canvas' force comes from Porter's well-known approach to assessing industries. Porter's first question is: What is the structure of the industry and how is it likely to evolve over time? If the entrepreneur's business is not in an attractive industry – and we will show how to measure its attractiveness – then the person may want to get out of it or redefine it.

Porter's second question is: What is the company's relative position in the industry? No matter how attractive the game is, entrepreneurs will not do well if their company does not hold a good position in it. Conversely, the business can be in a lacklustre industry with low average profitability, yet if it occupies exactly the right niche it can perform well. 'Most small companies, of course, cannot change an industry's structure. What they can do, however, is establish a good position in the industry, a position based on sustainable competitive advantage', Porter says.[56]

In determining how to achieve a competitive advantage, Porter suggests to start with an overall strategy. Porter's **five forces model** of industry analysis has been widely used and Figure 8.6 illustrates its use.[57] The five forces analysis is designed to help companies understand how profitable an industry is and also what they can do to mitigate negative forces and thereby improve profitability.

five forces model
A famous model developed by Michael Porter that determines competitive intensity and market attractiveness of an industry in the context of profitability. An industry approaching 'pure competition' would be very unattractive.

According to Porter, the five forces determine the competitive environment of an industry: threat of new entrants, bargaining power of buyers, bargaining power of suppliers, threat of substitutes and rivalry among the existing competitors. The combined power of these five forces has a decisive effect on the success of an organisation. These forces influence prices, costs and required investment of the competitors in an industry. Using this model, entrepreneurs can assess an entire industry structure.

WHAT ARE THE MACROECONOMIC FORCES?

Although industries vary in size and development, certain characteristics are common to new and emerging industries that today's entrepreneur need to consider. These tend to increase uncertainty as opposed to risk because the only way these can be resolved is through careful and mindful participation in the industry. In contrast to risks, there is little one can do to mitigate uncertainty, as there is no past experience of it to rely on. The most important of these uncertainties are outlined below.

- **Technological uncertainty**: A great deal of uncertainty usually exists about the technology in an emerging industry. Which product configuration will ultimately prove to be the best? Which production technology will prove to be the most efficient? How difficult will it be to develop this technology? How difficult will it be to copy technological breakthroughs in the industry?
- **Strategic uncertainty**: Related to technological uncertainty are a wide variety of strategic approaches often tried by industry participants. Since no 'right' strategy has been clearly identified, industry participants will formulate different approaches to product positioning, advertising, pricing and the like, as well as different product configurations or production technologies.
- *First-time buyer uncertainty:* Buyers of an emerging industry's products or services are perfectionist first-time buyers. The marketing task is therefore one of substitution, or getting the buyer to make the initial purchase, and then buy another or a better one.
- *Short-time horizon and strategic uncertainty:* In many emerging industries, the pressure to develop customers or produce products to meet demand is so great that bottlenecks and problems are dealt with expediently rather than based on an analysis of future conditions. Short-run results are often given major attention, while long-run results are given little consideration, creating strategic uncertainty.

technological uncertainty Uncertainty as to which product configuration will prove to be the best, which production technology will prove to be the most efficient or how easy it will be to develop or even copy the technological breakthroughs in the industry.

strategic uncertainty Uncertainty arising from the lack of a unified approach to product positioning, advertising, pricing and the like, as well as differences in product configurations or production technologies.

SUMMARY

The goal of this chapter is to discuss the final two topics in Part 2, hypothesis-driven lean marketing and the important concept of business model design.

Lean marketing helps you to test your concepts constantly and to make the decision whether to pivot or persevere. Lean marketing originated with Eric Ries' *The Lean Startup* and uses the build-measure-learn framework we learned about in Chapter 5. Lean marketing is all about customer discovery using hypothesis-based methods and techniques.

In the past, we used to refer to the marketing mix as the *four Ps:* product, price, promotion and place. Today, the marketing mix is widely referred to as the *four Cs*: co-creation, communities, customisation and choice, all of which means content is king. Although customers in the social media age tend to isolate themselves in information silos, they are nonetheless constantly searching for value. Lean marketers appeal to the deeper needs of the customer following the 'Cone of Experience' model.

We use the lean marketing canvas to design our marketing plan based on the objectives, target audience, channels of communication, present status, core brand value, competition, timeline, budget and metrics. Lean marketing uses unconventional advertisement techniques. This includes inbound marketing, buzz marketing, ambient marketing, ambush marketing, celebrity marketing, shock marketing, mosquito marketing, sensation marketing, stealth marketing and viral marketing. Despite its newness, lean marketers also need to do their 'traditional' research on such things as customer segmentation and consumer behaviour.

We then turned to the critical topic of business modelling, which is simply a way to produce a visualisation the factors on a one-page canvas that explains how a new venture works. A business model is a conceptual tool with nine elements that allows us to express the business logic of a specific venture. Important in this discussion is what is called business model ontology, which refers to the typologies, or visualisations, that create mental models. We defined a business model as an analytical tool that visualises (depicts) the content, structure and operation of the entrepreneur's choices of how to create customer value. We described different models, including standard business models, social business models and disruptive business models.

We then went on to distinguish between the business model canvas (BMC) and the lean canvas (LC), and to justify why we prefer the LC for the experiential exercise in this book. We also examined the forces outside your lean canvas resulting from government, political, economic, social and technological forces.

KEY TERMS & CONCEPTS

access over ownership
affordable loss
average revenue per user (ARPU)
benefit variables
bricks, clicks and flips
business model
business model canvas (BMC)
business model design
business model ontology
buzz marketing
cash engine
click-through rate (CTR)
co-creation
co-marketing
conversion funnel
conversion rate
cooperative business model
customer acquisition costs
customer development
customer discovery
customer lifetime value (CLV)
customer segmentation
customer segment
demographic variables
durable competitive advantage
email capture
entrepreneurial marketing
five forces model
four Cs
four Ps
free and open business model
Generation C marketing
gig economy
growth hacking
growth stack
guerrilla marketing
hybrid business model
hypermarket
inbound marketing
influencer
influencer marketing
lead scoring
lean canvas (LC)
lean marketing
long-tail marketing
marketing mix
mutuals business model
new four Cs

online marketing
ontology
outbound marketing
platform business model
product ecosystem
psychographics
razor and blades
remarketing
search engine marketing (SEM)
search engine optimisation (SEO)
segmentation variables
sharing economy
strategic uncertainty
technological uncertainty
thought leader
two-step flow of communication
unbundling business model
unfair advantage
user experience
web scraping
word of mouth (WOM)
zero-budget marketing

REVIEW & DISCUSSION QUESTIONS

1 What are the differences between entrepreneurial marketing and 'traditional' marketing?
2 How is lean marketing different from traditional marketing?
3 How is lean marketing also hypothesis-based, like the techniques in the previous chapters?
4 Give an example of how you would implement Dale's Cone of Experience in a social media campaign.
5 Which are the most important parts of a lean marketing plan? Defend your answers.
6 Which of the lean marketing techniques interests you most? Defend your answer.
7 What are the most important components in marketing research for lean marketers? For each, list three questions that you would like to answer.
8 In your own words, what is customer segmentation? Give examples.
9 Identify and discuss three psychographic characteristics that help the entrepreneur identify and describe customers.
10 When developing a lean marketing plan, which of the seven steps do you consider indispensable? Which are optional?
11 Give an example of a business model not discussed in the section 'The logic of value creation'.
12 Describe how the business model canvas and the lean canvas focus the start-up entrepreneur on distinctive issues. What are the specific differences between the two canvases in application?
13 What are the top 'outside forces' in your business venture?

EXPERIENCING ENTREPRENEURSHIP

Uberisation as a business model

Here is Uber's business model. It is like a recipe. Take one driver, anyone with a driving licence and a car with unused seats. Add one passenger, who registers and downloads the Uber app to their phone. When the passenger makes the order, the app sends a car directly. The driver knows exactly where to go. Payment is completely cashless. Uber sets fares based upon load: high fares during peak times and flat rate for off-peak times. Payment is secure because passengers pay via credit card using the Uber app (though cash is now accepted). The fare is based on car type, distance and peak or off-peak time. Profits are divided – 80 per cent to the driver and 20 per cent to Uber – and the drivers usually earn more than those who drive for traditional taxi services. Uber does not own any cars and so a higher proportion of its earnings are profits.

The app is user-friendly, and the server is fast. When Uber started, it had no competitors, but now companies such as Lyft and Cabify are copying the model, and all must compete on infrastructure, branding and consumer trust. On the negative side, Uber has been plagued with liability and insurance issues. It is constantly in court being sued by regular taxi companies and unions. As a disruptive business, it has received criticism from established taxi companies. But its internet-driven business model, together with its rapid and efficient service, means that it can 'ticket-clip' (take a percentage or commission of) each transaction. Some bad publicity has even helped increase its visibility.

gig economy
An economy in which lifetime careers no longer exist, and instead people make their livelihood from temporary, flexible jobs. Derives from musicians playing 'gigs' (one-time musical

Uber is part of the **gig economy**. For all its faults, the gig economy is employing millions of people in temporary, short-term positions as independent contractors. This new workforce is mobile and work can increasingly be done from anywhere. For employers, it is good too: they can select the best individuals for specific projects, and they save resources in terms of benefits, office space and training. For the freelancer, a gig economy can improve work-life balance.

Uberisation is an example of the sharing economy business model (see Figure 8.7), which has hit many industries. No one needs to own anything, it reduces waste, and many people share the need or pain, leading to more competition, lower costs, economic benefits, more productivity, and efficient use of resources.[58]

FIGURE 8.7 THE UBER BUSINESS MODEL

PROBLEM	SOLUTION	VALUE PROPOSITION	UNFAIR ADVANTAGE	CUSTOMER SEGMENTS
Don't trust taxis Want to know my driver Want price in advance Afraid driver takes long route	App puts me together with rated driver Fare in advance GPS routing	Get ride quickly. Car comes directly to you. Driver knows where to go. Payment is cashless.	Owns no cars Cheaper than taxis Rated driver service Newer vehicles Advance fare estimate	Passengers Professional drivers Amateur drivers
EXISTING ALTERNATIVES Regular taxis Rental cars Buses	**KEY METRICS** Driver supply Wait time Daily active users Session duration Retention rate Revenue per user	**HIFH-LEVEL CONCEPT** Like Amazon shopping for taxis	**CHANNELS** App for passengers App for drivers Phone	**EARLY ADOPTERS** Always-one smartphone users
COST STRUCTURE Software development Infrastructure System maintenance Driver fee			**REVENUE STREAMS** 20% commission per ride	

Here's a lean canvas based on the Uber business model.

Questions

1 Describe the Uber business model.
2 Discuss these scenarios.
   a What is the impact of possible regulation on Uber's business model? Will amateur drivers be banned? Which blocks in the model will change?
   b What is the impact of technology on Uber's business model? Will self-driving cars replace the current fleet? Which blocks in the model will change?
3 Redo the lean canvas based upon your projected scenarios.

EXPERIENCING ENTREPRENEURSHIP

Lean canvas business model exercise

By now, you should have identified your opportunity, created your value proposition, designed and validated a pretotype, and devised a lean marketing campaign to support it. With that information and a bit of ingenuity, you can now create your 'lean business model canvas' (see Figure 8.5).

It should not take long to complete your lean canvas if you have completed the previous activities in Part 2. You can capture your entire venture in a portable one-page diagram. There are nine building blocks to the lean canvas. Remember, in each block you should have no more than five bullet points totalling no more than 50 words. You can find templates and resources in Table 8.5.[59] You can follow the suggested numerical sequence, or not.

1 *Problem*: What are the top customer problems that you are solving? What are the needs to be satisfied? Describe the practical problem that the customer has, and when they have it. Use the 'customer voice': 'I have a problem with …' Also list *today's alternatives.* What workarounds solve the problem today? What competitors are available today?
2 *Customer segments*: Define your potential customers, dividing them into segments. You can transfer this information from your value proposition. Who is your target customer? Be specific. Who feels the pain?
3 *Value proposition*: This should be a simple, persuasive message that turns a prospect into a buyer. What is the unique value that you are proposing to deliver to your customers?
4 *Solution*: Write a list of the products/services you will make/perform to solve the problem. Explain practically how the product/service works and its benefits.
5 *Channels*: What are the channels of communication that you will use to acquire, sell to and retain your customers?
6 *Revenue streams*: What is your **cash engine**? Where do your revenues come from? When do the customers pay? Be as specific as possible, e.g. paid per customer, grants, sales of your data, fixed price, commission, licence fee. List even far-out sources such as conference revenue, possible franchises, or subscriptions.
7 *Cost structure*: Where do your costs arise? What are your cost centres, e.g. marketing, cost paid per unit, utilities? Distinguish between fixed and variable costs.
8 *Key metrics*: List the key performance statistics (numbers) that can tell you if your business is succeeding, e.g. actions, sales per week, users acquired.
9 *Unfair advantage*: Do you have anything that cannot be imitated or bought by someone else? Which resources or knowledge belongs exclusively to you, e.g. patents, new technology, personal network, fundamental partners, staff with PhDs? Even if you lack these, the surest way to unfair advantage is speed to market.

cash engine
A business' stable income that generates enough surplus cash to cover dividends and fund the company's future growth.

EXPERIENCING ENTREPRENEURSHIP

Marketing your online product or service

Imagine that you need to build a lean marketing campaign for your online product or service. Your goal is not thousands of downloads but rather revenue.

- *Do you know where your customers are?* What websites are they on? Where do they look for information? Are you offering free content that helps them connect with your brand? Do you have a great website, interesting emails, exciting social media posts and eye-catching digital advertisements that help build an emotional bridge between you and your audience? Are you giving them a good experience? You don't want to annoy them by filling up their inbox or spamming them via Facebook. You want them to feel like they are part of a community.

- *Do you have excellent content?* Once you have attracted their attention, how do you convert this relationship into a download? Do you have a regular schedule to create content (memes, blog posts, ads, etc.) and publish them on social networks such as Facebook, LinkedIn, Google+ and Twitter? Use social media to post videos and updates, run competitions, talk to your customers and respond to their concerns. Retweet and post creative images of customers using your products.
- *Are you using the standard marketing tools?*
- *Are you performing analytics?* Make sure you have Google Analytics set up and attached to your campaigns. Use advanced metrics. *Monetisation* metrics include average dollars earned per user and average user lifetime value (LTV). *Demographics* metrics include most used devices and country/language. Study these to understand who and where your users are. *Acquisition* metrics include cost per user, activities that generate downloads and DAU/MAU (daily active users/monthly active users). *Retention/Churn* metrics include lifetime value (LTV) of your users (how much money they earn you during their use of your app), average session length per user and unsubscription rate. This greatly impacts the profitability of your business.

CASE STUDIES

CASE 8.1

42BELOW VODKA

BACKGROUND

42Below was founded by Wellington-based entrepreneur and ex–Saatchi and Saatchi marketing executive, Geoff Ross, in 1999. Hailed by many observers as a unique marketing success, 42Below was New Zealand's first premium vodka. Like many start-ups, 42Below was financed from Ross' personal sources. In the early days, Ross distilled at home using a home brewing kit. … 42Below's claim to fame is grounded in the quality of its ingredients. Described as 'New Zealand in a bottle', 42Below has unashamedly associated itself with all the attributes of the country. It uses water sourced from the crystal-clear spring flowing through the 42-degree latitude that holds the international benchmark for water and air purity. The alcohol content is set at 42 per cent, much higher than average, to signal higher quality and greater purity. 42Below's limpidness is the result of a sophisticated six-week-long distillation process with multiple filtrations that apparently creates a more viscous character on the palate. … [They are not only sourcing] the best possible ingredients and processing, but also finding the perfect packaging that symbolises 42Below attributes.

ENTREPRENEURIAL MARKETING ACTIVITIES

Although vodka is not widely consumed in New Zealand, vodka-based cocktails are popular in the US and parts of Europe. Responding to global trends towards flavoured spirits, 42Below introduced unique New Zealand flavours such as Kiwifruit, Passionfruit, Feijoa and Manuka Honey.

Their creativity was not limited to the product. This extended to the way they promoted 42Below, quite unlike the mass advertising that is often used by their competitors. Their use of viral marketing was hugely successful. More interesting is the way they have tackled many social issues, such as LGBQTI rights or national identities (German, French, English), in a cheeky and irreverent way and without regard about being politically correct. Ross' extensive advertising background was complemented by his network of shareholders, who held a collective expertise in advertising, fashion and media. … 42Below targets what they call the 'elite of the cocktail set', a segment with high disposable income. This segment wants to be unique, entertained and provoked. As such, they are likely to respond to individuality, cheek and irreverence. Individuals belonging to this segment respond to brands they and their social circles discover, not those endorsed by the mass media. When it comes to cocktails, this group relies on word-of-mouth recommendations from friends and bartenders. Realising that the cocktail set naturally converged in bars, Ross saw bar staff as the way to reach their target consumers. As this segment rejects mass advertising, 42Below relies on web technology and interpersonal communication for their promotion strategies.

Ross believed truly successful brands evoke fresh stories and exotic experiences of people and places. Needless to say, its country of origin being clean, green, pure and creative became a source of competitive advantage for 42Below. It was for this reason that 42Below launched the Annual International Cocktail World Cup where the most influential people behind the best bars of the world are flown to Queenstown for a truly unique New Zealand experience. In this event, 42 top bartenders from around the world mix vodka cocktails while doing extraordinary adventures, such as jumping off a helicopter, bungy jumping or on bars on top of snow-peaked mountains. This event attracts extensive worldwide television coverage.

42Below aims to be the most desired and talked about vodka in the world and sets its own standard. They sell stories designed to evoke a different reaction from every customer and many customers post their stories on blogs, including Saatchi and Saatchi's Lovemarks page.

CONCLUSION

42Below's marketing strategy approach deviates from traditional marketing practices. They exploited international opportunities long before they were established domestically. This approach usually requires the use of networks to penetrate various niche markets and advocates the use of personal experience as ways of minimising risk and uncertainty. Ross used his networks of creative people to design and develop 42Below products and marketing tactics specifically for their niche market. He also called on his personal experience, both from his advertising career and by visiting the bars where 42Below's target customers are frequently found.

This approach precludes entry to new markets for the sake of territorial expansion. Each market is carefully chosen and entered only where there is scope for the brand to become meaningful. Their entry into new territories has consistently relied on positioning as a premium brand using premium price points and highly selective distribution channels. 42Below's pricing strategy is consistent with that positioning. In the US, it sells at about US$30 per litre.

QUESTIONS

1 Does 42Below's marketing strategy fit the definition of guerrilla marketing?
2 This case is now 10 years old. How could 42Below promote their brand through word of mouth today? What social media channels would you use?
3 What are 42Below's customer segments? How are they different from normal vodka drinkers?
4 What are some of the surprising characteristics of 42Below's entrepreneurial marketing campaign?

Adapted from Morrish, Sussie C., and Jonathan H. Deacon. (2011). "A Tale of Two Spirits: Entrepreneurial Marketing at 42Below Vodka and Penderyn Whisky." *Journal of Small Business & Entrepreneurship*, 24(1),113–124. https://www.tandfonline.com/toc/rsbe20/current.

ONLINE STUDY RESOURCES

Visit http://login.cengagebrain.com and use the access code that comes with this book for 12 months' access to the resources and study tools for this chapter.

CourseMateExpress

The CourseMate Express website contains:

- take it further activities
- revision quizzes
- video activities
- and more!

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PART TWO

ENTREPRENEURIAL CASE ANALYSIS

PRETOTYPING A SOCIAL ETHNODROID TO TEST CHILDREN'S LEARNING PROGRESS

Howard Frederick, Plymouth University

Janet Wiles[1], Professor of Complex and Intelligent Systems at The University of Queensland, pulled together a team of researchers from a wide range of disciplines: from designers and developmental psychologists to engineers and cognitive scientists. The brief was simple: The team wanted to study the interaction of technology and language. They sought to develop a child-friendly robot that could evaluate young children's interactions with tablet-based language learning tasks and games. Would the children be willing to learn language from a robot? Would it be possible eventually to design a teacher's assistant that promoted learning of Aboriginal languages in remote Australian regions? These were some of the questions the researchers wanted to answer.

To that end, they first created what they termed an *ethnodroid* – a child-friendly research robot that functions as an ethnographer to observe and collect information about human behaviours. Rather than build an expensive prototype, they used the impostor test to develop a cardboard ethnodroid with tablet computers in its face and torso. The key requirements for this 'minimum viable product' were that it be both child-safe and socially engaging.

Wiles and her fellow researchers then used the ethnodroid, whom they called 'Opie', as a means to answer the pretotyping questions we discussed in Table 7.1. They were particularly interested in seeing if putting Opie in different contexts would elicit different answers to the pretotyping questions. Using A/B testing, they tested their ethnodroid first in the relatively structured environment of an early-learning centre, and then in the relatively unconstrained setting of a science fair. Their idea was to do a 'quick and dirty' test before they launched into full product design, and it provided insights into how children interacted with Opie and what could be improved with the design to encourage better, more meaningful interaction in the future.

Throughout the pretotyping phase of the research, a range of robots were developed (see Figure 8A.1).[2] The general form was a semi-anthropomorphic robot with a stylised elliptical head, a torso constructed of sheets of medium-density fibreboard secured to a wooden frame, and arms constructed from foam tubes ending in paddle-shaped hands. The frame and equipment behind the robot were covered by a black curtain. A tablet computer in the head showed a face, and another tablet in the torso was used for games. The inexpensive equipment allowed the researchers to constantly tweak and work on their design, giving them the freedom to 'pretotype often and validate relentlessly' with each new iteration of Opie.

Generally, when using the ethnodroid to facilitate research at the early-learning centre, Opie was positioned in the corner of a small, child-safe room and the Wizard of Oz test was used. A dissembler-facilitator (the 'Wizard') hid behind the curtain attached to the ethnodroid and interacted with children both in groups and individually. Testing was an ongoing process, and as mentioned above, that enabled many small refinements of the design. At the science fair, research with Opie took place in a roped-off corner. Savoia's pretotyping questions were adapted to the children's interactions with Opie, and are answered below. See Chapter 7, 'Methods of experimental validation', for more about the techniques used.

FIGURE 8A.1 DESIGNS OF SOCIAL ETHNODROIDS TO TEST CHILDREN'S LEARNING PROGRESS

Source: Images from http://www.itee.uq.edu.au/cis/opal.

WERE THE CUSTOMERS (CHILDREN) AT ALL INTERESTED IN A MINIMALLY VIABLE ETHNODROID?

Few of the research team expected that Opie would engage children's interest for a substantial period of time. To their surprise, most children were strongly attracted to the ethnodroid in both the classroom and science fair settings. To be 'human', robots have to respond in the 100–200 millisecond range, so the Wizard filled this role when the robot was offline or slow to respond. The children gladly interacted with the robot and most played through all four available games, spending up to 23 minutes at a time interacting with the ethnodroid. The children were also tolerant of the robot's occasional malfunctions. The team concluded that children were sufficiently interested even in the ethnodroid's pretotype form to support its research functions and gather meaningful information on tablet-based learning.

WOULD THE CHILDREN'S CARERS AND PARENTS BUY A REAL, FUNCTIONAL ETHNODROID IF THE PROJECT BUILT IT?

One of Savoia's most important pretotyping objectives is whether there could be a market for a product in advance of production. So, after seeing this (admittedly imperfect) pretotype, is there any market for it? The team were very interested in the reactions of the ethnodroid's main market, the parents and teachers – the actual gatekeepers to the children's time and attention, and to researchers who deploy the ethnodroid as a context for interaction. Both the classroom and science fair settings involved voluntary visits with the robot, so it was not surprising that all parents were positive about the research aspects of the study. However, the team were surprised by the enthusiasm shown by parents, despite Opie's limited functionality and form. They could still see the value in a product that promoted tablet-based learning.

WILL CHILDREN, THE ETHNODROID'S PRIMARY CUSTOMERS, USE THE ETHNODROID AS EXPECTED?

Testing showed some unexpected behaviours between the children and Opie with respect to the tablet, voice, eye contact and physical touch. The team had anticipated interest in Opie's hands and had implanted touch sensors. However, children in the classroom rarely touched the ethnodroid except for the tablet in the torso, and the touch sensors were not triggered. At the fair, however, participants touched the robot on the hands, arms and torso, and some even used the frame for support. This showed that sensor placement needed adjustment. Massive amounts of data were generated from every trial, prompting rapid innovation in sensors to automate the touch analyses, visualisations to interpret the data and the design of automated analysis tools much earlier than planned.[3]

The key finding of pretotyping a social ethnodroid with children is just how little it actually needed to be social and engaging: children were happy to play and learn on the tablet in the torso regardless. A cardboard frame, foam arms and two tablet computers can be socially engaging, given the right context and of course the Wizard. The social interactions were not just between child and Opie, but were structured by the settings, the parents, the facilitator, the impostor and Wizard of Oz validation techniques, and the robot's autonomous communication. In its ethnographic role, it became obvious that the robot could generate more low-level sensor data than could be stored for analysis, and that interpretation of the data deluge had to be designed into the 'droid from the start.

In the end, the team concluded that pretotyping was a useful product development tool, and also research tool. The process proved useful in assisting the researchers to know what to look for and identifying future needs for functionality, demonstrating the value in extending the pretotyping concept beyond its current setting in the commercial world.

For some of the team, these pretotyping experiments led to a 'pivot moment', when they realised that the ethnodroid could also be used for purposes other than studying tablet-based learning. For example, Opie could be used to teach children from a remote Aboriginal community their traditional languages. The technology has been deployed in classrooms in the southeast Arnhem Land community, where it is programmed to help teach heritage languages. The ethnodroid offers interactive language activities and memory games that encourage the children to identify, sound out and repeat words back so that teachers can track their progress.[4]

The major learning from the 'droid experiment was 'Fail fast, pretotype often, validate relentlessly and pivot quickly'.

QUESTIONS

1. Can you describe the difference between a pretotype and a prototype by brainstorming a new product or service and validating it? You might find Table 7.1 useful.
2. What are the A/B testing experiments that the team carried out?
3. Name five 'Wizard of Oz' tests that you can imagine for other products or services.
4. Can you think of any even cheaper way to test children's learning through robots? (Hint: Think 'mechanical Turk test' in Chapter 7.)
5. The team discovered how little a robot actually needs in order to be social and engaging. Are there any features of the ethnodroid that could have been left out and still resulted in a strong validation?

ENDNOTES

1 This case was inspired by Wiles, J., Worthy, P., Hensby, K., Boden, M., Heath, S., Pounds, P., … & Weigel, J. (2016). Social cardboard: Pretotyping a social ethnodroid in the wild. In *The Eleventh ACM/IEEE International Conference on Human Robot Interaction* (pp. 531–2). IEEE Press. Retrieved from http://dl.acm.org/citation.cfm?id=2906962.

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PART THREE

GROWING AND PLANNING ENTREPRENEURIAL VENTURES

CHAPTER 9

STRATEGIC ENTREPRENEURIAL GROWTH

Unlike the giants, small businesses cannot rely on the inertia of the marketplace for their survival. Nor can they succeed on brute force, throwing resources at problems. On the contrary, they have to see their competitive environment with particular clarity and they have to stake out and protect a position they can defend. That is what strategy is all about.

Michael E. Porter,
Harvard Business School[1]

Today, thanks to a thriving world economy, global telecommunications and expanding travel, exchange among Europe, North America and the Pacific Rim is happening at an unparalleled pace … For the companies that sell these new international products, that understand the world as one single market, it is an economic bonanza.

Naisbitt and Patricia Aburdene,
Megatrends 2000[2]

CHAPTER OBJECTIVES

1. To outline entrepreneurial strategy development and the benefits of strategic planning
2. To discuss the stage transitions of business growth
3. To understand how to manage entrepreneurial growth
4. To examine the motivations and means for global growth
5. To understand how to prepare for going global
6. To identify other opportunities for going global

UNCERTAINTY AND GROWTH: THE KEY DRIVERS OF STRATEGIC PLANNING

Having understood the basics of entrepreneurship in Part 1 and then learned the techniques of hypothesis-driven entrepreneurship in Part 2, you hopefully have developed and launched your bright idea to the waiting public. Assuming you have achieved a product-market fit, you may be wondering how to transit to the next growth and strategy stages for your venture. That helps us to turn the page to Part 3 about growth and strategy.

Although most entrepreneurs do some form of planning for their ventures, it often tends to be informal and unsystematic.[3] The actual need for systematic **strategic planning** will vary with the nature and structure of the business, but not necessarily its size. Traditionally, a two-person business has been able to use informal planning processes, but nowadays even small businesses face bewildering complexity, especially in relation to their online markets and communication. An emerging venture that is rapidly expanding with constant increases in personnel and market operations will ultimately need to formalise its strategy process.

strategic planning
The primary step in determining the future direction of a business, influenced by the abilities of the entrepreneur, the complexity of the venture and the nature of the industry.

An entrepreneur's strategic style is also likely to need to shift from an informal to a formal and systematic approach for other reasons. First, there's the degree of *uncertainty* within which the venture is attempting to become established and to grow. With greater levels of uncertainty, entrepreneurs need to hold a more responsive and adaptive strategic approach to help shape the business model. With lower levels of uncertainty, a more planned strategic development is likely to be more useful (although strategic flexibility should never be discounted or rejected). Second, the strength of *competition* (in both numbers and quality of competitors) will add to the importance of a more planned strategic approach in order for a new venture to monitor its operations and objectives closely vis-à-vis the competition.[4] Finally, the amount and type of *experience* the entrepreneur has will grow and influence the extent of formal strategic planning. A lack of adequate experience, either technological or business, may constrain the entrepreneur to informal and ad hoc strategising, but as experience grows, the use of a formal strategy process will help to determine future paths for the organisation.

As the world evolves and develops, you will increasingly also need to consider a global context for growth. The new breed of global entrepreneur has grown of age using global networks for resources, design and distribution. The trend has accelerated the global economy, and by all accounts, the pace and magnitude of this global economy are likely to continue to accelerate. Adept at recognising opportunities, the new breed of global entrepreneur understands that success in the global marketplace requires agility, certainty, ingenuity and a global perspective. These global entrepreneurs and social entrepreneurs are the true vanguard in the second decade of the twenty-first century.

High-horizon entrepreneurs are opportunity-minded and open-minded, able to see different points of view and weld them into a unified focus. They rise above national differences to see the big picture. English is the primary language of global entrepreneurs, but they have a working knowledge of others. This type of entrepreneur wears many hats, taking on various assignments, gaining experience in various countries and seizing the opportunity to interact with people of different nationalities and cultural heritages.

This chapter has three primary objectives. First, it deals with entrepreneurial strategy and planning. It addresses the perceived positives and negatives associated with planning and explains how strategic planning is an essential aid to an entrepreneur with an ambition for growth. Next it uncovers how businesses grow and what an entrepreneur can expect to encounter in confronting growth. It provides tips for managing a rapidly evolving and changing business that is in the growth fast lane. Third, the chapter describes how entrepreneurs go global with their products and services and outlines approaches to growth that adopt collaborative strategies.

entrepreneurial strategy
System of strategies that underpin long-range plans for the effective management of opportunities and threats in light of an entrepreneur's, an entrepreneurial team's or a venture's strengths and weaknesses.

CourseMateExpress
On CourseMate Express read about the strategic growth of Hendrick's Way: The one-product company.

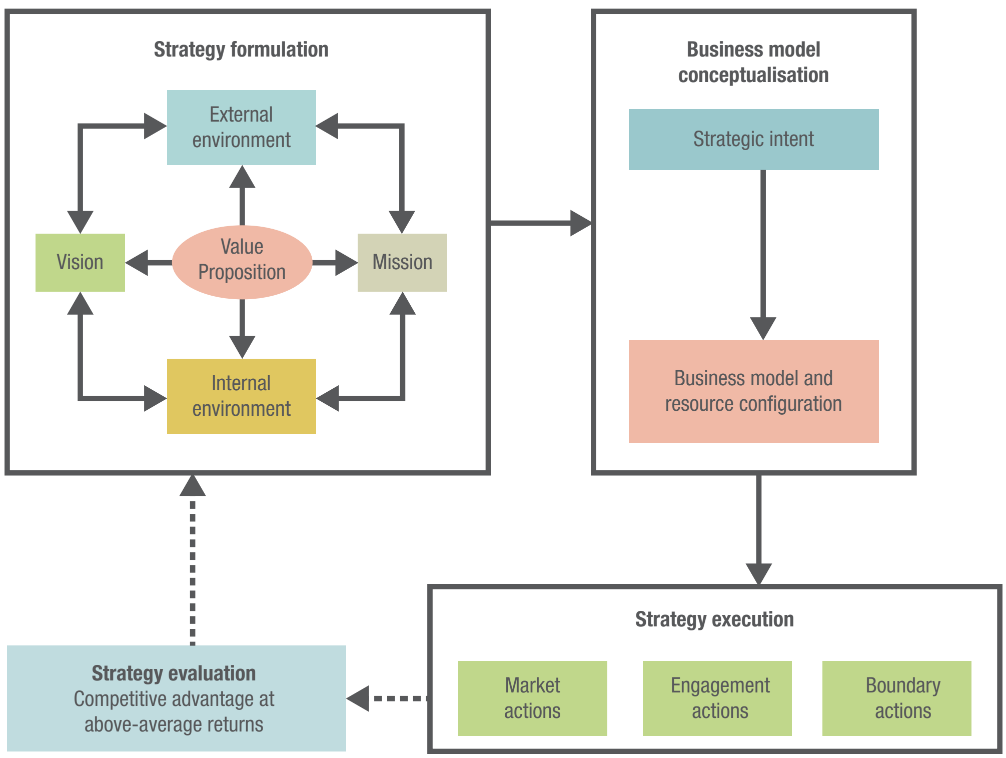
mission
In an entrepreneurship context, a stated mid-term objective that will affect or change a venture's position by incremental steps toward a particular strategic direction.

strategic intent
A statement that envisions a desired leadership position for a venture for the purpose of guiding resource allocation, providing stability under changing circumstances, focusing attention on the essence of winning and motivating people by communicating value while leaving room for individual and team contributions.

ENTREPRENEURIAL STRATEGY DESIGN AND PLANNING

Entrepreneurial strategy involves the formulation of long-range plans for the effective management of opportunities and threats in light of a venture's strengths and weaknesses. Entrepreneurial strategy-making includes defining the venture's vision, **mission** and **strategic intent**; specifying achievable objectives; and comprehending the complexities within the business model and the market and industry setting within which the business will operate. Dynamic in nature, the entrepreneurial strategy process (see Figure 9.1) is the full set of commitments, decisions and actions required for a business to achieve competitive advantage and earn above-average returns. It requires developing strategies and setting policy guidelines. Relevant strategic inputs derived from analyses of the opportunity in the context of the internal and external dynamic environments are necessary for effective strategy formulation and implementation. In turn, effective strategic actions are a prerequisite for achieving desired outcomes. Therefore, the entrepreneurial strategy process (as distinct from a corporate strategic sequential management process) is continuously cyclic, and is used to respond to the conditions of an ever-changing market and competitive structure with a new business' opportunity and continuously evolving resources, capabilities and core competencies (the sources of strategic inputs).

FIGURE 9.1 THE ENTREPRENEURIAL STRATEGY PROCESS



Source: Authors.

Effective strategic actions that take place in the context of carefully integrated strategy formulation and implementation actions result in desired strategic outcomes.[5] Strategy development is the primary step in determining the future direction of a business. The 'best' strategic plan will be influenced by many factors, among them the abilities of the entrepreneur, the complexity of the venture and the nature of the industry. Yet whatever the specific situation, five basic tasks must occur in strategic planning:

1 Examine the internal and external environments of the venture (strengths, weaknesses, opportunities, threats).
2 Formulate and define the venture's long-range and short-range strategies (vision, mission, value proposition, strategic intent, objectives, business model design, tactics, budgets and policies).
3 Implement the strategic plan (take engagement actions to recruit, attract and acquire resources and capabilities; take market actions of entry, product/service positioning, procedures and practices development; adopt boundary actions, forming alliances, partnerships, supplier relationships, etc.).
4 Evaluate the performance of the strategy against strategic intent, desired returns and competitive advantage.
5 Take follow-up action through continuous feedback.

Figure 9.1 illustrates these basic tasks in a flow diagram.

A succinct review of the internal and external factors that influence the opportunity and hence the viability of a venture is called a **SWOT analysis**; SWOT is an acronym for a venture's internal *strengths* and *weaknesses* and its external *opportunities* and *threats* (learn more about this through the 'Experiencing entrepreneurship: The TOWS matrix' exercise at the end of the chapter). The analysis should include not only the external factors most likely to occur and have a serious impact on the opportunity and the company, but also the internal factors most likely to affect the implementation of present and future strategic decisions. Focusing on this analysis prepares an emerging venture to work through the other tasks of formulation, execution, evaluation and feedback.[6]

SWOT analysis
A strategic analysis of strengths, weaknesses, opportunities and threats.

Analyses of the external and internal environments provide the information required to develop the vision and mission. It is essential to keep the value proposition to the customer at the centre of this analysis – a vision and mission must be relevant and valuable to the target customers. Now you are in good shape to state a strategic intent that communicates the value the business creates by its very existence, and defines what the business will excel at (better than competitors). The statement of strategic intent is a key communication tool for the venture and plays an important role in stabilising the business and providing focus on the reason the new venture exists.

The strategic intent also influences the design of the business model (Chapter 8). In practice, '*a business model is the design of organisational structures to enact a commercial opportunity*'.[7] Looking more deeply you find that there are three interrelated ways of viewing the business model.[8] The top-line perspective of the business model adopts a *market positioning* stance, which views the company's strategic competitive market positioning, interactions across organisational boundaries and growth opportunities. For example, the business model for Facebook when considered through the *strategic market perspective* might state that Facebook's business model delivers value to a substantial, loyal and frequently interacting community through the design of an appealing and 'sticky' (addictive) web interface. A second view is the *operational perspective*, which considers the value-creating architecture of the company: the set of sequences, processes and activities that the business does to create value. To restate the business model of Facebook in these terms is to say that Facebook is structured as a networking platform providing the infrastructure for its online community to connect, share and interact with their friends across the internet. The base element is the *economic perspective*, which is concerned with the logic of profit from producing and/or delivering the good or service a company may offer. Facebook's business model in economic terms is structured around profiting from advertising revenues that target the individual preferences of its enormous online community. Facebook's business model, then, can be described in terms of the three strategic elements: an attractive and 'sticky' community interface operationalised by a reliable online networking platform that offers opportunities for a profitable advertising revenue stream.

An entrepreneur needs to know the business model inside out and from each of these perspectives. At the heart of any good business model is the value proposition, and this is the centrepiece for designing business growth strategies. The three perspectives are interrelated through nine components, as described by Osterwalder[9] and illustrated in Figure 9.2. Refer also to Chapter 8 for a discussion of the Osterwalder's Business Model Canvas.

FIGURE 9.2 THE NINE ELEMENTS AND THREE PERSPECTIVES OF THE BUSINESS MODEL

2 Customer segment The groups of customers a company identifies for its value offering	**3 Customer relationships** The information exchange links with customers that inform a company's value offering	**4 Distribution channels** The means of transferring the value offering to the customer	**Strategic positioning perspective**
5 Revenue model The money a company acquires in exchange for its value offering	**1 Value proposition** The firm's value offering that attracts customer and operational transactions	**6 Cost structure** The money a company spends to create and/or maintain its value offering	**Economic perspective**
7 Key resources Everything, other than money, that is used by the company to create the value offering	**8 Partner network** Those companies that a company selects to cooperate with to enable and create its value offering	**9 Key activities** The things a company does to utilise its resources in creating the value offer	**Organisational architecture perspective**

Source: Adapted from Osterwalder, A. (2004). *The business model ontology: A proposition in the Design Science Approach* [unpublished dissertation]. University of Lausanne, 43. http://www.academia.edu/download/30373644/thebusiness-model-ontology.pdf.

The business model and the business model canvas are useful tools in strategic planning. The greatest value of the strategic planning process is the *strategic thinking* it promotes among business owners. Although not always articulated formally, strategic thinking synthesises the intuition and creativity of an entrepreneur into a vision for the future.[10]

dynamic capabilities
The strategic capabilities that lead a business to change the what, the how and/or the why of what it does.

operational capabilities
The capabilities inherent in maintaining the routine organisation and management of a firm in conducting its regular business.

The task and challenge for an entrepreneur is to master the art of balancing transient and dynamic factors[11] while building and maintaining two sets of capabilities: **dynamic capabilities**, those capabilities that are concerned with the strategic development of the business, to innovate and differentiate from competitors and adapt to changing competitive landscapes; and **operational capabilities**, which attend to management of routine business operations.[12] There are two ways of building dynamic capabilities: *internal* (utilising the creativity and knowledge of employees) and *external*[13] (searching for external competencies such as joint ventures and strategic alliances to complement the business' existing capabilities).[14] An entrepreneur needs to design a business model that provides a blueprint for the acquisition and growth of capabilities to deliver a clear value proposition to the market with a cost and revenue equation that ensures the company's survival and ongoing stakeholder support. Consistency and coherence across the business model is paramount.

ENTREPRENEURIAL EDGE

FINE TUNING A BUSINESS MODEL

Here's an example of give and take in a business model. John Spence, CEO of Karma Royal Group and Ernst and Young's 2010 Australian Entrepreneur of the Year, tackled what may seem to some a mature and saturated market with a business model that, after the fact, was found to be quite naive. Spence entered the global upmarket hotel business on the belief that there was an international market for holiday properties in India. Soon, it was apparent that there was not sufficient wealth in India to target sales in India, which turned the business model value proposition on its head. As market knowledge accumulated, a secondary market became obvious – Indian expatriates scattered across the globe – and in the 1990s more than 70 sales offices were set up across South-East Asia, Africa and Europe.

Learning and experimentation didn't stop there, and listening to the market paid off. Similar properties were in demand, but in other locations. The company started developing resorts in Indonesia and Thailand.

Market experimentation does not come without some risks. Spence made mistakes along the way. In applying the same strategy to enter Bangladesh, recruiting an Indian to head up the team in Bangladesh proved to be a cultural affront to the market and this, combined with a poor sales office location, ultimately led to a lack of sales. However, careful management meant the cost of this experiment was kept to $50 000 and Spence learned good lessons about key points to consider when entering different international markets.

Spence explains that entering South-East Asian markets is modelled on two key principles. First, roll out the proven business template. Second, hire a local management team quickly. The company then provides training through its own training division. The cultural differences throughout Asia (for example, India alone has 90 languages) mean that each community is best served by a local team who respect the local culture. However, the infrastructure behind them is rigorously developed and common to all jurisdictions.

Maintaining culture is a key competitive weapon and the company works hard to maintain a young outlook to differentiate itself from the global competition with a boutique-style offering. With no uniforms or conforming decor, employees are free to express their own way of doing things and the result is a culture that thrives on the 'just do it' attitude.

Sources: Ernst & Young. ''Asian Agenda 2011 – Part 2 – Case Study: The Karma Royal Group,'' 2011. https://go.ey.com/2nbG2EH; ''Profile: John Spence of Karma Royal Group.'' *Financial Times*, June 13, 2011. https://www.ft.com/content/b4f88614-95bd-11e0-8f82-00144feab49a.

THE VALUE OF STRATEGIC PLANNING

Does strategic planning pay off? Research shows it does. A number of studies have focused on the impact of planning on entrepreneurial businesses.[15] These studies support the contention that strategic planning is valuable; indeed, it influences a venture's chance of survival. Lack of planning is one of the top reasons for small business failures;[16] businesses engaged in strategic planning outperform those that do not use such planning.[17] In small and medium enterprises (SMEs), strategic thinking and action seem to be undertaken through the use of a written business plan as a strategic framework; however, few other sophisticated strategy-making techniques appear to be employed.[18] A study of 220 small companies further established the importance of selecting an appropriate strategy (niche strategy) for a venture to build distinctive competence and a sustainable competitive advantage.[19]

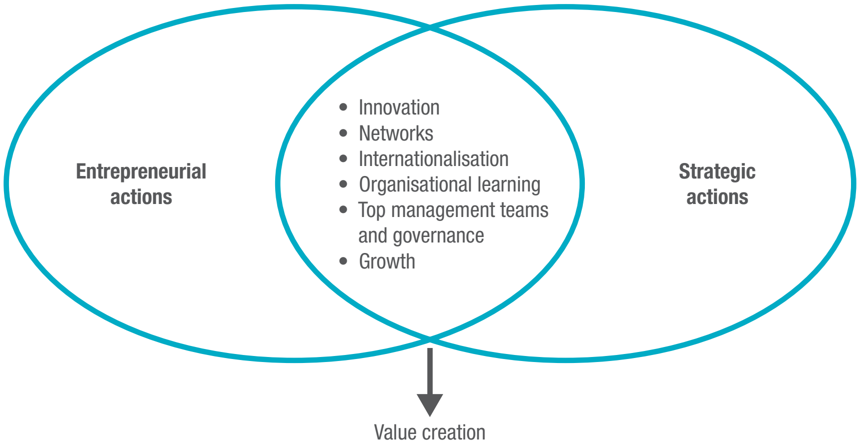
In summary, all of the research indicates that emerging companies that engage in strategic planning are more effective than those that do not. Most importantly, it emphasises the significance of the planning process, rather than merely the plans, as a key to successful performance.[20]

Entrepreneurial and strategic actions

Entrepreneurship and strategic management are both dynamic processes concerned with company performance. Strategic management calls for companies to establish and exploit competitive advantages within a particular environmental context. Entrepreneurship promotes the search for unfair or competitive advantages through product, process and market innovation. While strategic management for existing companies is concerned with managing and innovating the business model it has, entrepreneurship is focused on building an operable business model that has inherent competitive or unfair advantage and sufficient returns for those who invest in the new business (see also Chapter 8).

Researchers argue that entrepreneurial and strategic actions often are intended to secure new market or competitive space for the business to create wealth. As discussed in earlier chapters, entrepreneurial businesses try to find fundamentally new ways of doing business that will disrupt an industry's existing competitive rules, leading to the development of new business models that create new competitive business forms. The degree to which the business acts entrepreneurially in terms of innovativeness, risk taking and proactivity is related to dimensions of strategic management. Specific domains that define the extent of wealth creation have been delineated from the commonalities of entrepreneurial and strategic actions. These domains are: innovation, networks, internationalisation, organisational learning, top management teams and governance, and growth (see Figure 9.3). Understanding the critical intersections of these specific domains allows entrepreneurs to increase their knowledge, which, in turn, leads to higher-quality entrepreneurial and strategic actions.[21]

FIGURE 9.3 THE INTEGRATION OF ENTREPRENEURIAL AND STRATEGIC ACTIONS



Source: Ireland, R. D., Hitt, M. A., Camp, S. M., & Sexton, D. L. (2001). Integrating entrepreneurship and strategic management actions to create firm wealth. *Academy of Management Executive*, 15(1), 51. Published by Academy of Management, copyright 2001.

THE LACK OF STRATEGIC PLANNING

The importance of new ventures to the economy is substantial in terms of innovation, employment and wealth created, and effective planning can help these new companies survive, transition through growth stages and dynamic phases, and ultimately grow. Unfortunately, research has shown a distinct lack of strategic planning on the part of many new ventures. Five reasons for this deficiency have been found.

- *Time scarcity*: Managers report that their time is scarce and difficult to allocate to strategic planning in the face of day-to-day operating schedules.
- *Lack of knowledge*: Small-business owners/managers have minimal exposure to and knowledge of the planning process. They are uncertain of the components of the process and the sequence of those components. They are also unfamiliar with many planning information sources and how they can be used.
- *Lack of expertise/skills*: Small-business managers typically are generalists and often lack the specialised expertise necessary for the planning process.

- *Lack of trust and openness*: Small-business owners/managers are highly sensitive and guarded about their businesses and the decisions that affect them. Consequently, they are hesitant to formulate a strategic plan that requires participation by employees or outside consultants.
- *Perception of high cost*: Small-business owners perceive the cost associated with planning to be very high. This fear of expensive planning causes many business owners to avoid or ignore planning as a viable process.[22]

Other factors have been reported as difficulties of the planning process. For example, both high-performing and low-performing small ventures have problems with long-range planning. Both time and expense are major obstacles. Additionally, low-performing businesses report that a poor planning context, inexperienced managers and unfavourable economic conditions are problems. Clearly, strategic planning is no easy chore for new ventures, but the time spent on such planning can deliver many benefits.

CourseMateExpress

On CourseMate Express read about Abdul's phone repair shop. What strategic advice would you give this Malaysian electronic entrepreneur?

Fatal flaws in strategic execution

The actual execution of a strategy is as important as the strategy itself. Many entrepreneurs make unintentional errors while applying a specific strategy to their venture. Competitive situations differ and the application of known strategies must be tailored to those unique situations.

Porter has noted five fatal strategic flaws (FSFs) entrepreneurs continually fall prey to in their attempt to implement a strategy.[23] Here are these mistakes and an explanation of them.

- *FSF 1: Misunderstanding industry attractiveness*. Too many entrepreneurs associate attractive industries with those that are growing the fastest, appear to be glamorous or use the fanciest technology. This is wrong, because attractive industries have high **barriers to entry** and the fewest substitute products or services; that is, attractive industries keep competitors out and the products and services offer little opportunity for alternatives and substitutes. The more high-tech or glamourous a business is, the more likely a lot of new competitors will enter and make it unprofitable.

barriers to entry
Elements restricting new business entry into an industry, such as proprietary technology; limited access to distribution channels, raw materials and other inputs; cost disadvantages due to lack of experience; and risk.

- *FSF 2: No real competitive advantage*. Some entrepreneurs merely copy or imitate the strategy of their competitors. That may be an easy tactic and it is certainly less risky, but it means an entrepreneur has no competitive advantage. To succeed, ultimately new ventures must develop unique ways to compete.
- *FSF 3: Pursuing an unattainable competitive position*. Many aggressive entrepreneurs pursue a position of dominance in a fast-growing industry. However, they are so busy getting off the ground and finding people to buy their products that they forget what will happen if the venture succeeds. For example, a successful software program will be imitated quickly. So the advantage it alone gives cannot be sustained. Real competitive advantage in software comes from servicing and supporting buyers, providing regular upgrades and getting customers dependent on the support organisation. That creates a barrier to entry. Sometimes, small companies simply cannot sustain an advantage.
- *FSF 4: Compromising strategy for growth*. A careful balance must exist between growth and the competitive strategy that makes a new venture successful. If an entrepreneur sacrifices their venture's unique strategy in order to have fast growth, then the venture may go out of business. Although fast growth can be tempting in certain industries, it is imperative that entrepreneurs maintain and grow their strategic advantage as well.
- *FSF 5: Failure to explicitly communicate the venture's strategy to employees*. It is essential for every entrepreneur to clearly communicate the company's strategy to every employee. Never assume employees already know the strategy. Always be explicit.

As Porter says:

> One of the fundamental benefits of developing a strategy is that it creates unity, or consistency of action, throughout a company. Every department in the organisation works toward the same objectives. But if people do not know what the objectives are, how can they work toward them? If they do not have a clear sense that low cost, say, is your ultimate aim, then all their day-to-day actions are not going to be reinforcing that goal. In any company, employees are making critical choices every minute. An explicit strategy will help them make the right ones.[24]

STRATEGY, VENTURE DEVELOPMENT AND GROWTH

Although many entrepreneurs may want their company to be as innovative, flexible and creative as Apple, Google and Facebook, and many may also envy their growth, there are thousands of new businesses that presumably have tried to be innovative, to grow and to show other entrepreneurial characteristics, but have not made the same kind of breakthroughs. Remaining entrepreneurial while recognising the need to transition to some of the more administrative traits of management is vital to the successful growth of a venture. At the two ends of the continuum (from an entrepreneurial focus to an administrative focus) are specific points of view. One study characterised these in question format.

- **The entrepreneur's point of view:**
  - Where is the opportunity?
  - How do I capitalise on it?
  - What resources do I need?
  - How do I gain control over them?
  - What structure is best?
- **The administrative point of view:**
  - What resources do I control?
  - What structure determines our organisation's relationship to its market?
  - How can I minimise the impact of others on my ability to perform?
  - What opportunity is appropriate?[25]

The logic behind the variance in the direction of these questions can be presented in a number of different ways. For example, the commitment of resources in the entrepreneurial frame of mind responds to opportunity in changing environmental needs, whereas the managerial point of view is focused on the reduction of risk. In the control of resources, entrepreneurs will avoid ownership because of the risk of obsolescence and the need for more flexibility, whereas managers will view ownership as a means to accomplish efficiency and stability. In terms of structure, the entrepreneurial emphasis is placed on a need for flexibility and independence, whereas the administrative focus is placed on ensuring integration with a complexity of tasks, a desire for order and controlled reward systems.

effectual logic
An approach to entrepreneurial strategy, popularised by Saras Sarasvathy, that is unconstrained by either limited resources or fixed objectives.

Saras Sarasvathy in her research and interviews with many entrepreneurs identified that entrepreneurs have a tendency to work with an **effectual logic**; that is, creating, crafting and adapting 'means' to meet imagined new 'ends' (see Chapter 5, page 158). She counterpoints the entrepreneur with two other types, the manager and the strategist. While managers, she argues, use causal reasoning working with given 'means' to achieve given 'ends', the strategist adopts creative causal reasoning, by *shaping* given 'means' and creating new 'means' to meet given 'ends'.[26]

To illustrate this point, we adapt a recognised corporate strategy tool, called the Ansoff Product-Market Matrix[27] (see Figure 9.4), which plots the level of technology newness embedded in the product along the *x* axis and the level of market newness along the *y* axis when viewed from any company's

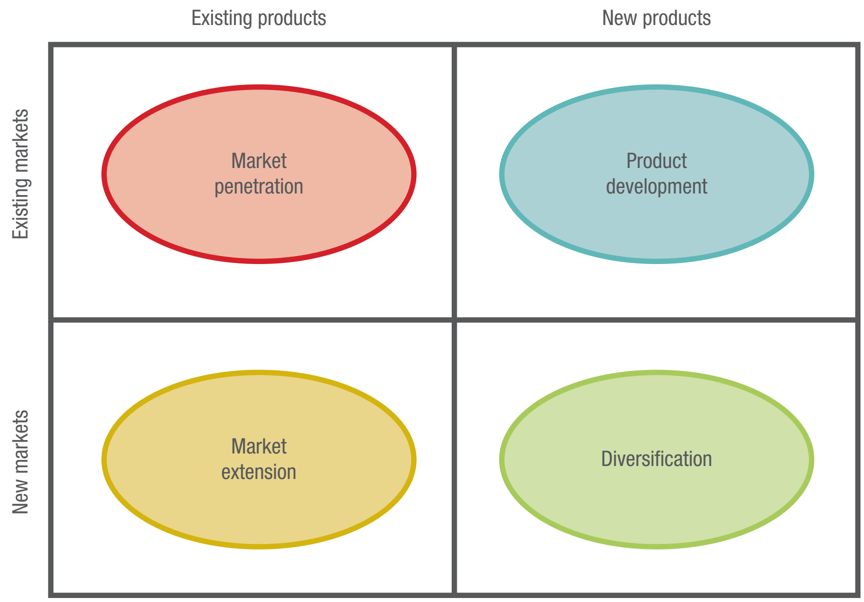


FIGURE 9.4
THE PRODUCT-MARKET MATRIX

individual perspective. If we think about the types of reasoning that might be involved in operating in the different quadrants, we can superimpose the type of logic or reasoning that might best be suited to exploiting those different quadrants.

The effectual logic (see previous page) has its place in Ansoff's Diversification quadrant. Here we are constrained neither by known products nor by known markets. Imagination, vision, confidence to sell, ambition and so on will be necessary to succeed. This is the world of entrepreneurial reasoning and effectual logic, imagining new possibilities (the ends) and arranging the resources (the means) to achieve them.

As we consider the Product Development and Market Extension quadrants, constraints creep in with either the product or market. This influences the type of logic and reasoning that will be effective as the focus shifts to choosing among product and market options (or, in other words, choosing and crafting different means). The objective end, though, is fixed: to either move more of the known product into an unknown market or create new products to increase revenues from the existing market. These quadrants require higher levels of strategic logic and reasoning.

In the Market Penetration quadrant, on the other hand, both the product and markets are known and the objective is to maximise sales within this combination of fixed means (product and market) to achieve a known end (higher revenues, sales and/or profits). This requires management logic and reasoning.

Entrepreneurship of various types can originate in any quadrant, but over time any and every business will need, at different points in time, the service of these different forms of reasoning and logic. Herein lies two problems. First, the entrepreneur who may be well equipped with effectual logic to start an innovative new business may not be equally well equipped to manage the strategic and managerial reasoning as the business grows. Second, if the business successfully grows there is an increasing risk that progressively the effectual reasoning will be squeezed out of the company and the company will then be unable to exploit expansion opportunities with any combination of new products and markets. You may recall in Chapter 4 we discussed disruptive innovation, which illustrated the innovation dilemma and how established businesses have a propensity to overlook the new product and new market opportunities.

Managing the journey of the business as it encounters the various quadrants will require calling upon different rational and logic approaches. Each point of view – entrepreneurial, strategic and managerial – accounts for different considerations that need to be balanced across time if effective growth is to be achieved.

STRATEGIC MARKET POSITIONING: THE ENTREPRENEURIAL ADVANTAGE

Market positioning is all about thinking strategically. It is about placing your business in the minds of customers in a position that differentiates you from the competition. Thinking strategically about your market position can make you stand out, attracting customers away from established competitors or drawing new customers into the market. In principle, the established business with an entrenched market position and the new company entry with next to no market exposure face the same challenges in finding new strategic positions. In practice, entrepreneurs with new companies often have the edge.

strategic positioning The process of perceiving new positions that attract customers from established positions or draw new customers into the market.

Locating a **strategic position** is often not obvious, and finding it requires creativity and insight. Entrepreneurs often discover unique positions that have been available, but simply overlooked by established competitors. For instance, Netflix started as an internet DVD distribution business making cult-classic films accessible, a market overlooked by the major competitor Blockbuster. In addition, entrepreneurial ventures can prosper by occupying a position that a competitor once held, but has ceded through years of imitation and straddling.

Fundamental approaches to strategic positioning include establishing and defending a superior position, leveraging resources to dominate a market and pursuing opportunities to establish new markets (see Table 9.1). Entrepreneurs must understand that the pursuit of opportunities is the best choice for capitalising on change.

TABLE 9.1 STRATEGIC APPROACHES – POSITION, LEVERAGE, OPPORTUNITIES

STRATEGIC LOGIC	ESTABLISH POSITION	LEVERAGE RESOURCES	PURSUE OPPORTUNITIES
Strategic steps	Identify an attractive market Locate a defensible position Fortify and defend	Establish a vision Build resources Leverage across markets	Jump into the confusion Keep moving Seize opportunities Finish strongly
Strategic question	Where should we be?	What do we need?	How should we proceed?
Source of advantage	Unique, valuable position with tightly integrated activity system	Unique, valuable, inimitable resources	Key processes and unique, simple rules
Works best in	Slowly changing, well-structured markets	Moderately changing, well-structured markets	Rapidly changing, ambiguous markets
Duration of advantage	Sustained	Sustained	Unpredictable
Risk	It will be too difficult to alter position as conditions change	Company will be too slow to build new resources as conditions change	Managers will be too tentative in acting on promising opportunities
Performance goal	Profitability	Long-term dominance	Growth

Source: Eisenhardt, K. M., & Sull, D. N. (2001). Strategy as simple rules. *Harvard Business Review*, 79(1), 109. Copyright 2001 by Harvard Business Publishing. Used by permission. http://www.academia.edu/download/32493622/HBR-StrategyAsSimpleRules-R0101Gp2.pdf.

Most commonly, new positions open up because of change. New customer groups or purchase occasions arise, new needs emerge as societies evolve, new distribution channels appear, new technologies are developed and new machinery or information systems become available. When such changes happen, entrepreneurial ventures unencumbered by a long history in the industry can often more easily perceive the potential for a new way of competing. Unlike incumbents, these organisations can be more flexible because they face no trade-offs with their existing activities.[28]

LINKING STRATEGY TO NEW PRODUCTS IN NEW MARKETS

A major hindrance to the success of an entrepreneurial venture is the limited resources that may be available to take on competition in a hotly contested market. Strategy draws much of its language from wars and battles, whereby the aim is to obliterate or expel an opponent. An entrepreneur, though, does not need to play this game and can instead be true to the pioneering spirit of new enterprise and target the conquest of market spaces not yet contested or identified by competitors. Using effectual logic, an entrepreneur can carve out a unique and dominant market presence in spaces that are yet uninhabited by competitors.

This type of strategy has been coined **Blue Ocean Strategy**.[29] Blue oceans are market spaces where industries do not yet exist. Contrast this with red oceans, which are the tightly contested known markets that leave blood-soaked waters as competitors brutally contest for customers. Although it may sound strange to suggest that entrepreneurs should aim to establish a market presence where the market is as yet unknown, as we will discuss, this is precisely what Cirque du Soleil did by redefining the circus experience and what Australia's Casella wines did by launching their Yellowtail brand in the USA.

Blue Ocean Strategy
The strategy of seeking a market space that is not yet contested or that remains unidentified by competitors. Also the strategy of creating new market spaces to avoid the tightly held known markets that competitors hotly contest for customers.

The key to this strategy is to carve out a new market space not yet addressed by competitors. How is this done? Essentially, it requires two critical insights. The first is a realisation that the current industry and/or market boundaries and conditions are not fixed and that you as an entrepreneur are not bound to play by the rules of the established market contestants. As an entrepreneur, ask yourself what accepted norms for an industry should either be raised or lowered to better deliver value to the customer? Casella wines launched their Yellowtail brand in the US targeting the new wine drinker with distinctive advertising and an approachable, easy-drinking flavour palate, shaking up the self-imposed industry market boundary of the sophisticated consumer. They redefined the industry-standard customer.

The second insight requires an acute awareness of how the value proposition experienced by a customer can be improved by redefining the current rules of the industry and market space and establishing your business to exploit these new conditions. The questions an entrepreneur may ask here are: What experience is the customer not receiving that could lift the customer value proposition? What experience does the customer receive that actually undermines customer value? Cirque du Soleil redefined the customer experience by lifting the narrative, emotion and spectacle of the circus performance and removed the animals that conflicted welfare-conscious consumers. By focusing on the customer, the value proposition was redefined, adding value and removing that which undermined value.

Finding the blue ocean requires an entrepreneur to think of innovation through the lens of value or **value innovation**. Strategists often make the distinction between two fundamental types of strategy: seeking differentiation and establishing a low-cost base. Thinking about value innovation leads one to not think of these two positions as either/or strategies but instead as a case where differentiation *and* low-cost opportunities can be exploited as principle strategies. This position means a business can charge a premium for the value created in a differentiated and relatively less contested market space, but with a low-cost base it means it can also keep more money in the business as profit. Cirque du Soleil, for instance, differentiated their performances by incorporating elements of theatre and dance,

value innovation
Innovation that considers new conceptions or means to create value for customers that step outside of pre-existing or established industry and market norms and practices.

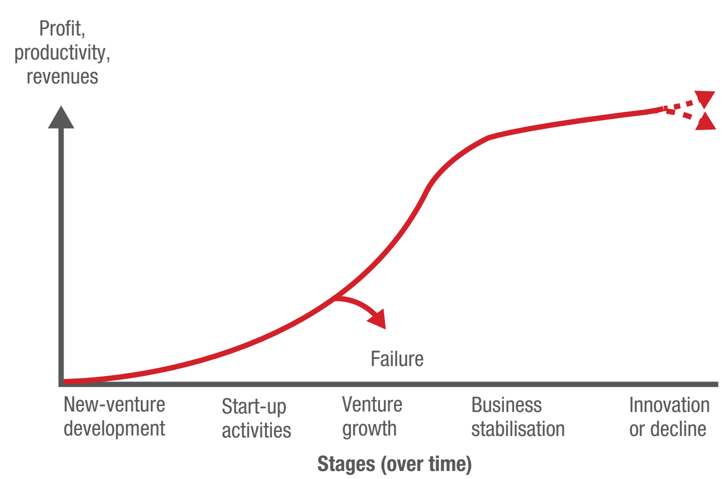
constructing themed performances, and making the musical score a fundamental and integrated part of the circus. At the same time they eliminated the costs of healthcare, transport, training and feeding of animals as part of the circus act and avoided the social backlash emerging from animal welfare issues. Instead of investing in expensive star performers, they redirected their investment toward developing transfixing performances. Cirque du Soleil changed the circus industry standard and the value proposition for the customer, increasing value and lowering costs.

VENTURE DEVELOPMENT STAGES

life cycle stages
The stages through which a venture progresses, including venture development, start-up, growth, stabilisation and innovation or decline.

Finding the right strategy in a market with plenty of upside growth potential can set a new business on a path of rapid growth and change. Over the years researchers have noted that businesses, just like products and markets, tend to transition through stages as they grow and develop. Just as a child growing up experiences the different stages of infancy, adolescence and maturity, so too do businesses. The traditional **life cycle stages** of an enterprise are presented in Figure 9.5. These stages include new-venture development, start-up activities, growth, stabilisation and innovation or decline. Other authors have described four[30] to six[31] stages in varying terms. In short, authors generally observe that ventures seem to experience a life cycle, although the number of stages may not always be agreed. However, some authors argue that the lack of a consistent stage theory misrepresents the actual experience of a venture, which is far more fluid and dynamic.[32] To a large extent this is likely true, but regardless, it is useful as an entrepreneur to use the analogy of stages to anticipate and respond to the changes that will undoubtedly be experienced as a new business grows. The word of caution is to not expect that the pattern will be as linear as the theory suggests. Here we summarise five stages. By turning to the 'Experiencing entrepreneurship: The venture life cycle' exercise at the end of the chapter you can test your awareness of what the different stages mean for an entrepreneur.

FIGURE 9.5
A VENTURE'S TYPICAL STAGES OF GROWTH



Stage 1: New-venture development

The first stage, new-venture development, consists of activities associated with the initial formulation of the venture. This initial phase is the foundation of the entrepreneurial process. In addition to the accumulation and expansion of resources, this stage requires creativity, assessment and networking for initial entrepreneurial strategy formulation. The enterprise's general philosophy, mission, scope and direction are determined during this stage.

Stage 2: Start-up activities

The second stage, **start-up activities**, encompasses the foundation work that contributes to the processes of business planning (whether formally written or not) and includes searching for capital, carrying out marketing activities and developing an effective entrepreneurial team. These activities typically demand an aggressive entrepreneurial strategy with maximum effort devoted to launching the venture. Stage 2 is typified by strategic and operational planning steps designed to identify the business' competitive advantage and to uncover funding sources. Marketing and financial considerations tend to be paramount during this stage as the business struggles to survive.[33]

start-up activities
The second stage of a new-venture life cycle, encompassing the foundation work needed for creating a formal business plan, searching for capital, carrying out marketing activities and developing an effective entrepreneurial team.

Stage 3: Growth stage

In the **growth stage**, competition and other market forces call for the reformulation of entrepreneurial strategies. For example, some businesses find themselves 'growing out' of business because they are unable to cope with the growth of their ventures. Highly creative entrepreneurs are sometimes unable, or unwilling, to meet the administrative challenges that accompany this growth stage. As a result, they leave the enterprise and move on to other ventures.

growth stage
The third stage of a new-venture life cycle, typically involving activities related to reformulating strategy in light of the competition.

This growth stage presents newer and more substantial problems than those the entrepreneur faced during the start-up stage.[34] The growth stage is a transition from an informal 'one-person' leadership to managerial, formalised and team-oriented leadership. This transition for the entrepreneur, as discussed earlier, requires developing a different set of skills while maintaining an entrepreneurial perspective for the organisation.[35]

Stage 4: Business stabilisation

The **stabilisation stage** is a result of both market conditions and the entrepreneur's efforts. During this stage a number of developments commonly occur, including increased competition, consumer indifference to the entrepreneur's good(s) or service(s) and saturation of the market with a host of 'me too' lookalikes. Sales often begin to stabilise and the entrepreneur must begin thinking about where the enterprise will go over the next three to five years. This stage is often a *swing* stage in that it precedes the period when the business either swings into higher gear and greater profitability or swings toward decline and failure. During this stage, innovation is often critical to future success.

stabilisation stage
The 'swing' stage of new venture growth, characterised by increased competition, consumer indifference, market saturation, 'me too' lookalikes and sales plateauing. Either the firm swings into higher gear or moves toward decline.

Stage 5: Innovation or decline

Companies that fail to innovate will die. Financially successful enterprises will often try to acquire other innovative businesses, thereby ensuring their own growth. In addition, many companies will work on new product/service development in order to complement current offerings.

All of a venture's life cycle stages are important strategic points and each requires a different set of strategies. However, this chapter concentrates specifically on the growth stage since this is when entrepreneurs most need to manage strategy. We will now examine the key factors affecting the ability to manage this stage.

MANAGING ENTREPRENEURIAL GROWTH

Managing entrepreneurial growth may be the most critical challenge for the future success of a business enterprise. After initiation of a new venture, the entrepreneur needs to develop an understanding of management transition and the strategic and tactical skills and abilities needed. As ventures grow, entrepreneurs must remember two important points. First, an adaptive business needs to retain certain entrepreneurial characteristics in order to encourage innovation and creativity. Second, the entrepreneur needs to translate this spirit of innovation and creativity to their personnel while personally making a transition toward a more managerial style.[36]

The growth stage often signals the beginning of a metamorphosis from a personal venture to a group-structured operation. Domination by the lead entrepreneur gives way to a team approach biased heavily toward coordination and flexibility. Research has shown that new-venture managers experiencing growth, particularly in emerging industries, still need to adopt flexible, organic structures.[37] Rigid, bureaucratic structures are best left for mature, stabilised companies. Therefore, the cultural elements need to follow a flexible design of autonomy, risk taking and entrepreneurship. This type of culture reflects the entrepreneur's original force that created the venture. In confronting issues such as control, responsibility and staying the course, growth entrepreneurs tend to build an **adaptive business** and manage paradox well.

adaptive business
A venture that remains adaptive and innovative both through and beyond the growth stage.

BUILDING THE RESILIENT BUSINESS

An entrepreneurial company facing growth needs to remain agile and resilient to the changing environment beyond start-up. Such an adaptive business increases opportunity for its employees, initiates change and instils a desire to be innovative. Entrepreneurs can build an adaptive business in several ways.[38] The following are not inflexible rules, but they do enhance a venture's chance of remaining adaptive and innovative both through and beyond the growth stage.

Share the entrepreneur's vision

The entrepreneur's vision must permeate throughout the organisation in order for employees to understand the company's direction and share in the responsibility for its growth. The entrepreneur can communicate the vision directly to the employees through meetings, conversations or seminars. It also can be shared through symbolic events or activities such as social gatherings, recognition events and displays. Whatever the format, a shared vision allows the venture's personnel to catch the dream and become an integral part of creating the future.[39]

Increase the perception of opportunity

This can be accomplished with careful job design. The work should have defined objectives for which people will be responsible. Each level of the hierarchy should be kept informed of its role in producing the final output of the product or service. This is often known as *staying close to the customer*. Another way to increase the perception of opportunity is through careful coordination and integration of the functional areas. This allows employees in different functional areas to work together as a cohesive whole.

Institutionalise change as the venture's goal

Planning, operations and implementation are all subject to continual changes as the venture moves through the growth stage and beyond. If opportunity is to be perceived among the market and industry dynamics, building an organisational preference for change rather than preservation of the status quo must be not only encouraged, but established as a goal. Within this context a desire for opportunity can exist if resources, people and structures for faster managerial response are made available and departmental barriers are reduced.

Instil the desire to be innovative

The desire of personnel to pursue opportunity must be carefully nurtured. Words alone will not create an innovative setting.[40] Specific steps such as the following should be taken.

- *A reward system*: Explicit forms of recognition should be given to individuals who pursue innovative opportunities. For example, bonuses, awards, salary advances and promotions should be tied directly to the innovative attempts of personnel.
- *An environment that allows for failure*: Fear of failure must be minimised by general recognition that often many attempts are needed before success is achieved. This does not imply that failure is sought or desired. However, learning from failure, as opposed to expecting punishment for it, is promoted. When this type of environment exists, people become willing to accept the challenge of change and innovation. Three distinct forms of failure should be distinguished:
  - **Moral failure**: a violation of internal trust. Since the company is based on mutual expectations and trust, this violation is a serious failure that can result in negative consequences.
  - **Personal failure**: failure brought about by a lack of skill or application. Usually responsibility for this form of failure is shared by the company and the individual. Normally, therefore, an attempt is made to remedy the situation in a mutually beneficial way.
  - **Uncontrollable failure**: failure caused by external factors. This is the most difficult to prepare for or deal with. Resource limitations, strategic direction and market changes are examples of forces outside the control of employees. Top management must carefully analyse the context of this form of failure and work to prevent its recurrence.
- *Flexible operations*: Flexibility creates the possibility of positive change. If a venture remains too rigidly tied to plans or strategies, it will not be responsive to new technologies, customer changes or environmental shifts. Innovation will not take place because it will not 'fit in'.
- *The development of venture teams*: In order for the environment to foster innovation, venture teams and team performance goals need to be established. These must be not just work groups, but visionary, committed teams with the authority to create new directions, set new standards and challenge the status quo.[41]

moral failure
A violation of internal trust.

personal failure
A form of failure brought about by a lack of skill or application.

uncontrollable failure
A form of failure caused by external factors that are outside the control of employees, such as resource limitations, strategic direction and market changes.

MANAGING PARADOX AND CONTRADICTION

When a venture experiences surges in growth, a number of structural factors also begin to present challenges. These include cultural elements, staffing and development of personnel, and appraisal and rewards. Entrepreneurs can struggle over whether to organise these factors in a rigid, bureaucratic design or a flexible, organic design.

When designing a flexible structure for high growth, entrepreneurs must realise that a number of contradictory forces are at work in certain other structural factors. Consider the following.

Bureaucratisation versus decentralisation

Increased hiring stimulates bureaucracy. Companies must formalise procedures as staffing doubles and triples. Employee participation and autonomy decline and internal labour markets develop. Tied to growth, however, is also an increased diversity in product offerings. This favours less formalised decision processes, greater decentralisation and recognition that the company's existing human resources lack the necessary skills to manage the broadening portfolio.

Business environment versus strategy

High turbulence in the business environment coupled with competitive conditions favours company cultures that support risk taking, autonomy and employee participation in decision making. Companies confront competitors, however, through strategies that depend on the design of formal systems that inhibit risk taking and autonomy.

Strategic emphasis: quality versus cost versus innovation

Rapidly growing businesses strive to simultaneously control costs, enhance product quality and improve product offerings. Minimising costs and undercutting competitors' product prices are best achieved by traditional hierarchical systems of decision making and evaluations. Yet these strategies conflict with the kinds of autonomous processes most likely to encourage the pursuit of product quality and innovation.[42]

These factors emphasise the importance of managing paradox and contradiction. Growth involves the two primary challenges of: (1) the stresses and strains induced by attempts to control costs to maintain competitive parity while simultaneously enhancing quality and creating new products and competitive advantages; and (2) centralising to retain control while simultaneously decentralising to encourage the contributions of autonomous, self-managed professionals to the embryonic corporate culture. Rapidly growing businesses are challenged to strike a balance among these multiple pulls when designing their managerial systems.

CONFRONTING THE GROWTH WALL

growth wall
A psychological wall against change that prevents entrepreneurs from developing a managerial ability to deal with venture growth.

In attempting to develop a managerial ability to deal with venture growth, many entrepreneurial owners confront a **growth wall** that seems too gigantic to overcome. Therefore, they are unable to begin the process of handling the challenges that growth brings about.

Researchers have identified a number of fundamental changes that confront rapid-growth companies, including instant size increases, a sense of infallibility, internal turmoil and extraordinary resource needs. In addressing these changes that can build a growth wall, successful growth-oriented companies exhibit a few consistent themes:

- The entrepreneur is able to envision and anticipate the company as a larger entity.
- The team needed for tomorrow is hired and developed today.
- Hierarchy is minimised.
- Employees hold a financial stake in the company.
- The original core vision of the company is constantly and zealously reinforced.
- New 'big-company' processes are introduced gradually as supplements to, rather than replacements for, existing approaches.[43]

These themes are important for entrepreneurs to keep in mind as they develop their abilities to manage growth.

One researcher found that internal constraints such as lack of growth capital, limited spans of control and loss of entrepreneurial vitality occur in growth businesses that struggle to survive versus those that successfully achieve high growth. In addition, fundamental differences exist in the businesses' approach to environmental and contextual changes and trends.[44] Therefore, a few key steps are recommended for breaking through the inability to handle environmental changes or trends. These include:

- *Creating a growth task force* to organise and interpret the environmental data, to identify the venture's strengths and weaknesses, to brainstorm new ideas that leverage the business' strengths and to recommend key ideas that should be developed further
- *Planning for growth* with strategies to resolve the stagnation, a set of potential results and identification of the necessary resources

- *Maintaining a growth culture* that encourages and rewards a growth-oriented attitude
- *Developing an outside board of advisers* to become an integral part of the venture's growth. This board should help determine, design and implement an organisational structure to enhance the desire for growth.[45]

ENTREPRENEURSHIP IN PRACTICE

SUCCESSFUL COMPANIES DESIGN BLUEPRINTS FOR HIGH-TECH START-UPS

The Stanford Project on Emerging Companies (SPEC) tracked a sample of 200 high-technology start-ups in California's Silicon Valley over eight years. The goal was to discover how founders of these businesses made key organisational and human resource (HR) decisions that supported their business' growth in the formative years. Through interviews with founders, chief executives and HR directors – and supplemental quantitative data on strategy, HR practices, partners and financing of the project – they concluded that building organisations with coherent HR systems is critical to sustaining the company. Underpinning the designs of these companies were three dimensions that tended to have common practices: attachment, coordination and control, and selection.

Attachment to a young company is generated primarily through one of three drivers: love (creating a strong family-like emotional commitment among employees), work (offering interesting and challenging work that created a commitment to seeing the project through) and money (a financial contract to secure commitment). *Coordination and control* has four primary forms: informal or cultural peer control, whereby commitment to each other encourages self-regulating behaviour; professional control, in which the work demands a professional standard and commitment that in turn provides a means of control; formal procedures and systems, which guide the employees in their tasks and provide performance criteria; and lastly, direct oversight and supervision. The *selection* process of new employees is characterised by three types of routines: recruitment based largely upon the necessary skills and experience; a focus on a more long-term view with employees selected for their potential; or an emphasis on cultural fit with the organisation and team.

Although there is a broad array of combinations between the three dimensions, the SPEC team outlined five blueprints of HR practice that seemed to describe a coherent set of practices used by successful high-technology businesses. Each is described by a quote that helps to characterise the business' culture and HR practice. The five blueprints are:

- **Star** – 'We recruit only top talent, pay them top wages and give them the autonomy and resources they need to do their job.'
- **Engineering** – 'We were very committed. It was a skunk-works type of mentality and the binding energy was very high.'
- **Commitment** – 'I wanted to build the kind of company where people would only leave when they retire.'
- **Bureaucracy** – 'We make sure things are documented, have job descriptions for people, project descriptions and pretty rigorous project management techniques.'
- **Autocracy or direct control** – 'You work, you get paid.'

Table 9.2 details the practices of each blueprint in the three dimensions discussed above and summarises some performance findings.

TABLE 9.2 FIVE HR BLUEPRINTS BASED ON THREE DIMENSIONS

BLUEPRINT	DIMENSIONS			KEY FINDINGS
	ATTACHMENT	SELECTION	COORDINATION AND CONTROL	
Star	Work	Potential	Professional	*Slowest to go public* *Post IPO, highest growth in market capitalisation* *Harder to scale* *More fragile and difficult to manage*

continue

continue

BLUEPRINT	DIMENSIONS			KEY FINDINGS
	ATTACHMENT	SELECTION	COORDINATION AND CONTROL	
Engineering	Work	Skills	Peer, culture	*More robust and scalable* *Average performance*
Commitment	Love	Cultural fit	Peer, culture	*Fastest to go public* *Least likely to fail* *Harder to scale* *More fragile and difficult to manage*
Bureaucracy	Work	Skills	Formal	*More robust and scalable* *Average performance*
Autocracy/direct control	Money	Skills	Direct	*Most likely to fail*

Source: Baron, J. N., & Hannan, M. T. (2002). Organizational blueprints for success in high-tech start-ups: Lessons from the Stanford Project on Emerging Companies. *California Management Review*, 44(3), 8–36. Copyright 2002 by the Regents of the University of California. Used by permission. https://doi.org/10.2307/41166130.

incrementalist approach An approach to entrepreneurship guided by the notion that firms go through a predictable pattern of escalating activities when they develop export strategies – from non-exporting domestic producer through to fully globalised operations. This is the opposite of the 'born global' firm.

born global A company that goes global from its very 'birth'. It rapidly expands on the world market without conquering the domestic market first.

GOING GLOBAL FOR GROWTH

Growing businesses though internationalisation has traditionally been conceptualised as a gradual and sequential process that occurs in stages. The business is assumed to build a stable domestic position before successively increasing commitment to international activities and foreign markets. Research literature has traditionally focused on patterns that companies go through when they venture offshore (by offshore, we also mean neighbouring countries). One is described as an **incrementalist approach** to export and expansion. This sees businesses moving through a specific sequence of events, starting out with no offshore activity, then employing intermediaries and finally setting up subsidiaries or agents.

A second approach tips this conventional theory on its head. Recent research has shown changed attitudes towards this process. Today the focus is on small businesses that begin exporting right from start-up. These are called '**born global**' businesses, who are exporters from the get-go.[46] Without the advent of global communications and transportation, they simply would not exist. Think of the giants Google and Facebook, which generated export revenues at impressive speed. Think also of the small entrepreneurs like Skype, which was acquired by eBay and then by Microsoft. Young entrepreneurs – especially those with a gap year or two under their belts – tend to move quickly toward international and global markets where resources are more easily and widely available.[47]

WHAT ARE YOUR MOTIVATIONS FOR GOING GLOBAL?

The first question you should ask is: Why should I go global in the first place? An entrepreneurial business should be able to answer 'yes' to many of the following questions.

- *Profit maximisation*: Is the company driven by a need to maximise profits? Are shareholders or investors expecting quick returns? This might mean adopting an opportunistic strategy in which the company moves from market to market in search of the best possible returns, rather than slowly building a position in any particular market.

- *Market share*: Does the company want to establish a strong position in an undeveloped market? Is it willing to charge less initially (penetration pricing) in order to get buyers? This may mean spending more on advertising and marketing and having less concern with short-term profitability. This strategy works best in a market where demand is strong (or can be stimulated with appropriate marketing) and where competition, particularly from local suppliers, is weak.
- *Cash flow maximisation*: Another strategy may be simply to find a way of maximising cash flow. Businesses strapped for cash may go abroad to bring in more revenue. This strategy may be used, for example, by companies that have large stocks of unsold or discontinued inventory or with idle production capacity.
- *Repositioning the business*: Global market entry may help an entrepreneurial business reposition their business by developing new product lines and new capabilities. It may make more sense to roll out a different product in a new market, where the company is relatively unknown, than to attempt to change the company's image in its original market, possibly undermining its existing business in the process.
- *Domestic impact*: Aggressive businesses may go overseas in order to acquire new knowledge, skills or technologies for their domestic operations. Such strategies are often pursued by companies in technology-intensive industries or in sectors undergoing rapid change.

The entrepreneur can actively engage in the international market in many ways. These include: importing, exporting, joint ventures, direct foreign investment, royalties and licensing, franchising, mergers and acquisitions, and greenfield investment. These are all becoming part of the extended enterprise, but each of these methods involves increasing levels of risk. The final decision whether or not to go global will depend on the organisation's needs and the risk it is willing to take. The 'Experiencing entrepreneurship: Market selection matrix' exercise at the end of the chapter is a useful tool for assessing opportunities in different market contexts.

ENTREPRENEURIAL EDGE

BORN GLOBAL: THE WIGGLES

Australian band The Wiggles are an international success story. Their core business has been built on providing family entertainment through concerts, CDs, DVDs, television, toys, play centres, theme parks and online communities.

The Wiggles began their international activity by touring with the support of business partners. They have been active in New Zealand, the UK, the Republic of Ireland, the US, Canada and Taiwan, with additional markets in Asia and South America. Globally the group has sold over 23 million DVDs, 2 million albums and 8 million books. For this born-global company, foreign expansion – notably into the US – was part of a conscious strategy to sustain the business. Indeed, up to 80 per cent of The Wiggles' revenue has come from overseas markets.

The Wiggles were formed in 1991 by two members of Sydney rock band The Cockroaches. Their undertaking was informed by individual Wiggles obtaining tertiary qualifications in early childhood development. Initially, The Wiggles played at children's birthday parties and shopping centres. Yet they soon discovered that both children and adults were highly receptive to their performance in its own right. Ignoring discouraging criticism from many in the childhood entertainment industry, The Wiggles pursued a novel business model, in which children's entertainment was made accessible to adults.

Now, The Wiggles' personnel has changed to feature a new troupe that includes the first female Wiggle in the yellow skivvy. With an exclusive deal of global distribution rights with the Australian Broadcasting Company (ABC Commercial), The Wiggles market across a broad range of platforms, including CD, DVD, electronic sell-through, transactional video on demand, subscription video on demand and mobile, among others. The band and the business model has succeeded in succession.

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The Wiggles are a striking example of an Australian enterprise whose international expansion has gone far beyond exporting. According to Risk and Quality Assurance Manager Pablo Munoz, the secrets of The Wiggles' success can be summarised as 'persistence, ethics and innovation'.

Sources: Adapted from Liesch, P. W., M. Steen, S. Middleton, and J. Weerawardena. *Born to Be Global: A Closer Look at the International Venturing of Australian Born Global Firms*. Australian Business Foundation, 2007. https://bit.ly/2M280jZ; Staff writers. "AC/DC Tops BRW Entertainment Rich List, Ahead of Kylie Minogue and the Wiggles" archive.is, September 3, 2012. http://archive.is/NWfr; Haynes, Rhys. "Australia's Top 50 Entertainers Include The Wiggles Global Creatures Naomi Watts and Nicole Kidman." *The Advertiser*, November 13, 2011. https://bit.ly/2vFMk3g; The Editor, Copyright © 2018 The Bugg. "The Wiggles Sign Exclusive Global Deal with ABC." *The Bugg Report*, September 6, 2016. https://buggreport.com.au/blog/wiggles-sign-exclusive-global-deal-abc/.

IMPORTING AND GLOBAL SOURCING

importing
Buying and shipping foreign-produced goods for domestic consumption.

global sourcing
A cross-border search for suitable suppliers that meet specific quality, time and price requirements.

The traditional definition of **importing** is buying and shipping foreign-produced goods from foreign sources. Entrepreneurs trade because it enables them to acquire goods they cannot produce themselves. But today, importing is called **global sourcing**, which means sourcing goods and services across geopolitical boundaries. This means spotting global efficiencies in the delivery of a product or service. These efficiencies include low-cost skilled labour, low-cost raw materials and other economic factors such as tax breaks and low trade tariffs. Global sourcing makes it possible to meet an increase in product demand.

There is also an issue of quality to consider. Some countries have a reputation for producing high-quality, sought-after products with high reliability. Another issue to consider is the penetration of growth markets. An entrepreneur may get a foothold in a new country by sourcing in that country. Last, but not least, is the issue of cost. Buying abroad is sometimes cheaper than domestic buying.

Of course, there are disadvantages as well, particularly relevant to businesses dealing in physical goods. There are extra cost factors and time factors, such as travel and communication. A foreign broker's and an agent's fee must be paid. Then there is the cost of distribution, which adds hugely to the unit cost.

EXPORTING

exporting
Participating actively in the international arena as a seller of goods and services into foreign markets.

On the flip side is **exporting**: shipping and selling locally produced products and services abroad. Free-trade agreements open up all sorts of markets to entrepreneurs with the right products. Every globally active entrepreneurial seller is an exporter of some kind. This is particularly important for Asia-Pacific countries.

Obviously every country has its export advantages. Exports can be commodities such as wood and meat products, manufactured goods such as electronics or automobiles, knowledge products such as software or video, services sold to foreigners or even education sold to international students. Exporting is important for entrepreneurs because it often means increased market potential. Instead of being limited to a small market, the exporting company has a broader sales sphere. Take Australia as an example. Australian exports to China have grown at a steady rate. Many sectors are benefiting, including agriculture, manufacturing, minerals and energy, and services. Australia's export advantages to Malaysia would be dairy and horticultural products, halal meat, seafood, fruits and wine (yes, even to a country where Islam is the official religion).

Increased export sales volumes lead to lower unit costs, which lead to increased margins and profits. As more and more units are exported, the company becomes more efficient at production of the units, thereby lowering the cost per unit. The lower unit cost then enables the business to compete more effectively in the marketplace.

Exporting to foreign markets takes two forms. **Direct exporting** means setting up expensive subsidiaries or establishing contractual relationships with foreign companies. Direct exporting does give greater control over sales channels and intellectual property protection, but the entry costs, time to market and ongoing costs are higher.

The other form is **indirect exporting**, which means selling goods to foreign buyers through third parties such as export agents, export merchants or buying houses. This is an especially good mode of entry for the novice exporter or for a manufacturer who lacks country knowledge.

Doing business in China is a good example. Many exporters do not have the expertise to enter the Chinese market successfully. However, when they use indirect exporting, they offer their products through intermediaries who take the product directly to the markets. This way, time to entry in the Chinese market is shorter and more flexible. Exporters can receive payment earlier and risks are minimised, particularly involving volatile foreign exchange markets and credit risks.

One of the greatest benefits of indirect exporting is the ability to obtain export know-how and personal contacts through the export merchant or agent. The exporter can possibly realise greater sales volumes since the foreign export agent often represents several different related products or product lines and can therefore deliver on economies of scale. As well, exporters find it easier to ascertain whether their products will sell well in a foreign market without the effort, financial investment or risk associated with direct exporting. They do not have to worry about all the complexities; they merely give instructions to the agent about packing, labelling, transportation and so forth.

direct exporting
Selling directly to customers through establishment of subsidiaries or contractual or partner relationships with foreign companies in destination countries.

indirect exporting
Selling goods to foreign buyers through third parties such as export agents, export merchants or buying houses.

CourseMateExpress

Go to CourseMate Express for further discussion on direct, indirect and mixed approaches to accessing export markets.

PREPARING TO GO GLOBAL

Figure 9.6 illustrates the classic process for an entrepreneur to follow when deciding whether to pursue a global expansion. The following pages summarise the process as five distinct steps. This five-step process begins with research and moves into a feasibility study. From this point, the financial arrangements are secured, the necessary documentation is prepared and, finally, the plan is implemented.

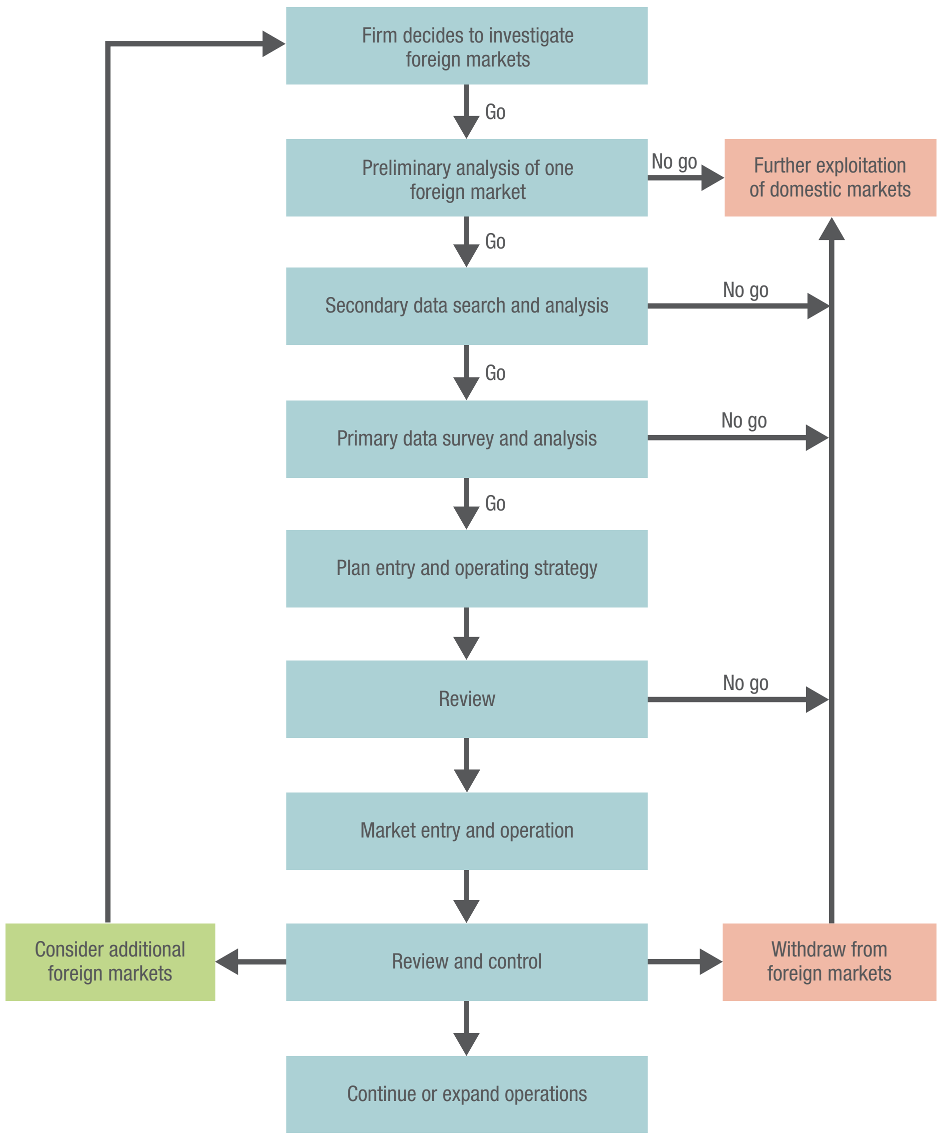
CONDUCT RESEARCH

Here are some of the key elements that have to be addressed in any foreign market entry plan.

- *Macro-level market attractiveness:*
  - Which markets should be given further attention?
  - Is there a basic need for the company's product/service?
  - Are business conditions suitable for the business' risk profile and capabilities?
- *Basic fit:*
  - Is the country receptive to imports of products or services such as those provided by the company?
  - Are there reasons why the product would not be right for this market (for example, climate for sending snowsuits to the tropics), including infrastructure considerations (for example, reliability of power for electronic goods) and related products (for example, computer software requires an installed base of computer hardware)?
- *Economic environment (market indicators):*
  - What is the relative overall market size (gross national product [GNP], population)?
  - How strong/concentrated is the consumer or industrial purchasing power (income distribution, capital expenditures)?
  - How rapid is overall growth in the market (GNP **growth rate**, per capita income growth)?

growth rate
The percentage rate of change (usually by year) in any financial characteristic of a company or an economy, such as population, jobs or sales.

FIGURE 9.6
ANALYSIS OF GLOBAL EXPANSION DECISIONS



Source: Blackwell, R. D., & Stephan, K. (1990). Growing profits for small business through global expansion. *Small Business Forum*, Winter, 55. Copyright 1990 by Roger D. Blackwell. Used by permission.

- *Political/legal environment (risk, requirements, regulations):*
  - How stable/risky is the political situation/level of civil unrest and how would this affect trade?
  - Would government regulations restrict access to certain types of trade, or create excessive burdens for the business' entry plans (for example, do they require a certain level of local production)?
  - Are there tariffs, entry barriers or non-tariff barriers that would either hamper or help market entry of a product from your country (for example, a special trade arrangement such as a free-trade agreement could help market entry to the US)?

- Are there legal restrictions that would require excessive modification to the product (for example, restrictions on the use or protection of a trademark or brand name, labelling requirements)?
- *Financial environment:*
  - How stable/volatile is the overall economy (for example, inflation, interest rates)?
  - Are there restrictions on exchanging foreign currency (can the business be paid in a suitable currency)?
  - What is the level of general credit availability and payment reliability?
- *Sociocultural environment:*
  - To what degree is language a factor in the company's ability to do business in foreign markets?
  - To what degree would the social structure affect/alter the way the business operates?
  - Will cultural factors require the business to change features of its marketing mix?
  - Will language affect the company's marketing efforts in the target market? Is there more than one language that must be considered?
- *Market potential/industry attractiveness:*
  - Is there sufficient demand in the industry for the business' product or service?
  - How much adaptation would be needed?
  - Will income exceed the cost of doing business?
- *Economic/market considerations:*
  - How will economic factors affect the standardisation of the product or the marketing mix (for example, will product sizes need to be reduced or less choice provided at the premium end to accommodate lower purchasing power)?
  - How strong is the current and potential demand for this product (for example, what is the market size and growth trend)?
  - What market segments exist that could create opportunities?
  - What stage of the **product life cycle (PLC)** would the business' export be entering?
- *Competitive considerations:*
  - How strong is the current competition (company size and market share, product quality, level of after-sales service, intangible advantages – member of a favoured nation)?
  - What is the source of the competitors' products (for example, imported or locally produced)?
- *Political/legal considerations:*
  - Are there specific tariffs, taxes, duties and/or permits that apply to the business' product?
  - If permits are necessary, would they be difficult or costly to obtain?
- *Infrastructure considerations:*
  - What are the characteristics of the shipping, transportation, warehousing and distribution facilities and the general level of access to the markets?
- *Physical/geographic considerations:*
  - Are there specific characteristics that would affect the marketing mix and require adaptation?
  - What is the internal suitability like? How will it affect the business' other operations?
  - What form of business should the business adopt (internal/external exporting, indirect/direct exporting, licensing or franchising, technology transfer)?
  - If the company adopts an external form of exporting (for example, through an agent, distributor, trading house), how will it select the best representative?

product life cycle (PLC)
The stages of time on the market through which a product progresses. Typically, life stages can be divided into introduction, growth, maturity and decline. Life cycles vary in stage duration with every type of product.

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- How will the business manage the representative? What relationship will it have with the representative? What are the legal implications of the relationship?
- If the business licenses, franchises or transfers technology, how will it find and select the right partner?
- What type of payment/credit arrangements would be most suitable?
- Is there a solid chance of product acceptance compensating for the cost of entry and ongoing support?

OTHER GROWTH OPPORTUNITIES

In line with our earlier discussion on adaptive and flexible entrepreneurial businesses and thinking about how entrepreneurs leverage other people's resources, it is worth considering a number of other options for investing in growth while minimising cost. The following strategies leverage other people's and businesses' capabilities, leaving your own business to concentrate on what it is good at. Some provide added learning opportunities but nearly all have the advantage of sharing risk.

STRATEGIC ALLIANCES

strategic alliance
Any formal relationship, short of a merger or acquisition, between two companies, formed for the purpose of gaining synergies.

In sharing risks and partnering or joining with others, some form of **strategic alliance** is generally made. The term 'strategic alliance' encompasses everything from informal agreements to sharing of information all the way to joint ventures. In short, a strategic alliance is any formal relationship, other than a merger or acquisition, between two companies, formed for the purpose of gaining synergies. In the new economy, strategic alliances enable a business to gain competitive advantage through access to a partner's resources, including markets, technologies, capital and people.

Teaming up with others adds complementary resources and capabilities, enabling participants to grow and expand more quickly and efficiently. Fast-growing companies, especially, rely heavily on alliances to extend their technical and operational resources. In the process, they save time and boost productivity by not having to develop from scratch. Thus, they are freed to concentrate on innovation and their core business.[48]

JOINT VENTURE

joint venture
An organisation owned by more than one company; a popular approach to doing business overseas.

A **joint venture** (JV) is a business collaboration in which two or more parties (with one or more potentially being an international business) establish a new business enterprise to which each contributes and in which ownership and control are shared. There are good business and accounting reasons to create a joint venture, such as distribution, technology and finance. A joint venture may allow a business to gain an intimate knowledge of particular local conditions and government where the facility is located. It provides the opportunity to obtain new capacity and expertise. Another benefit is that each participant would be able to use the resources of the other businesses involved in the venture. This allows participating businesses a chance to compensate for weaknesses they may possess.

It is important to consider certain factors before forming a joint venture. These include:

- Screening of prospective partners
- Joint development of a detailed business plan and a shortlist of prospective partners based on their contribution to developing the business plan
- Due diligence – checking the credentials of the other party ('trust and verify' – trust the information you receive from the prospective partner, but it's good business practice to verify the facts through interviews with third parties)

- Exit strategy and terms of dissolution of the joint venture
- The most appropriate structure (for example, most joint ventures involving fast-growing companies are structured as strategic corporate partnerships)
- Availability of appreciated or depreciated property being contributed to the joint venture (by misunderstanding the significance of appreciated property, companies can fundamentally weaken the economics of the deal for themselves and their partners)
- Special allocations of income, gain, loss or deduction to be made among the partners
- Compensation to the members that provide services.[49]

The central characteristic of a joint venture is that it is an equity-based relationship. In a joint venture, two or more 'parent' companies agree to share capital, technology, human resources, risks and rewards in the formation of a new entity under shared control. Each parent owns a part of the joint venture and is represented on its board of directors or other governing body.

If the ownership of the joint venture is split 50/50, it is usually because the partners are about the same size and both want a large say in the company. A different split usually reflects a difference in the resources committed by each parent. Here are three possible joint venture governance arrangements:

- Full equality – the parents decide policy and operating matters together
- Policy equality – the parents must concur on joint venture policy terms, while one takes the lead in operating matters
- Lead parent arrangement – one parent has the lead on policy as well as operating questions.[50]

DISTRIBUTING THROUGH ROYALTIES AND LICENSING

A **royalty** is a payment made in return for permission to exercise a right owned by another person. Most commonly, it refers to the payment made by a publisher or record producer to the author of a book or performer of a piece of music, but it can apply equally to a payment made for producing something by a patented process. This method of distribution is usually entered into when the developer of a product or component does not have the capital, time or commitment to manufacture and market the product/component themselves, or there are substantial tariff barriers to imports in the market of interest. You effectively sell your intellectual property to someone else to manufacture on your behalf, or to incorporate into a product they are already manufacturing. You then receive an agreed amount – a royalty – every time they make a sale. This method is often entered into when a small component has been developed that can be used in other processes – for example, a microchip that can be used in computers.

royalty
Sum of money paid for the use of a licence, or for use of works covered by copyright, patent, registered design or trademark.

Licensing is a global-market entry tool in which the company enters into an agreement with a licensee in the foreign market, offering the right to use a manufacturing process, trademark, patent, trade secret or other item of value for a fee or royalty. Licensing can cover inventions, technologies, software, manufacturing systems and processes, products, and artistic and literary material. The entrepreneur as licensor need not make an extensive capital outlay to participate in the international market, nor be concerned with the daily production, marketing, technical or management requirements; the licensee will handle all of this. Due to the high cost of manufacture and the comparatively small investment of a licensing program, many of the risks that a company would otherwise face in exploiting its intellectual property are transferred to the licensee. Depending on the exclusivity of the licence, there are varying degrees of risk involved for the licensee and licensor; however, an effective licence strategy will minimise risk for both parties.[51]

licensing
A business arrangement in which the manufacturer of a product (or a firm with proprietary rights over technology or trademarks) grants permission to a group or an individual to manufacture that product in return for specified royalties or other payments.

- *Advantages of licensing:*
    - It can be an extremely attractive way to enter the international arena. It requires a minimal capital outlay and can generate savings in tariffs and transportation costs.
    - It is a more realistic means of expansion than exporting, particularly for high-tech businesses.
    - Access to the market is easier than with equity investments, and foreign governments are more likely to give their approval because technology is being brought into the country.
    - A potential exists for the licensees to become partners and contributors in improving the 'learning curve' of technology.
- *Disadvantages of licensing:*
    - It is possible that the licensee will become a competitor after the contract expires.
    - The licensor must get the licensee to meet contractual obligations and to adjust products or services to fit the licensee's market.
    - The licensing entrepreneur must manage the relationship's conditions and circumstances, as well as resolve conflicts or misunderstandings as they occur.
    - The integrity and independence of both the licensor and licensee must be maintained.

To be competitive with larger businesses, small businesses have to be on the cutting edge of bringing in new and innovative technology. Moreover, some small businesses may not have the financial resources available to participate in the international marketplace by exporting, joint venture or direct investment. For many of these businesses, international licensing is a viable and exciting method of expanding operations.[52]

Before a company considers licensing out its technology, however, it should consider whether other ways of taking advantage of its property, such as joint ventures and strategic alliances with other companies, would better complement its economic position. Once licensing is chosen as the direction, the nature of the company, as well as the particular property it wishes to utilise, should be carefully considered before deciding the architecture of the licence.[53]

FRANCHISING

franchising
A form of licensing that involves selling the rights to a complete package of trademarks, processes, technologies, designs and copyrights, as they are all involved in the operation of a specific business.

Franchising is a specific form of licensing that involves selling the rights to a complete package of trademarks, processes, technologies, designs and copyrights, as they are all involved in the operation of a specific business. Perhaps the best-known franchises are in the fast-food business, with the world leader arguably being McDonald's. Whether it is in North America or Russia, a McDonald's restaurant promises the same food, the same quality and the same level of service to customers. Moreover, its business formula involves service standards (quick service, a standard menu), an approach to employment (hiring younger people), technology (high-tech ovens, foolproof cash registers), marketing (Ronald McDonald, frequent promotions) and a common look that is reinforced by logos and other symbols. In selling its franchise, McDonald's provides an entire process, employee training, monitoring of performance, quality control and marketing support as part of the package.

Generally, though, terms of a franchising arrangement can vary; the purchaser usually pays a lump sum for the franchise and then remits a percentage of all subsequent profits. The sale of a franchise marks the beginning of an ongoing partnership between the franchise owner and the purchaser that apportions responsibilities in both directions. That partnership may include an agreement that the purchaser buy specific products or supplies from the franchise owner on an exclusive basis. The franchise owner will certainly provide ongoing training and marketing support to the purchaser.

MERGERS AND ACQUISITIONS

Mergers and acquisitions (M&A) are another way for companies to grow and position themselves in new markets or acquire new products. They can also be important for companies seeking to develop greater economies of scale or to acquire new capabilities. A merger occurs when two corporations join into one, with one corporation surviving and the other corporation disappearing. An acquisition is one company taking control of another, often through an 'unfriendly' or 'hostile' acquisition. A prospective exporter interested in acquiring a foreign business would do well to develop a cooperative business relationship with it first. This gives both companies a chance to work out an effective relationship, develop trust and assess the real advantages and disadvantages of a merger or acquisition.

mergers and acquisitions (M&A)
A market entry strategy with two varieties. A merger occurs when two corporations join together into one, with one corporation surviving and the other disappearing. An acquisition occurs when one company takes control of another, often through an 'unfriendly' or 'hostile' acquisition.

The four main reasons for making an acquisition include acquiring:

- complementary products in order to broaden the line
- new markets or distribution channels
- additional mass and benefit from economies of scale
- technology to complement or replace the currently used one.[54]

ETHNIC NETWORKS

Another very powerful mode of global entrepreneurship is maximising your ethnic networks. Ethnic entrepreneurs start their own business in their new country of residence, often through an individual connection with former immigrants. On the reverse side are immigrant groups who launch start-ups in a new country but maintain deep links to their home country. We call them **diaspora entrepreneurs**. Diaspora comes from the Greek word for 'dispersed' and means any group dispersed outside its traditional homeland, especially involuntarily, but who maintain a relationship with their country of origin. In both directions, immigrant entrepreneurs are the new Argonauts, using family and ethnic networks and their bounded solidarity to build close ties between their two homelands. From this perspective, the often-lamented 'brain drain' is actually a kind of brain circulation, not only pushing the home economy but benefitting the countries of origin as well.

diaspora entrepreneur
An entrepreneur who supports their home country by sending remittances, and combining local business know-how with knowledge of their home country. *Diaspora* (from Greek διασπορά) refers to people who are scattered from their original homeland.

Both ethnics and diasporans confront institutional environments that often are quite different from those that existed in their countries of origin. Both must acculturate. But both have tremendous social capital. Immigrant family and friends blend together the performance-based world of business and the emotion-based domain of family. Economic benefits abound in working with your ethnic community, from coping with social exclusion to rapid mainstreaming and access to transnational opportunities. Well known are American entrepreneurs with mixed ancestry, such as African-Americans, Korean-Americans and Mexican-Americans, and especially Indian and Chinese engineers who immigrated to California's Silicon Valley. Participating in ethnic networks of family and friends helps with raising capital at the initial stages of a start-up, and allows the entrepreneur to rely on business colleagues and professional associations for finding capital in larger amounts and at later stages of the business.

ENTREPRENEURSHIP IN PRACTICE

IMMIGRANT ETHNIC NETWORKS FUELLING GROWTH

Migrants have enjoyed high-profile business success in Australia and across the Asia-Pacific. This is a remarkable achievement given the challenges of transition in a new country. About 30 per cent of small businesses in Australia are migrant-owned, which is similar to the proportion of migrants in the working-age population. They have overcome disadvantages through determination and hard work, and in the process have created jobs and wealth in Australia. From the earliest days of Australian immigration, Chinese, Greek, Italian and Lebanese immigrants had relatively high rates of entrepreneurship. While many migrants come to Australia to seek employment, others set up their businesses as a matter of necessity due to a lack of English, or discrimination in the workplace. While generally less educated than other Australians, they often have more business experience than their Australian-born counterparts. Immigrants have traditionally made less use of credit to finance their businesses, and although they often start off smaller than Australian-born and owned businesses, they tend to grow faster and be more profitable. They also have a lower failure rate and seem to be generally more successful in small business than Australian-born entrepreneurs. Korean-Australians are reputed to have the highest rate of entrepreneurship of any immigrant group in Australia at twice the Australian average.

Malaysian business The Lion Group illustrated the power of ethnic networks as they pursued an internationalisation strategy of market expansion and diversification. The Lion Group is a conglomerate active across such diverse markets as steel, motor vehicles, retailing, food, property and plantations. The CEO over many years had made social and political connections in China and leveraged the ethnicity of their Malaysian – Chinese investors, opening up trusted network opportunities to expand into Indonesia, Taiwan, China, the United States and Germany. This collaborative activity drew upon personal relationships, known in China as *guanxi*, to gain the benefits of local knowledge; access to local markets; and introductions to distribution channels, customers, partners, financiers and other business and political connections. Although an immigrant business might start small, being part of a global network with those who share language and cultural backgrounds can offer enormous expansion opportunities.

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SUMMARY

Although many ways of strategically planning a venture exist, all have one common element: Each is an extension of the entrepreneur's vision by taking the owner's concept of the business and putting it into action. Strategy is the step that follows lean business planning (Chapter 8). The development of strategy for an entrepreneur is cyclical and iterative and relies on market learning and customer insight.

A number of benefits to strategic planning exist. In particular, studies have shown that small businesses that use this process tend to have better financial performance than those that do not. Other benefits include more efficient resource allocation, improved competitive position, higher employee morale and more rapid decision making. However, there are also a number of fatal flaws to be avoided in defining a strategy. Entrepreneurs may choose not to use strategic planning for many reasons, among them scarcity of time, lack of knowledge about how to plan, lack of expertise in the planning process and lack of trust in others.

Strategic positioning was discussed with respect to defining defensible positions in a marketplace, and the concept of business model design drew attention to the various perspectives that need to be aligned during the strategy formulation through to implementation process. The different types of logic were discussed with respect to strategy relating to relative newness of products and markets. In particular, Blue Ocean Strategy was introduced as a means to minimise competition and create new market dominance.

The challenges of business growth were then introduced, starting with discussion of the five stages of a typical life cycle of a venture: development, start-up, growth, stabilisation and innovation or decline. We elaborated the divisions between an entrepreneurial and a managerial mindset and discussed ways to maintain an entrepreneurial frame of mind while making the necessary adjustments to deal with the growth phase by building the desired adaptive business and managing paradox and contradiction. In addition, the challenge of confronting the growth wall was addressed.

Next we looked at the variety of reasons for going global, each with associated risks and challenges. We discussed several ways the entrepreneur can actively engage in the international market. Importing involves buying goods from other countries. Exporting can take a variety of forms. We introduced the need to prepare to go global by conducting research in either case.

We also looked at other options for growth opportunities. First we discussed how businesses can partner in various forms of strategic alliance to share risk, leverage capabilities and open new markets while maintaining focus. One type of arrangement is a joint venture, either local or international, which offer many benefits for those looking particularly to growth opportunities. Royalties and licensing have both advantages and disadvantages. Franchising is an increasingly popular way of expanding market reach. Mergers and acquisitions were discussed for companies seeking to develop greater economies of scale or to acquire new capabilities. Lastly we introduced the concept of ethnic networks as a growth option.

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Review key terms with interactive flashcards.

KEY TERMS & CONCEPTS

adaptive business
barriers to entry
Blue Ocean Strategy
born global
diaspora entrepreneurs
direct exporting
dynamic capabilities
effectual logic
entrepreneurial strategy
exporting
franchising
global sourcing
growth rate
growth stage
growth wall
importing
incrementalist approach
indirect exporting
joint venture
licensing
life cycle stages
mergers and acquisitions (M&A)
mission
moral failure
new-venture development
operational capabilities
personal failure
product life cycle (PLC)
royalty
stabilisation stage
start-up activities
strategic alliance
strategic intent
strategic planning
strategic position
SWOT analysis
uncontrollable failure
value innovation

REVIEW & DISCUSSION QUESTIONS

1. In what way does an entrepreneur's vision affect the company's strategic plan?
2. Describe the entrepreneurial strategy process. What are the four major elements of the process and what does each entail?
3. Give three reasons why many entrepreneurs fail to formulate strategic plans.
4. Explain the five fatal flaws of strategic planning for an entrepreneur and outline how an entrepreneur can avoid these.
5. Briefly identify and describe the stages of development for a new venture.
6. What strategic approach can a new business take to avoid having to confront powerful competitors? Explain the two key insights needed to adopt this approach.
7. How can an entrepreneur build an adaptive business?
8. Define a business model and describe the three perspectives that are embedded in its definition. What are the elements of the business model that drive each of these perspectives and what is central to all the elements?
9. Comparing the entrepreneurial focus with the administrative focus involves five major areas of consideration. What are these areas?
10. Identify and describe the four key factors that need to be considered during the growth stage.
11. What is meant by managing paradox and contradiction?
12. Identify five unique managerial concerns of growing businesses.
13. What is a 'born-global' business? Name three born-global companies that you know.
14. What are the main motivations for going global?
15. How can an entrepreneur become aware of import opportunities?
16. How does a joint venture work? What are the advantages of this arrangement? What are the disadvantages?
17. Do you feel part of an ethnic network? If so, how would you maximise it for entrepreneurial advantage? What are the top ethnic entrepreneurial networks in your community?
18. Name three global entrepreneurship research topics that you would like to undertake.

EXPERIENCING ENTREPRENEURSHIP

The TOWS matrix

Directions: Using the concept of the SWOT analysis presented in this chapter, the TOWS Matrix allows an analysis of a new venture based on its combined Strengths, Weaknesses, Opportunities and Threats.

Find a new start-up venture and work with the CEO to establish the following combinations: Strengths in light of Opportunities; Strengths in light of Threats; Weaknesses in light of Opportunities; and Weaknesses in light of Threats. This combination of the SWOT Matrix will help you to understand that a company's tactics should be based on its own recognised strengths and weaknesses within the framework of the external environment.

TOWS MATRIX		
	Strengths – S	*Weaknesses – W*
Opportunities – O	SO Strategies	WO Strategies
Threats – T	ST Strategies	WT Strategies

EXPERIENCING ENTREPRENEURSHIP

The venture life cycle

Listed below are the five basic phases or stages of the typical life cycle of a venture, labelled (A) to (E). Rank these from 1 to 5, beginning with the first phase and continuing to the last. Then examine the list of activities (a) to (j) and place a 1 next to those that happen during the first phase of the venture, down to a 5 next to those that occur during the last phase. Answers are provided at the end of the chapter.

A Growth
B Innovation or decline
C Start-up
D Stabilisation
E New-venture development

- a Transition from one-person leadership to team management leadership
- b New product development
- c Search for capital
- d Increased competition
- e Venture assessment
- f Attempts to acquire other businesses
- g Consumer indifference to the entrepreneur's goods or services
- h Accumulation of resources
- i Major changes in entrepreneurial strategy
- j Development of an effective entrepreneurial team

EXPERIENCING ENTREPRENEURSHIP

Market selection matrix

This is useful for making comparisons between global opportunities and allows you to weight questions according to importance for your product/service. The following is a fictitious example of the questions a company might ask at the first stage of the market selection process.

In the first part of the exercise, the product we are seeking to export is a hair removal cream. We have started by assessing some very basic, but relevant, factors affecting its export potential in five broad regions. The weightings show which questions are the most important in terms of market selection for our product. A weighting of 10 means the issue is twice as important as one with a weighting of 5. The table currently has 38 points total score, but you can change the weightings if you wish and use any total you want. The key here is in the selection of the questions and the relative weightings. Do you agree with the scores given to North America? Continue with the other regions. Which region has the highest export potential?

	PROPORTION FEMALE POPULATION	PER CAPITA GDP	SOPHISTICATION OF RETAIL ENVIRONMENT	LACK OF TRADE BARRIERS	POSITIVE CULTURAL ATTITUDE TO HAIR REMOVAL	TOTAL POTENTIAL FOR EXPORT MARKET
Weighting	5	10	3	10	10	38
North America	4	10	3	6	8	31
Asia	5		2			
South America	3		2			
Europe	4		3			
Australia	3		3			

Now pick another export product and fill in all the blanks.

	FACTOR 1	FACTOR 2	FACTOR 3	FACTOR 4	FACTOR 5	TOTAL
Weighting						
Country/region 1						
Country/region 2						
Country/region 3						
Country/region 4						
Country/region 5						

CASE STUDIES

CASE 9.1

KEEPING THINGS GOING

Because of a surge in outsourcing contracts coming in from the US, the Wadhwani Company of Hyderabad has grown 115 per cent in the past year and 600-plus per cent in the past three years. A large portion of this growth is attributable to Sharma Subramonia's philosophy of hiring the best possible computer systems and people, and giving people the freedom they need to do their jobs.

Most of Sharma's personnel operate as part of work teams that analyse, design and implement computer systems for clients. First, the company will get a call from a potential client indicating that it needs to have a computer system installed or special software written for its operations. Sharma will send over one of his people to talk to the client and analyse the situation. If it turns out that the Wadhwani Company has the expertise and personnel to handle the job, the client will be quoted a price. If this price is acceptable, a Wadhwani work group will be assigned the project.

An example of a typical project is the manufacturing client who called three weeks ago and wanted to purchase five personal computers for his business' engineering staff. The company wanted these machines to be hooked up to the main computer and to have a dedicated connection to their Houston, Texas office. Additionally, the business wanted its computer-aided design software to be modified so the engineers could see their computer-generated drawings in a variety of colours, not just in monochrome. The Wadhwani group installed the entire system and modified the software in 10 working days.

Sharma realises that the growth of his enterprise will be determined by two factors. One is the creativity and ingenuity of his workforce. The other is the ability to attract talented personnel. 'This business is heavily labour intensive', he explains. 'If someone wants a computer system installation, that may take 100 labour hours. If I don't have the people to handle the project, I have to turn it down. My expansion is heavily dependent on hiring and training talented people. Additionally, I need more than just hard workers. I need creative people who can figure out new approaches to handling complex problems. If I can do these two things, I can stay a jump ahead of the competition. Otherwise, I won't be able to survive.'

In dealing with these key factors for success, Sharma has implemented three initiatives. First, he has instituted a bonus system tied to sales; these bonuses are shared by all of the personnel. Second, he gives quarterly salary increases, with the greatest percentages going to employees who are most active in developing new programs and procedures for handling client problems. Third, every six months the entire staff goes for a long weekend to a mountain area where they spend three days discussing work-related problems and ways of dealing with them. Time is also devoted to social events and to working on developing an esprit de corps among the personnel.

QUESTIONS

1. In what phase of the venture life cycle is Sharma's business currently operating?
2. How are Sharma's actions helping to build an adaptive business? Give three specific examples.
3. If Sharma's business continues to grow, what recommendations would you make for future action? What else should Sharma be thinking about doing in order to keep things moving smoothly?
4. Do you have ideas about how Sharma could acquire more of the US outsourcing business?

CASE 9.2

A FOREIGN PROPOSAL

Edgar Bruning left his job at a major computer manufacturing company and started his own business, naming it Bruning Computer. Since then Edgar has secured five patents for computer-related equipment. His latest is a computer chip that can increase the speed of most personal computers by 35 per cent. The cost of one of these computer chips is only $8 and the unit wholesales for $135. As a result, Bruning's profits have mushroomed.

Realising that everything he had developed could be copied by foreign competitors, Edgar entered into contractual arrangements with one company in Korea, one in Singapore and another in Dubai to market his product. Bruning ships 50 per cent of its production output to these three companies, while the rest is directly sold to companies in Australia and New Zealand. Edgar has recently been thinking about increasing his production facilities. He is certain he could sell 40 per cent more chips if he were able to make them.

Last week Edgar had a visit from the chief executive of a Chinese company. The company has proposed a joint venture between itself and Bruning. The venture would work this way: Bruning would ship the company as many chips as are currently sent to the three other companies. These chips would be paid for on a 90-day basis. The Chinese company would act as Bruning's Asia sales representative during this part of the agreement. Then, within 90 days, the Chinese company would purchase manufacturing equipment that would allow it to make the chips in China. 'This will save us both labour and shipping costs', the Chinese executive pointed out. 'And all profits will be divided on a 50/50 basis. Your only expenses will be your share of the manufacturing equipment and we will apply your profits against those expenses. So you will have no out-of-pocket expenses.'

The idea sounds very profitable to Edgar, but he is not sure he wants to give someone else the right to produce his product. 'Technological secrecy is important in this business. It's the key to success', he noted to a colleague. On the other hand, Edgar realises that without having someone to sell his product in Asia, he is giving up a large potential market. Over the next 10 days Edgar intends to make a decision about what to do.

QUESTIONS

1 What type of arrangement is Edgar using in his business dealings with the businesses in Australia, Singapore and Dubai? Be complete in your answer.
2 Is the Chinese business proposal a joint venture? Why or why not? Would you recommend that Edgar accept it? Why or why not?
3 What concerns should Edgar have with regard to legal challenges he might face (see Chapter 10)?
4 If Edgar were looking for an alternative approach to doing business with the Chinese, what would you suggest? Defend your answer.

ANSWERS TO 'THE VENTURE LIFE CYCLE'

a	3	d	4	g	4	j	2
b	5	e	1	h	1		
c	2	f	5	i	3		

ONLINE STUDY RESOURCES

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CHAPTER 10

LEGAL AND REGULATORY CHALLENGES

A major difficulty for the inexperienced entrepreneur is the host of strange terms and phrases which are scattered throughout most legal documents. The novice in this kind of reading should have some understanding not only of what is contained in such documents, but also why these provisions have been included. If an entrepreneur cannot find the time or take the interest to read and understand the major contracts into which his company will enter, he should be very cautious about being an entrepreneur at all.

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CHAPTER OBJECTIVES

1. To introduce the importance of legal and regulatory issues to entrepreneurs and recognise the important international protection regimes for intellectual property
2. To consider the regulatory environments within which a new venture must operate
3. To examine intellectual property protection, including patents, copyright, trademarks, domain names and trade secrets
4. To compare the common legal forms of business organisation in the Asia-Pacific, such as incorporation, sole proprietorship, partnership and other legal structures
5. To be aware of the signals that foreshadow insolvency and bankruptcy

LEGAL AND REGULATORY CHALLENGES

This chapter has a broad remit in considering the four types of legal and regulatory challenges that entrepreneurs will face in the Asia-Pacific region. We begin by examining one of the most critical aspects for entrepreneurs – how to protect your **intellectual property** (IP) – but not before considering why and when IP protection becomes important. Another key legal decision that has strategic and financial implications for the entrepreneur is the legal form under which to incorporate the business. In typical legalistic style, we do need to note that the Asia-Pacific region includes many different countries and the scope of this text is limited to general knowledge that cannot be construed as advice. For specific information on legal matters particular to a country and your venture, always seek the advice of appropriately qualified professionals knowledgeable about the jurisdiction of your operations.

intellectual property (IP)
The proprietary knowledge created through mind and intellect that is a valuable asset to the business.

Before rushing headlong into the topic of **intellectual property rights (IPR)** it is worth taking a cold-hard reality check on when and where IP fits into your new venturing strategy. First, you must be aware that not all ideas may be protectable. Things like a new approach to online sales, a new method of teaching, a new recipe or a new 'app' or game may be multi-million dollar ideas, but the ideas themselves may not be protectable.[1] Don't be disheartened; there may be other forms of IPR protection but just not the form you may imagine immediately for the idea. For instance, it may be that the brand or copyright are more appropriate strategies for protection, so read on. While there are a range of IPR protection options, the cost of protection versus the benefit, the obviousness of the idea (you would be surprised at how often your authors have heard the same 'brand new' idea) and your ability to defend your IPR all need to be taken into account. Taking a few basic preliminary steps can be helpful in sorting through what type of protection – if any – would be most suitable, and when.

intellectual property rights (IPR)
Legal protection of intellectual property, such as patents, trademarks or copyrights, against infringement by others.

First of all, do some basic searches. Use Google, Bing, Yahoo or preferably all three to see whether your idea or something close to your idea is already in the market. Try different search terms and be thorough. Once you are clear and satisfied about what else is out there, you will be in a better position to consider the right form of protection. That's where this chapter will come in handy. But wait, there are still a couple of things to consider before moving on.

A common mistake is to be so absorbed with the idea that the other critical piece of information – whether there are potential customers and whether that market of customers is large enough and sufficiently accessible – can easily be overlooked. Certain forms of protection can be highly expensive (think patents) and if there is no real market for the idea or the time to recoup the cost will be far too long, then there is no point in seeking protection. A golden rule is to do your homework – that's what the early parts of this book were about – and if you have no market intelligence or plan then you are likely not ready for a decision on IPR. A cautionary note, however: in some cases you do need to be careful about disclosure of your ideas, particularly with patents. Do your homework but be guarded about what you tell whom and how you protect your ideas (see the discussion on non-disclosure later in this chapter).

A third consideration, beyond the cost of the protection, is to consider your own position to exploit the IP. IPR protection can be costly and time consuming so be sure you are ready to take the plunge before making the effort. For instance, developing a prototype is an important step to undertake before patenting, as changes in material or tweaks to design can be difficult after patenting. Are you in a position to undertake this? What about access to markets, gearing up for volume production, facing a customer and asking for the sale or simply the exposure to risk? Are these thoughts making you feel uncomfortable or are they beyond your reach? If so, you may consider **open innovation** approaches.[2] With open innovation you work with others to see your idea come to fruition. You may partner with

open innovation
Innovation that turns to sources of ideas and support outside of an organisation, openly sharing the trials and rewards of innovation, as opposed to approaches that seek to protect, own and keep ideas and commercial development within an organisation.

another to assist in covering and defraying the research and development costs, and become an equity partner or agree to exclusive rights to the finished product that you can then market. Alternatively, you could become an exclusive supplier to your partner, thereby leveraging your own expertise and growing the business through the growth in end-product sales that you have helped to create. Of course, these approaches do not come without some risk, and therefore you need to know your legal rights. But if your idea and the protection you invest in sits on the shelf because of your own lack of abilities or funds, then the risks associated with open innovation may be offset by avoiding a substantial waste of time and money. In short, know your capabilities, limitations and strengths to exploit your ideas.

One last thing to consider is that the complexity of IPR means that it is a specialist topic. Know as much as you can, and then use IP legal businesses to support and advise on the decisions and choices proposed. Take an approach whereby your IP lawyer becomes part of the team. The better they know you, your circumstances and your objectives, the better they can assist you. As with all specialist topics, be it finance and tax, marketing and advertising or the law, the entrepreneur should be informed well enough to know what questions to ask and be able to recognise good advice.

Armed with a realistic view of novelty, market and exploitation plans, and with a legal adviser on your side, it is timely to get to know the IPR protection options.

ENTREPRENEURSHIP IN PRACTICE

PLAN YOUR ENTRY AND GROWTH STRATEGY – PLACES TO LOOK FOR OPEN INNOVATION SUPPORT

YBF

This Melbourne-based company partners with some of the world's most innovative corporations and links them with nascent technology startups. YBF's open innovation hub bridges the gap between start-ups, corporates and academic institutions by providing a hub where these organisations can drive real outcomes and foster new culture. Some of their partners include Clique, Aon, Dentsu Aegis, EY, Mirvac and ANZ. Part of YBF's corporate partner work includes encouraging intrapreneurialism, increasing internal capacity to innovate and creating new and disruptive joint ventures.

Source: http://yorkbutterfactory.com/.

Cisco Innovation Centres

Cisco's centres around the world inspire and catalyse digital innovation and development. Cisco leverages its ecosystem of partners and takes an accelerated approach to digital transformation to help organisations improve business outcomes by integrating, creating, testing and validating technology solutions. One of a network of innovation centres worldwide, the Cisco Innovation Centre Australia is the culmination of Cisco's commitments to drive innovation and countrywide digitisation.

Source: https://www.cisco.com/c/m/en_au/innovationcenter/australia-test.html.

PwC's Open Innovation Platform

This platform connects large corporations, government, researchers and start-ups at scale, around market opportunities. The platform builds on the success of PwC Australia's Open Innovation approach and Student Design Jams. PwC has engaged hundreds of start-ups and science, technology, engineering and maths (STEM) entrepreneurial groups in more than 30 corporate and government challenges. Through this experience PwC has built a strong community of innovators, and developed replicable methods and tools that clients can learn through use of the platform.

Source: https://openinnovation.com.au/innovation/about.

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CORE

CORE is Australia's first co-working, collaboration and innovation hub focused on the resources industry. Located in Perth, Western Australia, CORE is a common point for operators, suppliers, researchers, entrepreneurs and start-ups to connect and collaborate on innovative challenges across the oil, gas and mining, and mining equipment, technology and services (METS) sectors. CORE brings together industry partners to provide an environment for leadership in leveraging digital technologies to address industry's challenges today, and strengthen Australia as a global resources technology innovation hub. The innovation hub provides proximity to skills, solutions and opportunities along the supply chain, and a culture of entrepreneurship, open innovation, trust, collaboration and speed.

Source: http://www.corehub.com.au/about/.

Microsoft Innovation Centres (MICs)

MICs are local hubs that provide resources and support for students and entrepreneurs, helping to accelerate the creation of new companies and jobs and the growth of the local ecosystem. In over 100 locations worldwide, including Brisbane and Adelaide in Australia, Microsoft Innovation Centres embody collaboration with local government, universities and industry partners. Microsoft Innovation Centres exist to create real opportunities for entrepreneurs and start-ups, including IT skills development, ensuring that the vitality of the local ecosystem can successfully empower job creators and enable job seekers.

Source: https://www.microsoftinnovationcenters.com/aboutus.

INTERNATIONAL PROTECTIONS FOR INTELLECTUAL PROPERTY

Intellectual property protection has advanced considerably in the past 10 years. A great deal of the action is now taking place internationally (see Table 10.1). The field of IP protection is huge, but globally operating entrepreneurs need to know at least about the following:

- The World Trade Organization (WTO) is a place where member governments sort out trade problems and negotiate compliance with WTO agreements signed by the bulk of the world's trading nations.
- The WTO's agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPs) is especially important. It is an international agreement covering copyright, patents, trademarks, trade secrets, industrial designs and integrated circuit layouts. TRIPs is the most important international agreement on copyright, patents and other intellectual property rules in force today.
- The Berne Convention for the Protection of Literary and Artistic Works is one of the world's oldest treaties and is highly respected by countries around the world. This treaty, together with the Paris Convention, which provides equal treatment for foreigners and recognition of earlier filing date for IPRs in Convention countries under certain conditions, seeks to guarantee that copyrights are respected across national borders.
- The World Intellectual Property Organization (WIPO) is an international organisation that administers 23 international treaties dealing with different aspects of intellectual property protection. The organisation counts 182 nations as member states.
- The Patent Cooperation Treaty (PCT) streamlines patent applications across many countries by providing a single international application procedure that precedes the filing of individual applications in each country of interest.

The Paris Convention for the Protection of Industrial Property is a core convention that (among other aspects) provides for the priority date (first filing date) of an IP right filed in a country party to the Paris Convention to be recognised and effective in another country party to the Convention, provided that the IP right is filed in the other country within a set period of time. For patents, this period is 12 months. For designs and trademarks, the period is 6 months.

TABLE 10.1 ASIA-PACIFIC COUNTRIES' PARTICIPATION IN MAJOR IP REGIMES

	WTO	TRIPS	BERNE	WIPO	PCT	RESPONSIBLE AUTHORITY
Australia	✓	✓	✓	✓	✓	IP Australia: http://www.ipaustralia.gov.au
Bangladesh	✓	✓	✓	✓	✓	The Department of Patents, Designs and Trademarks (DPDT): http://www.dpdt.gov.bd
Brunei Darussalam	✓	✓	✓	✓		Brunei Intellectual Property Office: http://www.bruipo.gov.bn
China	✓	✓	✓	✓	✓	State Intellectual Property Office of the People's Republic of China: http://www.sipo.gov.cn State Administration for Industry and Commerce Trademark Office: http://sbj.saic.gov.cn
Fiji	✓	✓	✓	✓		Fiji Government online portal: http://www.fiji.gov.fj
Hong Kong	✓	✓				Intellectual Property Department of Hong Kong: http://www.ipd.gov.hk/eng/home.htm
India	✓	✓	✓	✓	✓	Intellectual Property India: http://www.ipindia.nic.in/
Indonesia	✓	✓	✓	✓	✓	Directorate General of Intellectual Property Rights: http://www.dgip.go.id
Japan	✓	✓	✓	✓	✓	Japan Patent Office (JPO): http://www.jpo.go.jp
Korea Republic	✓	✓	✓		✓	Korean Intellectual Property Office (KIPO): http://www.kipo.go.kr
Malaysia	✓	✓	✓	✓	✓	Perbadanan Harta Intelek Malaysia: http://www.myipo.gov.my/
New Zealand	✓	✓	✓	✓	✓	Intellectual Property Office of New Zealand: http://www.iponz.govt.nz
Pakistan	✓	✓	✓	✓		Intellectual Property Organisation Pakistan: http://ipo.gov.pk
Papua New Guinea	✓	✓		✓	✓	Intellectual Property Office of PNG: http://www.ipa.gov.pg
Philippines	✓	✓	✓	✓	✓	IP Philippines: http://ipophil.gov.ph
Singapore	✓	✓	✓	✓	✓	Intellectual Property Office of Singapore (IPOS): http://www.ipos.gov.sg
Sri Lanka	✓	✓	✓	✓	✓	National Intellectual Property Office of Sri Lanka: http://www.nipo.lk
Taiwan	✓	✓				The Taiwan Intellectual Property Office: https://www.tipo.gov.tw/mp.asp?mp¼2
Thailand	✓	✓	✓	✓	✓	Department of Intellectual Property of Thailand: http://www.ipthailand.org
Vietnam	✓	✓	✓	✓	✓	National Office of Industrial Property (NOIP): http://www.noipvietnam.com

Table 10.2 provides links to useful IP information sources relevant to some different countries.

TABLE 10.2 INTELLECTUAL PROPERTY INFORMATION SOURCES

New Zealand's Ministry of Business, Innovation and Employment has produced information on various aspects of law, policy and regulations, including the forms of intellectual property in New Zealand	http://www.mbie.govt.nz/
IP Australia is the federal government agency responsible for granting rights in patents, trademarks and designs in Australia	http://www.ipaustralia.gov.au
The United States Patent and Trademark Office website provides a wealth of valuable information for entrepreneurs. Go Trademarks > Trademark Electronic Search System (TESS). Users can locate patent and trademark information, such as registration forms, international patents, legal issues and FAQs. Users can also check the status of a trademark or patent application on this website.	http://www.uspto.gov
Patents.com provides the most comprehensive source of worldwide patent data.	http://www.patents.com
The Center for Global Innovation/Patent Metrics website, sponsored by Source, offers information and support.	http://www.bustpatents.com
The United States Copyright Office at the Library of Congress website provides information on copyright, licensing and legal issues.	http://www.loc.gov/copyright
The FindLaw website allows the user to look up any topic in a search and yield returns of the actual written law, court precedents and current cases and interpretations. FindLaw also gives topical searches that aid the user in getting started, as well as a business section to help put the laws into more practical applications.	http://www.findlaw.com
Espacenet is a European search database covering more than 70 million patents from around the world.	http://worldwide.espacenet.com

UNDERSTANDING ASIA-PACIFIC REGULATORY ENVIRONMENTS

It is worthwhile to consider the diversity of regulatory environments in our region and how they may influence your own ventures. Why do some entrepreneurs succeed while others fail in international competition? Perhaps it is better to turn the question around and ask: Why is it that a particular economy becomes the home base for a particular competitive, globally oriented entrepreneur? What makes Australia a global leader in wine exports? What made Malaysia a world leader in palm oil production? How did New Zealand make it to global ranks in the creative industries? What propelled South Korea to the forefront of electronics? Why is it all about location, location, location? One powerful factor is the regulatory environment.

Each year the World Bank analyses specific points of interest of great value to entrepreneurs, such as the time, cost and outcomes of bankruptcy proceedings against a limited liability company; the predictability and reliability of **property laws** and **labour regulations**; and many others. These figures can change each year, so don't be surprised if one or another country dramatically improves or declines. The World Bank's continual attention does have an effect as countries jostle for comparative advantage in the location game.

property laws The laws passed by governments that govern the ownership and rights of various forms of tangible and intangible property.

labour regulations The body of laws passed by a government that regulates the legal rights and restrictions that apply to employees, workers and organisations.

The regulatory environment in the Asia-Pacific is one of extremes, with some countries being among the best in the world while others leave much to be desired; however, the good news is that, generally,

environmental protection The practice by individuals, organisations and/or governments of protecting the natural environment from harm and preserving it for the benefit of current and future human generations.

business formation The act and procedures of starting a business.

investor protection Guarantee that investments made will not be lost due to misuse of corporate assets by directors for their personal gain, fraud, self-dealing, expropriation, etc.

doing business in our region is getting better – sometimes much better. Working in global markets means that you will have to comply not only with your own rules and regulations, but also with those of other countries. Unfortunately, business success can be affected as much by a government directive as by a management decision. Your fundamental entrepreneurial decisions – such as which lines of business to go into, which products and services to produce, which investments to finance, how and where to make goods, how to market, what prices to charge and **environmental protection** – are increasingly subject to governmental regulations beyond your control.[3]

The most important regulatory areas that influence entrepreneurs are bankruptcy laws, **business formation**, contract enforcement, credit regulations, international trading regulations, **investor protection**, labour regulations, licensing and permits, and property laws. Beyond this it is sometimes bewildering what else you have to take into account, including dispute settlement and arbitration, customs and tariffs, standards setting, research and development (R&D) and innovation policy, anti-trust legislation, personnel and human resources, finance and taxation, securities and banking, trade and securities commissions, food and drug regulations, consumer products and protection regimes, transportation and communications, defence and security, occupational health and safety, environmental protection, energy regulation, export-import transactions, and foreign relations and defence – the mind boggles! The good news is that expertise is available in all these areas, but this does not minimise your own responsibility for being knowledgeable about how your business affects, and is affected by, relevant and related laws.

Overall, some countries in our region are leaders in the global 'ease of doing business' sweepstakes. According to the World Bank, the Asia-Pacific region is represented by New Zealand, Singapore, the Republic of Korea and Hong Kong in the top five, with the US coming in at sixth and Australia slipping to fourteenth. Taiwan, Malaysia and Thailand fall in the top 30, with Japan slipping out of this group to come in at thirty-fourth of the 264 countries included in the study. At the other end of the scale are India, Fiji, Papua New Guinea, Sri Lanka, the Philippines, Solomon Islands and Pakistan, which fall in the 100–150 range (see Table 10.3).[4]

TABLE 10.3 EASE OF DOING BUSINESS, 2017

ECONOMY	EASE OF DOING BUSINESS RANK	ECONOMY	EASE OF DOING BUSINESS RANK
New Zealand	1	Indonesia	72
Singapore	2	China	78
Korea, Rep.	4	Samoa	87
Hong Kong	5	Tonga	89
United States	6	India	100
Australia	14	Fiji	101
Taiwan	15	Papua New Guinea	109
Malaysia	24	Sri Lanka	111
Thailand	26	Philippines	113
Japan	34	Solomon Islands	116
Vietnam	68	Pakistan	147

Source: World Bank (2017). *Ease of doing business.* https://data.worldbank.org/indicator/IC.BUS.EASE.XQ?end=2017&name_desc=false&start=2017&view=map. CC BY 3.0 IGO. https://creativecommons.org/licenses/by/3.0/igo/.

Of course, being at the top of this list of 'best countries to do business in' does not mean there is no regulation. No one would argue that it is a free-for-all in New Zealand, that workers are not at risk of abuse in Australia or that there is no need for fair bankruptcy processes in Korea. Indeed, to make the top rankings in terms of ease of doing business, countries need to put strong regulations in place, such as property rights protection and labour provisions. The problem is that some countries in our region make it excessively difficult for entrepreneurs to operate. Sadly, the countries with the biggest obstacles for entrepreneurs are the ones that most need them for creating jobs and wealth.

What does this mean for the entrepreneur? While different countries and even cities may have the same regulatory hurdles and cost structures for such things as starting a business, securing construction permits or getting your electricity connected, it may take longer, causing you delays in opening your doors and adding a time cost. This is something to keep in mind when you have the opportunity to choose the location for your new business.[5]

INTELLECTUAL PROPERTY PROTECTION

Ideas and knowledge are an important business asset and part of global trade. Some would say that in the modern era, intellectual property is the engine that drives the economy. A lot of the value of entrepreneurial products lies in the invention, innovation, research, design and commercialisation of new products – most often abroad. So it is vital that entrepreneurs have the incentive to create – and intellectual property rights are central to that, because a rising proportion of economic output is conceptual rather than physical.

Intellectual property protection is actually a two-way street. Entrepreneurs can legally obtain and exploit intellectual property from abroad. Or they can protect it abroad, stop others from using it and use these rights to negotiate payment in return for using it. The countries of the Asia-Pacific are actually net importers of intellectual property. That means that many of the creators and inventors of intellectual property consumed in the Asia-Pacific are actually located in other nations. It also means that Asia-Pacific entrepreneurs will just as frequently take advantage of licensing intellectual property from abroad as they will protecting it.

Of course, most entrepreneurs are not lawyers, so they need to be knowledgeable about intellectual property protection. The term 'intellectual property' is used to describe the intellectual assets that may attract rights. Some of these intellectual assets can be given some form of legal protection in order to prevent unauthorised use by others. The rights afforded these assets fall under the umbrella of intellectual property rights and include **patents**, **trade secrets** and **copyright**, as well as **trademarks** or service marks.

patent
An intellectual property right granted to an inventor giving him or her exclusive right to make, use or sell an invention for a limited time period (usually 20 years).

trade secrets
Customer lists, plans, research and development, pricing information, marketing techniques and production techniques. Generally, anything kept secret that makes an individual company unique and has value to a competitor.

copyright
A legal protection that provides exclusive rights to creative individuals for the protection of their literary or artistic productions.

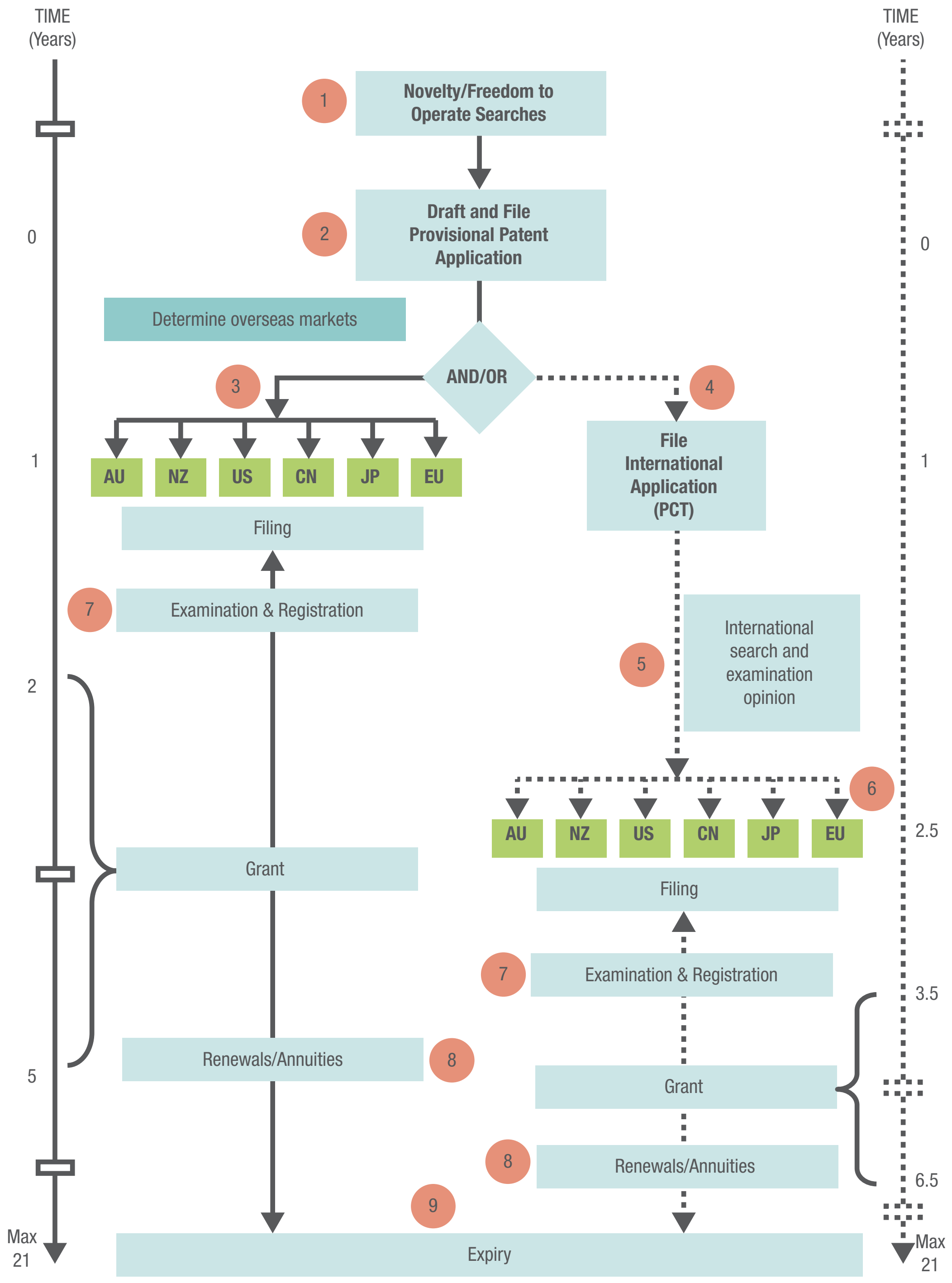
trademark
A distinctive name, mark, symbol or motto identified with a company's product(s).

PATENTS

One might say that a patent is a contract between society as a whole and an individual inventor. The objective of a patent is to provide the holder with a temporary monopoly on their invention and therefore to encourage the creation and disclosure of new ideas and innovations in the marketplace. A patent provides the owner with exclusive rights to hold, transfer and licence the production and sale of the product or process. But, it is not a permissive right, meaning that owning a granted patent does not guarantee that your patented invention doesn't infringe an earlier patent owned by another party.

Figure 10.1 illustrates a general patent process only. Many other variations are possible and the appropriate strategy should always be developed for the specific circumstances of the matter and reviewed on a regular basis to ensure that it remains relevant. Refer to notes 1–9 in the accompanying 'Entrepreneurship in practice' feature.

FIGURE 10.1
A GENERAL PATENT PROCESS



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ENTREPRENEURSHIP IN PRACTICE

A GENERAL PATENT PROCESS: NOTES

1. Conduct patent searches to determine the likelihood of obtaining patent protection for the invention and likely scope of protection. Remember that one of the requirements of obtaining valid patent protection is that the invention is new and inventive over the 'prior art'. Consider also conducting 'Freedom to Operate' searches to determine potential risks of infringing another party's patent rights. Keep in mind that searching is not a guarantee. There are millions of documents to search and relevant documents may not be located for many reasons. Furthermore, since patent applications are generally not published for 18 months from filing, searches will generally not locate any patent applications filed in the past 18 months.
2. Draft and file a patent application. A common form of first patent filing is a provisional patent application. The filing of the first patent application creates the 'priority date' for the patent application. The priority date is very important, as it forms the basis for future deadlines and is the date against which 'prior art' is assessed.
3. At 12 months from the priority date, if protection is still to be sought, it is possible to file one or more complete applications for a patent in one or more countries. (The countries indicated are examples only.) This must generally be done within 12 months of the earliest priority date. Corresponding patent applications are filed directly into each country of interest. The patent application then undergoes examination under the patent laws of that country by the relevant patent office (see note 7). Substantial costs may be incurred in the filing process depending upon the number of countries filed in and in which countries.
4. Alternatively, or in addition, an international patent application may be filed under the Patent Cooperation Treaty (PCT). This is not an 'international patent', but rather a system under which a single patent application can be filed that reserves the applicant's rights for up to 18* months to file in one or more countries that are members^ of the PCT. This effectively extends the 12-month period to 30* months before having to file individual patent applications in each country of interest, as per note 3, and incurring the potentially significant costs.
5. During the extended 18 months, an International Search and a Preliminary Opinion is provided, which is a non-binding indication as to the likelihood of obtaining patent protection for the invention claimed in the PCT application. This can be a useful tool in deciding whether to proceed to seek patent protection in the countries of interest.
6. National phase – at the 30-month* deadline, individual complete patent applications must be filed in each country of interest. Failure to do so by this deadline can result in the abandonment of patent rights in the relevant countries. This step is equivalent to that indicated in note 3 above, and from this point onwards, the patent application proceeds as if it were filed directly in the country of interest (countries indicated are examples only) and undergoes examination under the laws of the relevant country by the relevant patent office. Substantial costs may be incurred in the filing process depending upon the number of countries filed in and in which countries, and whether language translations are required.
7. Each country's patent office will examine the patent application under the patent laws of that country, including conducting patentability searches and issuing objections (in an 'Examination Report' or 'Office Action') to the patent application. In most countries, the applicant will have at least one opportunity to respond to the objections raised, by submitting arguments and/or amending the claims where possible. The examination process, including permissibility of amendments and timelines, will differ from country to country. This stage can also incur significant costs. If all objections are overcome by the relevant deadlines, the patent application will be granted in that country. The patent then becomes enforceable against infringers.
8. To keep a patent or patent application alive, maintenance fees, referred to as renewal fees or annuities, must be paid to the relevant patent offices. In some countries these fees are payable annually for the life of the patent, and in some countries they are payable every few years. The amount payable is dependent upon the country. Failure to pay the fee by the due date can lead to irrevocable lapsing of the patent and loss of rights in the invention. In some countries, maintenance fees (renewals/annuities) are payable even before the patent is granted.
9. A patent only has a limited lifespan, after which the patent expires. Provided that all relevant maintenance fees are paid, and in the absence of the patent being revoked for other reasons, a patent can reach its full term before expiring. The full term of most patents is 20 years from the filing date of the complete patent application. Some patents relating to pharmaceuticals may be able to be extended by up to another 5 years. Some countries also have other types of patent systems such as 'utility model patents' or 'innovation patents', which have shorter maximum terms, such as 8 years or 10 years. After its maximum term, a patent cannot be renewed and the invention becomes freely available for use to society.

*Some countries allow 31 months, 32 months or in some cases longer under certain circumstances.

^At the time of writing, there are 152 member countries, which include most of the main commerce countries. A notable exception is Taiwan. If Taiwan is a country of interest, a patent application must be filed directly in Taiwan by the 12-month deadline, as it is not available via the PCT route.

Source: Madderns Patent & Trade Mark Attorneys – Australia. Copyright Madderns Patent & Trade Mark Attorneys. Used by permission.

The WTO's TRIPs agreement provides, albeit with some exceptions, that the international standard for duration of patent exclusivity is 20 years from the date of filing. In some jurisdictions there are alternative patent systems (called 'second-tier') which have shorter patent terms. Under *all patent systems*, once the term of the patent period has expired, people are free to use the invention as they wish. However, pharmaceutical patents provide an exception to this rule in most countries, where the patent term may be extended by up to 5 years, to a total of 25 years, to compensate for the time taken to obtain regulatory approval before the patent owner is able to exploit the invention.

Although all WTO members are subject to patent provisions in the TRIPs agreement, patents are actually granted under national laws and so the rights are also national in scope. For example, an Australian patent can be enforced only against infringements in Australia. While the PCT system provides for a single international filing procedure, the system ultimately still requires the applicant to select their countries of interest, file in those countries and undergo the examination procedures in those countries – independently of each other. One of the several benefits of the PCT system is that it essentially provides a buffer of up to 30 months (from the earliest priority date) during the 'international phase' before the applicant has to file in individual countries (the 'national phase'). Figure 10.1, with the associated 'Entrepreneurship in practice' box, gives an indication of the timing of these phases.

Patents are provided for products or processes that are 'new, involve an inventive step and are capable of industrial application'.[6] A patent is the result of a unique invention and patent holders are provided protection against infringement by others. In general, machines, products, plants, compositions of elements (chemical compounds) and improvements on already existing items can qualify for patent protection.[7]

In some countries a 'second-tier' patent system allows protection for inventions with a lower threshold of inventiveness than that required for the 'usual' patent. Countries that currently provide this second-tier patent system include Australia (the Australian Innovation Patent with a maximum term of eight years – but note that at the time of writing, upon the recommendation of the Productivity Commission Inquiry Report on Intellectual Property Arrangements, this system is subject to potential phase out pending further consultation by IP Australia[8]), China and Japan (the Chinese and Japanese Utility Model Patents with a maximum term of 10 years), and some European countries.

To patent an invention, it must not only be 'inventive' but it must also not be publicly disclosed and therefore be legitimately 'invented' by the patent applicant prior to filing. This means that openly sharing your ideas with others can invalidate a patent and therefore it is recommended practice to safeguard any discussions involving the invention with a **non-disclosure agreement** (NDA). An NDA is an agreement between parties that the information specified by the agreement will not be disclosed to others. It binds the parties to protect the information discussed and keep it confidential. Disclosure can also be deemed to have occurred if the invention is put into commercial use prior to filing (although in Australia and the US there is a 12-month grace period that may be applied to any *publication* of the invention made by the patent applicant). However, this is not the case in all countries. Furthermore, in some countries, such as Australia, there is an additional requirement that the invention not be secretly commercially used prior to filing a patent application. While this is not a 'disclosure', since any information is kept confidential (secret), it can still invalidate a later patent if the nature of the secret use is considered to be of a commercial nature, such as a confidential agreement to sell products that may be later covered by a patent.

non-disclosure agreement
An agreement between parties that the information specified by the agreement will not be disclosed to others. It binds the parties to protect the information discussed and keep it confidential.

A patent specification (the written document forming the patent) comprises two main parts – the technical description and the claims. Each part performs its own function. The technical description is there to teach the reader how to make or perform the invention covered by the patent and usually includes drawings and tables. The claims are paragraphs that define the boundary of the legal monopoly 'claimed' by the patent. Here are some examples of text from notable patents:

- Thomas Edison defined the light bulb as 'an electric lamp for giving light by incandescence consisting of a filament of carbon of high resistance … enclosed in a receiver made entirely of glass and conductors passing through the glass and from which receiver the air has been exhausted … with a carbon filament or strip coiled and connected to electric conductors so that only a portion of the surface of such conductors shall be exposed for radiating light'.
- The Wright Brothers defined the aeroplane as 'a flying-machine, a normally flat aeroplane having lateral marginal portions capable of movement to different positions above or below the normal plane of the body of the aeroplane, such movement being about an axis traverse to the line of flight, whereby said lateral marginal portions may be moved to different angles relative to the normal plane of the body of the aeroplane so as to present to the atmosphere different angles of incidence, and means for so moving said lateral marginal portions, substantially described'.
- Nikola Tesla defined the electrical motor as 'a motor wound with coils forming independent energising circuits on the armature, which is a cylinder or disk mounted to rotate between two opposite magnetic poles. As a result of this, when the generator is set in motion, [electrical] currents of alternately opposite directions are directed … in such a manner as to produce a progressive shifting or rotation of the magnetic poles of the motor armature'.

Any inventor must weigh the value of the innovation against the time and money spent to obtain the patent. It is also important to remember that patents are not a foolproof system and they can be contested, which presents a number of risks. The first risk is that they can be declared invalid.[9] This can occur if a challenger of the patent is able to show that the patented invention was not new at the time the patent application was filed (or its earliest valid priority date, whichever is earlier); that it was new, but not sufficiently inventive; or that the patent did not describe the invention in enough detail to allow the invention to be fully understood and replicated. A second risk is that the court decides that the alleged infringing product or process is in fact not an infringement of the claims of the patent. A third risk is that an alleged breach of rights may not be upheld by the court. This can occur if the patent holder is ruled to have waited an unreasonable length of time before asserting his or her rights. A fourth risk may be that those bringing suit against the patent holder may seek to prove that an individual misused the patent rights – for example, by requiring certain purchases of other goods or services as part of the patent-use arrangement – which may bring other agreements such as licences into dispute.

One author recommends that the entrepreneur should spend their money on turning investors' heads rather than on high-priced lawyers. Too much protection of intellectual property increases litigation and slows innovation, some say. It is better to stay ahead of the competition by rolling out new products faster than people can copy them.[10]

Another simpler and cheaper form of protection is known as a **design registration**. This form of protection protects only the visual appearance of an article. Importantly, it does not protect the functionality of the article in the same way that a patent does. However, design registration is an easier and less expensive option that may be adequate for some purposes.

design registration
A means to protect a product's appearance, shape and/or configuration in either two or three dimensions.

A good example of design registration in automobile counterfeiting is the case of the LandWind X7 SUV, which is an exact replica of Jaguar Land Rover's Evoque. Unlike previous fake car fiascos (China had produced perfect copies of the Toyota RAV4), Jaguar Land Rover (JLR) put in place an IP protection strategy against copycats. It protected the *appearance* of the Evoque in Europe and China through trademark and design registrations. It also secured protection for specific features of the Evoque, such as the front radiator grill, the light clusters and the bumpers. With other companies, JLR also supported the establishment of the first dedicated IP court in China in 2014 to ensure that their IP is safe on Chinese soil.[11]

ENTREPRENEURIAL EDGE

TOP AUSTRALIA-NEW ZEALAND PATENTS

AUSTRALIA	1856	Mechanical ice-making machine
AUSTRALIA	1889	Electric drill
AUSTRALIA	1952	Rotary lawn mower
AUSTRALIA	1957	Permanent-crease clothing
AUSTRALIA	1964	Inflatable escape slide and raft
AUSTRALIA	1975	Ultrasound scanner
AUSTRALIA	1979	Cochlear ear implant
AUSTRALIA	1980	Dual flush toilet
AUSTRALIA	1982	Winged keel for America's Cup yachts
AUSTRALIA	1984	Networking of gaming machines
AUSTRALIA	1987	Sleep apnoea mask
AUSTRALIA	1992	Wi-Fi technology
AUSTRALIA	1997	High-speed inkjet printer
AUSTRALIA	1999	Spray-on skin
AUSTRALIA	2008	Tank-bred tuna system
AUSTRALIA	2009	Bionic eye
NEW ZEALAND	1890	Instant coffee
NEW ZEALAND	1906	Pearse Flying Machine
NEW ZEALAND	1953	Electric fence
NEW ZEALAND	1956	Disposable Hypodermic Syringe
NEW ZEALAND	1961	Jetboard
NEW ZEALAND	1986	Bungee Jumping

Source: Antonia. "New Zealand Inventions Shaping The World As We Know It." *Days to Come* (blog), February 28, 2017. http://www.tourradar.com/days-to-come/new-zealand-inventions/; Australia, I. P. "Search for Patents Overseas." Text, May 30, 2016. https://www.ipaustralia.gov.au/patents/understanding-patents/searching-patents/search-patents-overseas; Bellis, Mary. "An A-to-Z List of Important Inventions." ThoughtCo. Accessed August 4, 2018. https://www.thoughtco.com/a-to-z-inventors-4140564; cNet. "Best Aussie Inventions of All Time." CNET. Accessed August 4, 2018. https://www.cnet.com/au/pictures/best-aussie-inventions-of-all-time/; Derby, Mike. "Inventions, Patents and Trademarks." In *Te Ara Encyclopedia of New Zealand*. Accessed August 4, 2018. /en/inventions-patents-and-trademarks; IP Australia. "AusPat Patent Search Homepage." Accessed August 4, 2018. http://pericles.ipaustralia.gov.au/ols/auspat/quickSearch.do;jsessionid=tDEFsONT2UKUeRZLaEk0la5pfl145Gll_jB-6kTAT2GED_8Z8PyC!131429764; IP Australia. "History of Australian Innovation." Text, March 29, 2016. https://www.ipaustralia.gov.au/understanding-ip/getting-started-ip/educational-materials-and-resources/history-australian-innovation; Lloyd, Mike. "Australia's Top 10 Patents and What They Tell Us about Innovation." *Financial Review*, July 2, 2015. https://www.afr.com/brand/boss/what-australias-top-10-patents-tell-us-about-innovation-20150616-ghpnfh; Ministry of Business, Innovation and Employment. "History of IP in New Zealand." Intellectual Property Office of New Zealand. Accessed August 4, 2018. https://www.iponz.govt.nz/about-iponz/history-of-ip-in-new-zealand/; "Nine Inventions by Talented New Zealanders." *NZ Herald*, May 2, 2014, sec. New Zealand. https://www.nzherald.co.nz; The Australian Initiative. *Tomorrow's World "Notable Australian World Firsts."* Associated Pub. Corp, 1993. http://apc-online.com/twa/firsts.html.

Six rules of patent strategy

Because quite often the patent process is complex, careful planning is required. Experts recommend the following basic rules:

- *Rule 1*: Create an IP-protective environment to minimise the risk of losing your IP before even being able to apply for protection. This includes ensuring that the appropriate employer/employee or contractor agreements are in place and have the necessary IP and confidentiality clauses to ensure that you own the IP and that it is kept secret. This also includes establishing confidentiality and security policies to ensure that confidential information does not leak out, whether deliberately or accidentally. Such policies could include limiting the number and level of persons who have access to confidential information, classifying confidential information in different levels of confidentiality, educating staff about IP and the need for confidentiality (including directions not to speak about confidential issues in public places even among each other) and prohibiting certain levels of information from physically and electronically leaving the office. Failure to establish an IP-safe environment before IP is even created can result in inability to protect that IP.
- *Rule 2*: Pursue patents that are broad, are commercially significant and offer a strong position. This means that relevant patent law must be researched in order to obtain the widest coverage possible on the idea or concept. In addition, there must be something significantly novel about the innovation. In jurisdictions where a 'first to invent' system operates it is helpful to record all steps or processes in a notebook and have them witnessed so that documentation secures a strong proprietary position. Although this will not provide any protection or enforceable rights, it is necessary to show dates of the invention's development in order to prove 'first to invent' where such systems operate. Traditionally, the 'first to invent' system was applicable in the US, although under the *America Invents Act* (AIA) currently in force, the US has been a 'first to file' country since 16 March 2013, meaning ownership goes to the first inventor to file a patent application for the invention rather than the first to invent it. However, there is still value in keeping records of development to assist in proving 'inventorship', and particularly in cases involving copyright, where ownership must be proved to enforce copyright.
- *Rule 3*: Prepare a patent plan in detail. This plan should outline the costs to develop and market the innovation as well as analyse the competition and technological similarities to your idea (refer also to Figure 10.1 and the associated 'Entrepreneurship in practice' box). Attempt to detail the precise value of the innovation. Potential infringement searches should be conducted prior to committing to a plan to consider whether the invention to be exploited may itself infringe one or more patents already in existence in any of the countries in which the invention is to be exploited.
- *Rule 4*: Have your actions relate to your original patent plan. This does not mean the plan cannot be changed. However, it is wise to remain close to the plan during the early stages of establishing the patent. Later, the path that is prepared may change – for example, licensing out the patent versus exploiting it yourself.
- *Rule 5*: Establish an infringement budget. Patent rights are effective only if potential infringers fear legal damages. Thus it is important to prepare a realistic budget for prosecuting violations of the patent. Some insurance brokers provide patent insurance, which may cover some costs incurred in defending or enforcing your patent.
- *Rule 6*: Evaluate the patent plan strategically. The typical patent process takes three to five years, although it can be expedited. This should be compared to the actual life cycle of the proposed innovation or technology. Will the patent be worth defending in three years, or will enforcement cost more than the damages collected?[12]

In practice, an entrepreneur needs to consider carefully the value and benefit of patenting. Protecting intellectual property can consume a lot of money that may alternatively be used to fund marketing and product development. If patenting is a preferred pathway and cash to make the most of marketing is short, many experts suggest that inventors consider licensing their product rather than exploiting it themselves.[13]

If, after careful review, an entrepreneur concludes that the innovation has a good chance of withstanding a legal challenge and is commercially worthwhile, a patent should be pursued. If a challenge is mounted, legal fees may be sizable, but a successful defence can result in sufficient compensation to cover profits made by the patent infringer or damages plus possibly up to 60–70 per cent of legal fees. It's also worth considering IP enforcement insurance, which can be a great help in covering many of the costs incurred in enforcing and/or defending your patent.

In fact, US courts may award damages of up to three times the actual costs incurred by 'wilful infringement', although many countries do not include extra factors for damage. Australia has a 'punitive damages' element, whereby if the infringer is found to have been particularly wilful or mischievous, an additional punitive amount may be awarded over and above the usual profits or damages.

Considering the cost of the patent process and the amount of time and resources it takes to protect patents, getting patent protection may not be the best way to go. There are those who argue that the cost of mounting suits against infringers and defending litigation from challengers on a portfolio of patents renders the activity pointless.[14]

COPYRIGHTS

A copyright provides exclusive rights to creative individuals for the protection of their literary or artistic productions. It is not possible to copyright an idea, but the particular way that an idea is expressed can often be copyrighted. This expression can take many forms, including books, periodicals, dramatic or musical compositions, art, motion pictures, lectures, sound recordings and computer programs. Under TRIPs:

- Copyright extends beyond the death of the author to varying degrees depending upon the law of the country it was created in, but typically for 50 or 70 years after death. For instance, in Australia and Singapore it extends to 70 years but in New Zealand, Fiji and China it is 50 years. One exception is photographs, which may have shorter terms of 25 years after the death of the creator in some cases.
- Copyright is automatically granted to the producer, artist or author and does not require registration, although in some countries registration may be required before infringement claims can be made.
- Computer programs are viewed as 'literary works' and receive the same level of protection.
- National exceptions to copyright – such as the fair use doctrine in the US, which makes provision for reproduction and use of copyrighted material under certain conditions – must be tightly controlled.
- In each country, intellectual property laws may not offer local citizens any benefits that are not available to citizens of other TRIPs signatories (this is called 'national treatment'); TRIPs also has a most-favoured nation clause whereby a country will normally treat rights holders from different trading country partners equally.

The owner of a copyright may:

- reproduce the work
- prepare derivative works based on it (for example, a condensation or movie version of a novel)

- distribute copies of the work by sale or otherwise
- perform the work publicly
- display the work publicly.

Each of these rights, or a portion of each, also may be transferred.[15]

Understanding copyright protection

For the author of creative material to obtain copyright protection, the material must be in a tangible form so it can be communicated or reproduced. It also must be the author's own work and therefore the product of the author's skill or judgement. Concepts, principles, processes, systems or discoveries are not valid for copyright protection until they are put in tangible form – written or recorded. Copyright acts throughout the world diversely seek some variation of protecting such things as textual material, computer programs, compilations, artistic works, dramatic works, musical works, cinematographic works, sound recordings, broadcasts and published editions.[16]

Note that it is not possible to copyright an *idea* – the underlying ideas embodied in a work may be used freely by others. What is copyrightable is the particular way an idea is expressed. Whenever an idea and an expression are inseparable, the expression cannot be copyrighted. Generally, anything that is not an original expression will not qualify for copyright protection. Facts widely known to the public are not copyrightable. Page numbers are not copyrightable because they follow a sequence known to everyone. Mathematical calculations are not copyrightable. Compilations of facts, however, are copyrightable.

Formal registration of a copyright may only be required with a National Copyright Office of one's resident country when an author seeks to begin a lawsuit for infringement. In addition, in some jurisdictions an author can find their copyright invalidated if proper notice isn't provided. To prove that copyright exists is not necessarily easy but being able to verify the following points would help to prove the case:

- identity of the author or maker of the copyright material
- nationality or residence of that author or maker
- location in which it was made
- date or calendar year in which it was made.[17]

If an author can substantiate a copyright infringement, the normal remedy is recovery of actual damages plus any profits the violator receives. Works that one intends to defend against infringement on grounds of copyright entitlement may be signalled by putting the copyright notice (©) on it. It is not necessary to register copyrights with the Copyright Office except in the instance in some jurisdictions where you want to sue somebody for infringement. Remember, ideas cannot be copyrighted. Therefore, if someone writes an article automatically affording copyright, you are certainly free to read that article, digest it, take the ideas from that article and other sources and weave them into your own material without any copyright infringement problems. On the other hand, if someone has copyrighted an article, you cannot simply rephrase it or change minor words and claim it as your own. Exactly where the line is to be drawn is not entirely clear. However, a little common sense will give the appropriate answer in most cases.[18]

Anyone who violates an author's exclusive copyright is liable to be prosecuted for infringement. However, there are exceptions such as the **fair use doctrine** in the United States or the *fair dealing* provision in Australia. Fair use provides for the legal, non-licensed citation or incorporation of copyrighted material in another author's work under certain specifiable conditions. The US is the only country with the more generous but also less well-defined fair use doctrine. But outside the US, comparable copyright limitations can be found in many nations' copyright statutes. Most common-law

fair use doctrine
An exception to copyright protection that allows limited use of copyrighted materials.

countries (especially those with a history as British territories or colonies) have the related doctrine known as *fair dealing* with narrowly drawn exceptions. For example, in Australia, the grounds for fair dealing are:

- research and study
- review and criticism
- parody or satire
- 'reporting the news'
- legal advice.[19]

ENTREPRENEURSHIP IN PRACTICE

WATCH WHAT YOU SAY!

The government can't help protect your business from the competition if your employees are willingly sharing valuable information. Copious amounts of sensitive and confidential information are being made public every day by business travellers who pay no heed to the fact that people have ears. Carrying on a seemingly harmless conversation with a co-worker on a plane, in a bus or in a restaurant has wreaked havoc for more than one company. An employee of Fuld & Company, a management consulting business, was riding a shuttle bus when he heard every bit of a company's distribution strategy being discussed in the seat in front of him. Luckily for the two talkers, he wasn't competition. He did, however, let it be known what had just occurred.

Protecting trade secrets is not a new concept, but with the number of businesspeople travelling every day and the rapid development of portable communication and technologies, the smallest slip can be dangerous. Leonard Fuld, a competitive intelligence expert, states that it's common for companies to overlook the human factor when it comes to information leaking out. He emphasises the point by telling an anecdote 'about an executive business traveller on a known business route who waited until passengers had disembarked and then quickly roamed the aisle to see if any documents had been left behind'. A Silicon Valley businessperson comments, 'I know of people in firms who justify booking first-class airfares based on the quality of information they might be able to pick up that way'.

Verbal exchanges aren't the only way travellers are hurting themselves. Items left in rental cars, stolen briefcases and the simple misplaced memo are known to be gold mines as well.

Business travellers should keep these things in mind to protect intellectual property that can't be protected by the government.

1 Avoid talking shop in public areas where competitors are likely to be present. Business jargon isn't a code when the executive sitting right beside you is in the same industry.
2 Never expose laptop screens on planes, buses or other conveyances when working on confidential facts and figures. If the work is unavoidable, ask for a window seat and use smaller font sizes.
3 Be particularly vigilant at trade shows. Proprietary technology, new product releases and the like should be discussed in detail only behind closed doors.
4 Mobile phones pose an amazing opportunity for others to partake in the conversation. Be cautious of your surroundings when making important phone calls.
5 Protect the files on your computer by purchasing a cable lock or security software. Help deter computer theft by labelling both the case and the computer and never letting them out of your sight.
6 Keep unnecessary documentation back at the office. Also check your work area, and account for all paperwork after handling important documents to see if anything has 'mysteriously' landed on the floor.
7 Protect your digital devices using cyber security software, and try to avoid using public WiFi.

Source: Adapted from Barber, D. (1999, June). Loose lips sink you. *Inc*. https://www.inc.com/magazine/19990601/4628.html. Copyright by Mansueto Ventures.

TRADEMARKS

Thanks to trademark law, no confusion should result from one venture using the symbol or name of another. Article 15(1) of TRIPs states that 'signs, in particular words including names, letters, numerals, figurative elements and combinations of colours as well as any combination of such signs, shall be eligible for registration as trademarks'. A registrable trademark is a distinctive name, mark, symbol or motto identified with a company's product(s) and may be registered at the National Trademark Office of one's resident country. Trademarks also exist under common law without the need for registration. In this case a mark (or name, symbol, motto, etc.) used to distinguish the goods or services provided in the course of trade from the goods or services provided by others, with extended use over time, can be defended as a trademark.

Specific legal terms differentiate the exact types of marks. For example, trademarks identify and distinguish goods. Service marks identify and distinguish services. Certification marks denote the quality, materials or other aspects of goods and services and are used by someone other than the mark's owner. Collective marks are trademarks or service marks used by members of groups or organisations to identify themselves as the source of goods or services.[20] A trademark can be a design, like the Nike swoosh. It can be a colour, like purple for Cadbury. It can even be a sound, like the MGM lion's roar. There are several categories of trademarks:

- *Fanciful trademarks*: These have no meaning until they become trademarks – examples include Starbucks (coffee) and Vero (insurance).
- *Arbitrary trademarks*: These are common words that have an arbitrary relationship to the product – examples include Apple (computers) and Amazon (e-commerce).
- *Suggestive trademarks*: Suggestive trademarks indirectly allude to a quality of the product – examples include Playboy (men's magazine).
- *Descriptive trademarks*: These describe the goods or service they market – examples include Computerland (computer store) and Vision Centre (optics store).
- *Generic trademarks*: Generic trademarks describe a whole class of products – examples include Personal Computer (for a personal computer) and Milk (for milk).[21]

Descriptive and generic trademarks are less likely to be suitable for registration (see Figure 10.2).

FIGURE 10.2 THE SPECTRUM OF TRADEMARK DISTINCTIVENESS

Source: De Leon, K. (n.d.). Trademark law basics. http://www.registeringatrademark.com/trademark-law-basics.shtml.

Once filed, the trademark application, and later the trademark registration if successfully issued, is listed in the register of the trademark office. This listing offers several advantages:

- nationwide constructive notice of the owner's right to use the mark (thus eliminating the need to show that the defendant in an infringement suit had notice of the mark), although, especially in some countries, it is still recommended to mark the goods or services with the ® symbol to eliminate any argument of notice
- protection against importers using the mark
- in some countries, such as the US, the mark is incontestable after five years,[22] but this is not so in Australia.

A trademark registration lasts for a period of 10 years. The registration is thereafter renewable for further periods of 10 years, for an indefinite period. In most countries, a condition of renewing the registration, and indeed maintaining its validity, is that the trademark is used in relation to at least the goods or services in respect of which the trademark is registered.

To obtain protection for your trademark overseas you will need to file an application with intellectual property offices in overseas countries of interest. There are also a number of international agreements (e.g. the Madrid Protocol and Madrid Agreement) that provide for trademark coverage in multiple countries under a single international registration.

If a trademark is properly registered, used and protected, the owner can obtain an injunction against many uses of the mark that are likely to cause confusion. Moreover, if infringement and damages can be proven in court, a monetary award may be given to the trademark holder.

Avoiding the trademark pitfalls

Trademark registration and search can be costly, sometimes ranging into the tens of thousands of dollars. Trademark infringement can be even more expensive. To avoid these pitfalls, here are seven basic rules entrepreneurs should follow when selecting trademarks for their new ventures.

1. Never select a corporate name or a mark without first doing a trademark search.
2. If your lawyer says you have a potential problem with a mark, trust that judgement.
3. Seek a coined or a fanciful name or mark before you settle for a descriptive or a highly suggestive one.
4. Whenever marketing or other considerations dictate the use of a name or a mark that is highly suggestive of the product, select a distinctive logotype for the descriptive or suggestive words.
5. Avoid abbreviations and acronyms wherever possible, and when no alternative is acceptable, select a distinctive logotype for the abbreviation or acronym.[23]
6. Ensure that use is made of the trademark. In many countries, a trademark can become susceptible to invalidation after three or five years if the trademark is not being used. If you are licensing another party to use the trade mark, appropriate agreements and control over the use must be in effect.
7. Monitor descriptive use of the trademark to avoid invalidation by genericism (where the mark has become descriptive, for example, Kleenex). Be wary of first-to-file issues in some countries, such as China. In these countries a distributor could file your trademark for registration and own it in that country. It's good practice to file for trademark registration in each country before starting your business.

Test your understanding and build your entrepreneurial knowledge on trademarks in the 'Experiencing entrepreneurship: What kind of trademark?' exercise and make sure you can distinguish between trademark and copyright entitlements with the 'Experiencing entrepreneurship: Protecting your legal interests' exercise at the end of this chapter.

ENTREPRENEURSHIP IN PRACTICE

WHO OWNS THE COPYRIGHT TO A MONKEY'S SELFIE?

Is this a specious argument? Monkeys can own the copyright to selfies they click of themselves just like humans do.

This is the controversy between Wikimedia (the foundation behind Wikipedia) and British photographer David Slater. According to the Wiki, the selfie shot in Indonesia by a cheeky black macaque (see Figure 10.3) who was fooling around with Slater's equipment should not be bound by copyright law.

The photo was uploaded to Wikimedia, a public-domain image database. Slater claimed that free use of the image was jeopardising his income. But Wiki turned down Slater's request to remove the photo and refused to change the 'open' copyright classification. Wiki says the picture is in the public domain, because as the work of a non-human animal, it has no human author in whom copyright is vested.

continue

continue

FIGURE 10.3 MONKEY SELFIE

Wikimedia.org

The US Copyright Office ruled in the Monkey Selfie case that any works created by a non-human are not subject to copyright. The august authority also cited murals by elephants would not be copyrightable. 'To qualify as a work of "authorship" a work must be created by a human being. . . . Works that do not satisfy this requirement are not copyrightable. The Office will not register works produced by nature, animals or plants.'

A *Boston Globe* editorial argued the contrary: 'It wouldn't have happened without [Slater]. To claim that the photo cannot be licensed because the monkey has the best claim on the image is specious reasoning.' In 2017, a US district judge ruled that Slater did in fact own copyright of the image, with Slater agreeing to donate 25% of any future revenue from the image to wildlife charities.

Sources: Photographer "lost £10,000" in Wikipedia monkey "selfie" row (2013, 7 August). *BBC News*. http://www.bbc.com/news/uk-england-gloucestershire-28674167; Sparkes, M. (2014, 6 August). Wikipedia refuses to delete photo as "monkey owns it". *The Daily Telegraph*. https://www.telegraph.co.uk/technology/news/11015672/Wikipedia-refuses-to-delete-photo-as-monkey-owns-it.html; United States Copyright Office (2014, 19 August). Compendium of U.S. Copyright Office Practices, § 313.2, p. 54. https://www.copyright.gov/comp3/; Editorial (2014, 9 August). Photographer should have rights to monkey "selfie". *Boston Globe*. http://www.bostonglobe.com/opinion/editorials/2014/08/08/photographer-should-have-rights- monkey-selfie/twpCD7fNWkrHhqdeJtRjiL/story.html.

DOMAIN NAMES

Domain names are the human-friendly forms of internet addresses and are commonly used to find websites. While designed to serve the function of enabling users to easily locate computers (and people), domain names have acquired a further significance as business identifiers and, as such, have come into conflict with the system of business identifiers (protected by intellectual property rights) that existed before the arrival of the internet. Domain names may be awarded to trademark holders over others through arbitration or litigation. This means that having trademark registration in the same name as your domain name may ensure that you retain ownership of the name. However, an entrepreneur must keep in mind that filing for a trademark is a distinct and separate process to applying for a domain name. When deciding upon a trademark or a domain name an entrepreneur should check that both are available and free of potential conflict. Ideally, trademark and domain name registrations should take place simultaneously to avoid later difficulties.

domain name
The last part of a URL that includes the organisation's unique name followed by its organisational form, such as .com for 'commercial' or .edu for 'educational'.

A major problem arises when **cybersquatters** (people who purchase a large number of domain names in general) offer domain names for sale back to the person or company who should rightfully have the domain under trademark laws. Needless to say, trademark holders object to third parties registering domain names they believe should be theirs. The domain name registries, many of which are not governmental organisations, have had to find a solution to this and therefore have dispute resolution systems which operate in parallel with national laws. The majority of the generic top-level domain names (.com, .net, etc.) now use the Uniform Dispute Resolution Policy (UDRP), but some critics claim that the UDRP process favours large corporations. There have been instances of companies, individuals and governments trying to take domain names away from their current owners by making false claims of trademark violation. Sometimes they are successful. This practice is called reverse-cybersquatting.

cybersquatter
A person who seeks to profit by registering an unclaimed internet domain name knowing that it is likely to be sought after by another person, business or organisation.

ENTREPRENEURSHIP IN PRACTICE

SOME INTERESTING WIPO UDRP DECISIONS

- *Entrepreneur* magazine (EMI) has long been accused of 'trademark bullying' and claims it owns the US trademark for the word 'entrepreneur'. Since the early 1980s, EMI has sued or threatened to sue scores of businesses and organisations it claims infringed its trademarks, including domain names.
- Gucci has brought cases to win control of more than 100 domains, including: http://bigguccioutlet.com; http://buycheapgucci.org; http://buygucci-online.org; http://cheapguccibackpack.org; http://cheapgucci-bags.org; http://yourguccioutlet.com.
- An Arizona cybersquatter was forced by the F. Porsche AG company of Germany to stop using the URL www.pornsche.com because it resolved into a porn search engine and the domain name was confusingly similar to the complainant's trade name and trademark Porsche. It was determined that the addition of the letter 'n' is not sufficient to prevent confusion.
- The 140 year-old Berlitz language training company got http://www.berlitzsucks.com removed from the internet for extortion, inflammatory remarks and defamation.
- 'Hard Yakka' is a common phrase in colloquial Australian English, simply meaning 'hard work'. The Australian clothing business Yakka Pty Ltd, which has a line of clothes called Hard Yakka, got back http://www.hardyakka.com from a retail outlet in Victoria because it confused the customer.
- Chanel succeeded in an action in Korea to have the registration 'chanel.co.kr' cancelled. The domain name had been attached to a site selling condoms, pheromone perfumes and lingerie. This was held to be contrary to Korea's unfair competition legislation.
- Pfizer, the gigantic pharmaceutical, was successful in stopping the use of .net despite the plaintiff arguing that the domain consisted of the very common Chinese characters for brightness and luck. The finding for Pfizer was based on the grounds that the Respondent did not present a positive case with respect to their use of the claimed domain name but instead presented a negative case about why Pfizer should not be entitled to the right.

Sources: Barrett, P. M. (2011, 20 May). Entrepreneur, the magazine that sues entrepreneurs. http://www.bloomberg.com/news/2011-05-19/-cite-entrepreneur-cite-the-magazine-that-sues-entrepreneurs.html; Norwood, J. (2014, May 28). A fun primer on WIPO, ICANN, and the Uniform Domain Name Dispute Resolution Policy. *Arkansas Law Notes*. http://media.law.uark.edu/arklawnotes/2014/05/28/a-fun-primer-on-wipo-icann-and-the-uniform-domain-name-dispute-resolution-policy/; Thousands of interesting cases can be found at: WIPO (n.d.) Legal index of WIPO UDRP panel decisions. http://www.wipo.int/amc/en/domains/search/legalindex.jsp.

TRADE SECRETS

Trade secrets are business processes and information that are unpatentable, patentable but not enforceable or patentable but with no desire to disclose through patenting to make information public. This might include customer lists, plans, research and development, pricing information, marketing techniques and production techniques. For example, no company would reveal a complete map of its supply chain. Generally, anything that makes an individual company unique and has value to a competitor could be a trade secret.[24] Trade secret protection is only possible with employer and employee diligence. Staff who are privy to trade secrets must be clearly advised of their obligations, especially on leaving the organisation, and should be bound to these obligations through their employment contract.

Protection of trade secrets extends both to ideas and to their expression. For this reason, and because a trade secret involves no registration or filing requirements, trade secret protection is ideal for software. Of course, the secret formula, method or other information must be disclosed to key employees. Businesses generally attempt to protect their trade secrets by having all employees who use the process or information agree in their contracts never to divulge it. Theft of confidential business data by industrial espionage, such as stealing a competitor's documents, is a theft of trade secrets without any contractual violation and is actionable in itself.

In many instances, trade secrets are based on discoveries or inventions that could be patented, but the owner has chosen to keep the discovery or invention secret. Trade secrets, reputedly such as the formula for Coca-Cola, have been in effect for many years and will continue for as long as the secret is kept from the public. If it had been patented, the formula would have long been in the public domain.

The law clearly outlines the area of trade secrets. Information is a trade secret if: (1) it is not known by others, (2) the business would lose its advantage if the competition were to obtain it and (3) the owner has taken reasonable steps to protect the secret from disclosure.[25] Keep in mind that prosecution is still difficult in many of these cases.

OPPORTUNITIES FROM CHANGING INTELLECTUAL PROPERTY ATTITUDES

Advances in technology have opened up whole new areas of and issues with patentable products. Biotechnologies and computer software are two of the most noteworthy areas at the cutting edge of leading technologies. And then there is the question of so-called computer-implemented patents[26] and 'business method' patents. Technology development is making it increasingly difficult to enforce many of the more conventional forms of intellectual property. A good example of this is MP3 file-sharing on the internet, which raised questions regarding the viability of copyright in musical recordings. This has led to a movement to toughen protection to halt **piracy** and slow the decline in revenues and profits for established businesses on the one hand, while on the other it has raised the prospect of new business models such as Apple's iTunes. Perhaps now is the time for a radical rethink of traditional intellectual property concepts[27] and how they apply to business model innovation.[28] Instead of considering reforms to *strengthen* patents and copyrights, perhaps we should be moving in the opposite direction. Some examples can be found in India, where efforts are focused on creating generic AIDS drugs that are much less expensive than patented drugs made by the transnational drug companies. Entire nations (for example, China) are leaving Microsoft in the dust as they install open-source operating systems on their computers. Even Tesla, the leader in electric car technologies, has opened its patent portfolio for others to use, believing it to be the fastest way to stimulate the electric car market.[29]

Intellectual property laws are constantly in flux, with governments regularly reviewing the effectiveness and relevance of their country's IP laws. For example, in Australia, the Productivity Commission Inquiry Report on Intellectual Property Arrangements has recommended an increase in the thresholds for obtaining IP rights such as patents, and a general reduction in monopolies provided by IP rights.[30]

piracy
Copyright infringement (or copyright violation) in a manner that violates one of the copyright owner's exclusive rights.

CourseMateExpress

To incorporate or not to incorporate? What is your opinion? Should the Harlows incorporate? Read about it on CourseMate Express.

IDENTIFYING LEGAL STRUCTURES FOR ENTREPRENEURIAL VENTURES

Having examined IP rights, we now turn to the next aspect of this chapter: legal structures that might be chosen to incorporate the company.

Every country has a **regulatory body** – composed of legislation and a regulatory authority – that dictates how businesses are started, operated and wound up. Famous ones include: Australian Securities & Investments Commission (ASIC), New Zealand Companies Office, Singapore Accounting and Corporate Regulatory Authority (ACRA) and US Securities & Exchange Commission (SEC). These government bodies oversee the **incorporation** of companies and the regulation of businesses. We now look at the types of legal structures that businesses use to run their affairs. In the Asia-Pacific, there is a

regulatory body
A regulatory regime, composed of legislation and a regulatory authority, that dictates how businesses are started, operated and wound up.

incorporation
The birth of a company, where it is given legal form. The Certificate of Incorporation is like a birth certificate. Incorporated businesses become separate legal entities in their own right and are recognised therefore as separate from their owners.

variety of common legal business structures. These include unincorporated forms such as **sole traderships** and **partnerships**; **incorporated companies**; and other forms of business such as **trading trusts**, cooperatives and **non-profit organisations**. Because each form has specific advantages and disadvantages it is impossible to recommend one form over the other. The entrepreneur's specific situation, concerns and desires will dictate this choice.

If you are considering a non-profit form of organisation, a large variety of legal forms are available to you. The chosen legal structure will influence the types of legal activities the organisation can carry on and the government bodies from which it is required to seek registration.[31] The following different types of legal structures can apply:

- unincorporated association
- incorporated association
- company
- cooperative
- Indigenous corporation
- trust or charitable trust.[32]

Choosing the appropriate legal structure is a complex issue because of the inherent tax consequences and liabilities of the owner(s), and because the structure selected will determine what capital-formation options are available. Here are some of the important factors that must be taken into consideration when selecting a business structure.

- **Asset protection**: The business structure will determine the extent to which personal assets (such as the family home) are at risk against business failure.
- **Limited liability**: This refers to the important commercial characteristic whereby the business participants' personal liability for the business debts is limited to a specified amount.
- *Distribution flexibility:* Some business structures enable payment of different types of income, such as trading profits, capital gains and franked dividends, to different participants.
- *Financing:* As the business grows, it may be necessary to raise more funds by way of borrowing or equity. Consider the ease with which future financing can be raised while selecting the business structure.
- **Taxation**: This is a complex issue that goes well beyond merely selecting the structure that is taxed at the lowest rate.
- *Business environment*: This includes stringency of the regulatory approval systems and technological risks.
- For *non-profit organisations* other factors may include whether you will have employees or volunteers and what accountability you will have to your members and the community.
- *Personal and community relationships*: Increasingly, couples are sharing ownership, management and responsibility. Sometimes called copreneurs, they share trust, commitment, loyalty and work-life balance – or not! The increase in social enterprise activity has created structures that enable protection of assets that benefit the community, such as the steadily growing United Kingdom legal entity of the Community Interest Company, where there are now over 11 000 'community interest companies' registered.[33] In the USA, **benefit corporations (B-Corp)** are rapidly gaining popularity as a corporate structure and while in Australia there is a push toward identifying the benefit corporation legal structure, currently there is the voluntary **B-Corporation accreditation** process available to businesses. Administered by B-Lab, a not-for-profit organisation with office locations across the globe, it offers a new way for businesses to solve

sole trader
Also known as a sole proprietor, a business that is owned and operated by one person, that has no existence apart from its owner.

partnership
An association of two or more people acting as co-owners of a business for profit.

incorporated company
A company that is legally seen as being quite separate from the owner. While more expensive to set up than a sole trader, it offers some protection to the owner should things go wrong.

trading trust
In Australia and New Zealand, similar to a family trust; a trust that allows the beneficiaries to be paid money (profits) without them having to work in the business (unlike a company). Generally taxed on a 'flow-through' basis.

non-profit organisation
An organisation whose main objective is not profit, such as a religious, charitable or educational institution.

asset protection
A way to organise assets and transactions in such a way that personal assets (such as the family home) are shielded from future liabilities or business failure.

limited liability
A restriction on the amount of financial responsibility assumed by a partner or shareholder. (See also *unlimited liability*.)

taxation
Liabilities owed to the government such as GST (goods and services tax), sales or value-added taxes, revenue or income taxes.

social and environmental problems with B-Corporation certification (not to be confused with the benefit corporation structure). This addresses two critical problems:

1. Corporate laws make it difficult for businesses to consider employee, community and environmental interests in their decision making.
2. The lack of transparent standards makes it difficult to tell the difference between a socially proactive company and just good marketing.

There are over 2300 certified B corporations in over 50 countries across 130 different industries (from food and apparel to attorneys and office supplies). B corporations may be quite diverse, but they share one unifying goal: to redefine success in business. Through a company's public B Impact Report, anyone can access performance data about the social and environmental practices that stand behind their products.[34]

INCORPORATED COMPANIES

New ventures initially can be categorised as incorporated or **unincorporated businesses**. In fact, legally the term 'company' should only be applied to an incorporated business and not an unincorporated business. What is the difference between a company and a **corporation**? The public perception is confusing. Most people think that a company is a locally owned and operated business (such as a convenience store), while a corporation is a very large business (such as Woolworths). In legal terms, this is totally misleading.

In Australia, New Zealand and Singapore, as well as in the UK and Ireland, an incorporated company is a legal entity (distinct from a natural person) that often has similar rights in law to those of a natural person. This differs in the US, where this entity is known as a corporation. Both the incorporated company in Australia and the corporation in the US have limited liability and their shareholders are not normally responsible for the company's debts beyond the amount they paid for their shares. Accordingly, while the terminology differs, the concept of a company or corporation is largely the same.

In Australia, the use of 'Inc.' signifies an incorporated association; that is, a non-profit entity, also with limited liability for its members. In the US, however, 'Inc.' is used to indicate that an entity is a corporation, namely an incorporated company where personal assets of the shareholders are protected. In the US, corporations are often identified by the term 'Incorporated' added after the business name, as in 'Texas Instruments, Incorporated'.

Incorporation is the birth of a company; it means giving legal form to a company. The Certificate of Incorporation is basically a birth certificate. Just like infants, incorporated businesses become separate legal entities in their own right, recognised as separate from their owners.

Around the world there is a variety of terms used for the different types of incorporated small businesses, and Table 10.4 details some of these.

LIMITED LIABILITY COMPANIES

For almost all business purposes around the world, two forms – the private company and the public company – are the most frequent legal structures. In Australia, these different types of companies are denoted by the abbreviations Pty Ltd (proprietary limited) and Ltd (limited), respectively. The essential difference is that the private company cannot legally offer its shares to the public.

Private company

In English law and in other countries with similar laws, for a private company the assets available to the creditors in the event of bankruptcy are limited to the assets of the company. Consequently, if the

benefit corporation (B-Corp)
A type of for-profit corporation in the USA that builds into its constitution the commitment to create value for its shareholders while being accountable and transparent to meet a purpose that benefits society and the environment.

B-corporation accreditation
An accreditation standard available for businesses that accounts for the lack of laws that make transparent a combination of employee, community and environmental interests in addition to economic motives.

unincorporated business
A business, such as a sole tradership or a partnership, that is not organised and maintained as a legal corporation.

corporation
In the US, a legal business entity that often has similar rights in law to those of a natural person. Equivalent to an incorporated company in Australia, New Zealand, Singapore, the UK and Ireland. They have limited liability and their shareholders are not normally responsible for the company's debts beyond the amount they paid for their shares. Accordingly, while the terminology differs, the concept of a company or corporation is largely the same.

TABLE 10.4 BUSINESS STRUCTURES AROUND THE WORLD

ABBREVIATION	WHAT IS IT?	WHERE IS IT USED?
Inc.	An incorporated association; that is, a non-profit entity	Australia
Inc.	A corporation or incorporated company	United States
LLC	Limited liability company Similar to a corporation, but combined with a limited liability partnership	Worldwide (not used in Australia)
ILP	Incorporated limited partnership Similar to LLC but with more flexible investment vehicles –minimum level of investment $20 million	Australia (VIC, QLD, NSW)
LLP	Limited liability partnership Each partner is fully liable for the debts of the partnership, not including acts of professional negligence or malpractice	Worldwide
Ltd	Private company with liability limited by shares (not traded publicly)	Commonwealth countries (other than Australia), including India and New Zealand
Ltd	A public company Liability limited by shares or guarantee (guarantee applies to not-for-profit companies only) Shares may be traded publicly but will not always be	Australia
NL	Mining company not entitled to call on the unpaid issue price of shares No liability for shareholders, as distinct from limited liability	Australia
PLC	**Public limited company** Liability limited by shares which are traded publicly	Commonwealth countries (other than Australia)
Pty Ltd	Proprietary limited A private company with liability limited by shares, not traded publicly	Australia
PT	A state-owned or majority state-owned company	Indonesia
PT Tbk	A company listed on the public stock exchange	Indonesia
Bhd	Equivalent to a public limited company	Malaysia
Sdn.Bhd	A private company limited by shares, not traded publicly	Malaysia
HUF	Hindu Undivided Family – a business owned by a joint family belonging to the Hindu religion	India
PVT.LTD	A **private limited company**	India
PSU	A public sector unit – listed on the stock exchange with major ownership by state or central government	India
LTC	Look-through company – a limited liability company that allows the transfer of income and expenditure directly to shareholders	New Zealand
PTE LTD	Private limited company – maximum of 50 shareholders	Singapore

Public limited company
A company whose liability is limited by shares which are traded publicly in Commonwealth countries (other than Australia).

private limited company
See proprietary limited company (Pty Ltd).

company goes into liquidation, creditors cannot seize the private assets of the directors, such as home, car and savings. In theory, individual directors do not become bankrupt and they can start up in business immediately afterwards. In practice, however, directors are personally liable if they knowingly allow the company to trade when there is no reasonable expectation that it can pay its debts, as determined by an insolvency practitioner. Furthermore, a business' creditors and banks who finance a business will often ask the directors to personally guarantee the debt before trading accounts can be opened. A private company in Australia is referred to as a **proprietary limited company (Pty Ltd)**. A Pty Ltd is the opposite of a public company. For example, a Pty Ltd cannot invite the public to invest or deposit money with it, whereas a public company can raise capital by issuing a prospectus offering shares to the public.

proprietary limited company (Pty Ltd)
In Australia, a form of privately held company that has limits defined with respect to its financial responsibility. Unlike a public company, a proprietary company cannot offer shares to the public for equity capital raising. Limits and meaning may vary depending on the regulatory law of the country in which the company is created. Same as private limited company in Australia.

- **Advantages of a private company:**
  - liabilities of the shareholders and directors are limited to their subscribed share capital and any debts that are personally guaranteed
  - the company is a separate legal entity, which may enter into agreements, be sued and sue others
  - retained profits are taxed at the company income tax rate
  - ease of attaining ownership in the company by acquiring shares
  - ease of ownership change
  - additional capital is more available to this type of legal structure
  - shares are transferable and the authority of shareholders can be controlled through the type of shares issued
  - continuity of the company's existence is not dependent on the owners.
- **Disadvantages of a private company:**
  - set-up, administrative and operating costs are high
  - increased statutory requirements for taxation and corporation law
  - revenue and capital losses must be retained by the company – these cannot offset the owners' incomes.[35]

Public company

In Australia, a public company is indicated by the word 'Limited' or the abbreviation 'Ltd' at the end of the company's name, for example BHP Billiton Limited. In many other Commonwealth jurisdictions, 'PLC' indicates that a company is a public company. A public company is a type of limited company whose shares may be offered for sale to the public. The abbreviation Ltd or PLC status is roughly equivalent to a US corporation. It is not compulsory for a public company to 'float' its shares by making an initial public offering (IPO). However, many do float their shares, which are then usually traded on the stock exchange. The following offers a summary of the key advantages and disadvantages of the PLC.

- **Advantages of a public company:**
  - essentially those of a private company, plus
  - increased potential for raising finance by share issues to the public or through other financial investors.
- **Disadvantages of a public company:**
  - most expensive set-up cost of all forms of business organisation considered
  - if shares are traded publicly, more open to hostile takeover bids
  - tighter levels of regulation
  - public ownership by minority shareholders does not provide owners with any real control of the business
  - majority shareholders have a stronger voice at shareholder meetings and can sway business decisions.

QUASI-INCORPORATED BUSINESSES

limited partnership
An organisational arrangement that allows investors to put money into a partnership without assuming liability for any losses beyond this initial investment.

Limited partnerships are used in situations (for example, passive investor) where capital investment comes without responsibility for management and without liability for losses beyond the initial investment. Such an organisation allows the right to share in the profits with limited liability for the losses. The advantage of the limited liability partnership is that it allows an investor to invest in a partnership without being liable beyond the extent of their financial investment, provided certain conditions are met. Limited partners may not:

- draw out or receive back any part of their contribution to the partnership during its lifetime
- take part in the management of the business or have power to bind the business.

We can refer to these entities as quasi-incorporated, as they share some similarities with both incorporated and unincorporated business structures. However, strictly speaking, limited liability partnerships are unincorporated while limited partnerships are incorporated.

Limited liability partnership

limited liability partnership (LLP)
A relatively new form of partnership that allows professionals the tax benefits of a partnership without personal liability for the malpractice of other partners.

unlimited liability
A condition existing in sole proprietorships and partnerships wherein someone is responsible for all the enterprise's debts.

In a **limited liability partnership (LLP)** structure, the liability of a partner contributing capital can be limited to the amount of financial contribution, provided that person does not take part in the management of the business. LLPs are particularly common in oil and gas exploration, in motion-picture ventures and in venture capital investments. A general partner in a limited partnership has **unlimited liability** and therefore is personally liable for the debts of the business. However, a limited partner's liability is limited to the size of the investment they make, and they can only be involved in the business' management in certain prescribed circumstances. The standard features of limited partnerships include flow-through tax status (where tax is passed onto the partner(s) rather than paid by the partnership business entity in order to avoid double taxation, that is, tax being paid on income by both the business and the individual), limited liability for passive investment partners and separate legal personality.

Incorporated limited partnership

incorporated limited partnership (ILP)
In Australia, a form of a limited partnership (confusingly entitled a limited liability company or LLC in the US) with the capacity and powers of an individual as well as the powers of a company. Limited partners are not entitled to participate in management and general partners have unlimited liability.

An **incorporated limited partnership (ILP)** is a form of a limited partnership and is a relatively recent development in Australia, although the US equivalent (confusingly entitled a limited liability company, or LLC) has been in existence for some time. The ILP has been developed in response to calls by venture capital and private equity investors for more flexible investment vehicles. An incorporated limited partnership is a partnership with the capacity and powers of an individual as well as the powers of a company as a separate legal entity. It can have up to 20 general partners and an unlimited number of limited partners. As with all limited partnerships, the limited partners are not entitled to participate in management, and general partners have unlimited liability.

- **Advantages of an ILP:**
  - limited liability for limited partners
  - flow-through taxation – that is, each partner of the ILP is taxed pro rata based on their portion of the ILP's taxable income
  - the partners can offset any losses incurred by the ILP against other taxable income.
- **Disadvantages of an ILP:**
  - only able to be used for limited investment purposes
  - short lifespan of 5–15 years
  - must have minimum investment funds of $20 000 000, meaning that substantial investment is required before ILP structure can be implemented.

UNINCORPORATED BUSINESSES

There are two very common forms of doing business that are called unincorporated; that is, not organised and maintained as a legal entity.

Sole tradership

Most entrepreneurs start out as 'sole traders'. A sole trader (also known as a sole proprietor) is a business that is owned and operated by one person. The enterprise has no existence apart from its owner. This individual has a right to all of the profits and bears all of the liability for the debts and obligations of the business. The individual also has unlimited liability, which means their business and personal assets stand behind the operation. If the company cannot meet its financial obligations the owner can be forced to sell the family car, house and whatever assets necessary to satisfy the amounts owing to the creditors.

To establish a sole tradership a person merely needs to obtain the permissions or licences that are necessary in the field to begin operations. One must also normally apply for registration of the business name with the relevant state or territory department. In Australia, an Australian Business Number (ABN) is not compulsory but is recommended due to pay-as-you-go withholding obligations of suppliers that can also ease accrued tax burdens payable at financial year ends. Because of its ease of formation, the sole tradership is the most widely used legal form of organisation.[36]

- **Advantages of sole traderships:**
  - ease of formation – it is an inexpensive business structure to establish and maintain and it has the least government reporting requirements
  - losses reduce personal taxes – in both Australia and New Zealand, losses from the business can be offset against any other income or future earnings
  - less formality and fewer restrictions than with any other legal form
  - sole ownership of profits – the proprietor is not required to share profits with anyone
  - decision making and control vested in one owner – no co-owners or partners must be consulted in the running of the operation
  - flexibility – management is able to respond quickly to business needs in the form of day-to-day management decisions as governed by various laws and good sense
  - relative freedom from governmental control – very little governmental interference occurs in the operation, although there may be considerable compliance costs
  - freedom from corporate business taxes – proprietors are taxed as individual taxpayers, not as businesses
  - ease of winding up – it is easy to close the company and stop trading.
- **Disadvantages of sole traderships:**
  - few tax concessions – if the business is successful, the personal tax rate in Australia and New Zealand may be higher than the company rate
  - unlimited liability – the individual proprietor is personally responsible for all business debts and this liability extends to all of the proprietor's assets
  - lack of continuity – the enterprise may be crippled or terminated if the owner becomes ill or dies
  - lack of personal freedom – it may not be possible to take holidays, as there is nobody else with the expertise to run your business while you are away; the same problems arise with sickness or accidents
  - less available capital – ordinarily, proprietorships have less available capital than other types of business organisations, such as partnerships and corporations

- relative difficulty obtaining long-term financing – because the enterprise rests exclusively on one person it often has difficulty raising long-term capital
- relatively limited viewpoint and experience – the operation depends on one person, whose ability, training and expertise will limit its direction and scope.

Partnerships

Partnerships emerge in various ways. A sole trader may reach a stage where further growth requires taking on a partner. Alternatively, two or more people may decide to combine their skills and resources to start a business in partnership with each other.

In a partnership, a group of people contribute their time, talents and money toward the business. In return they share the responsibilities and profits. A partnership can be created by oral or written agreement, but a written agreement is preferable. In the absence of a formal partnership agreement, the law will assume that each partner has an equal share in the business. If, for example, one partner is contributing more money or time, the partnership agreement will normally provide that they have a greater share in the business. By clearly spelling out in the partnership agreement what has been agreed upon, the likelihood of disputes is reduced.

- **Advantages of partnerships:**
  - ease of formation – legal formalities and expenses are few compared with those needed to create a more complex enterprise, such as a corporation
  - direct rewards – partners are motivated to put forth their best efforts by direct sharing of the profits
  - flexibility – in a partnership, it is often possible to obtain more capital and a better range of skills than in a sole proprietorship
  - responsiveness – a partnership often is able to respond quickly to business needs in the form of day-to-day decisions
  - relative freedom from governmental control and regulation – very little governmental interference occurs in the operation of a partnership
  - confidentiality – partnerships do not have to disclose profits to the public.
- **Disadvantages of partnerships:**
  - few tax concessions – most partnerships pay taxes as individuals and the personal tax rate in Australia and New Zealand may be higher than the company rate
  - unlimited liability of at least one partner – although some partners can have limited liability (as in limited partnerships), at least one must be a general partner who assumes unlimited liability
  - lack of continuity – if any partner dies or simply withdraws from the business, the partnership arrangement ceases (however, operation of the business can continue based on the right of survivorship and the possible creation of a new partnership by the remaining members or by the addition of new members)
  - relative difficulty obtaining large sums of capital – most partnerships have problems raising capital, especially when long-term financing is involved; usually the collective wealth of the partners dictates the amount of total capital the partnership can raise, especially when first starting out
  - bound by the acts of just one partner – a general partner can commit the enterprise to contracts and obligations that may prove disastrous to the enterprise in general and to the other partners in particular

- difficulty in exit strategy – if the partnership is dissolved or altered, difficulties may be experienced in obtaining an acceptable valuation or in raising capital to purchase a retiring partner's share
- difficulty of disposing of partnership interest – buying a partner out may be difficult unless specifically arranged for in the written agreement.

It is important to correctly draw up the partnership agreement from the beginning. Uncertainty and ambiguity may come back to haunt a venture. Let us say that Alice, Bette and Cathy work as partners without an explicit agreement. The three women lease a factory as tenants in common and produce widgets. Each receives one-third of the profits. Later, Alice signs a contract for some plant and equipment to produce the Mark II widget. However, their business falters and Alice has to go back on the contract. Then, for totally unrelated reasons, Alice is declared bankrupt and the supplier sues for breach of contract. The court determines that Alice, Bette and Cathy were in fact partners. Alice is found to have bound the partnership to the equipment contract. As Alice has gone bankrupt, Bette and Cathy are ordered to pay all of the supplier's damages and costs.[37]

You can confirm your understanding and test your entrepreneurial knowledge on sole traders and partnerships in the 'Experiencing entrepreneurship: Get it right' exercise at the end of this chapter.

OTHER BUSINESS FORMS

Trading trust

A common alternative business form in Australia and New Zealand is the trading trust. It is very much like a family trust, except that it is able to operate as a business with the added advantage of being able to pay money (profits) to beneficiaries without them having to work in the business (unlike a company). A trading trust can ring-fence assets and insulate professional life from personal life when, for example, a doctor or dentist is facing malpractice or medical misadventure claims.

Cooperative society

The main difference between a **cooperative society** and a company is dividend distribution. Under a company structure there is a profit motive that returns dividends to shareholders of the company. A cooperative, in contrast, operates on a service motive that provides services to its members or on behalf of its members and any return of capital to members is limited. Each member contributes capital and shares in the control of the business on the basis of a one-member, one-vote principle. In other ways, it is run in a similar fashion to a company.[38]

cooperative society
An association operating on a service motive, which provides services to its members and receives limited return of capital. Unlike a company, all members of a cooperative have only one vote, irrespective of their shareholding.

Charitable trust

A familiar form of non-profit (or not-for-profit) corporation is the religious, charitable or educational organisation. Its purpose is not to make a profit, but it is permitted to do so if the profit is left within the trust.

Franchises

Actually, a franchise is not a legal form per se; it could be any one of the structures we have discussed. However, we include it here because it is a consideration as entrepreneurs launch new ventures (see also Chapter 9).

A franchise is any arrangement in which the owner of a trademark, trade name or copyright has licensed others to use it in selling goods or services. A franchisee (a purchaser of a franchise) is generally legally independent but economically dependent on the integrated business system of the franchisor (the seller of the franchise). In other words, a franchisee can operate as an independent businessperson but still realise the advantages of a regional or national organisation.[39]

What business legal structure should a franchise have? There is no right or wrong answer to this question. A franchise can be any of the forms discussed in this chapter. The differences relate to tax treatment and liability. Franchise entrepreneurs should take care to protect their personal assets from business liability in relation to contracts they execute, such as lease contracts and supplier contracts. For this reason many new franchisees are more interested in the corporate form for its tax differences than for its potential liability protection, although the importance of protection of personal assets in this decision should not be ignored. The advantage they see is the potential that corporate income will be subject to tax rates lower than personal income rates. There are also possible benefits related to increased options for retirement accounts and different treatment of certain income tax deductions (see also related text on franchising in Chapter 9).

FINAL THOUGHTS ON LEGAL FORMS

An entrepreneur should always seek professional legal advice in order to avoid misunderstanding, mistakes and added expenses. The average entrepreneur encounters many diverse problems and stumbling blocks in venture formation. Since they do not 'normally' have a thorough knowledge of law, accounting, real estate, taxes and governmental regulations, an understanding of certain basic concepts in these areas is imperative.

The material in this chapter is a good start toward understanding the legal forms of organisations. It can provide entrepreneurs with guidelines for seeking further and more specific advice on the legal form that appears most applicable to their situation. The following key questions can be helpful for placing legal forms of business in perspective.

- What is the size of the risk? What is the amount of the investor's liability for debts and taxes?
- What would the continuity (life) of the business be if something happened to the principal(s)?
- What legal structure would ensure the greatest administrative adaptability for the business?
- What effects will federal, state and local laws have on the operation?
- What are the possibilities for attracting additional capital?
- What are the needs for and possibilities of attracting additional expertise?
- What are the costs and procedures associated with starting the operation?
- What is the ultimate goal and purpose of the enterprise and which legal structure can best serve this purpose?

INSOLVENCY AND BANKRUPTCY

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Would you recommend bankruptcy or not? All she needs is a little more breathing room. Read about it on CourseMate Express.

insolvent
Describes the state of a business that cannot pay its debts as and when they fall due.

'Looking back on it, my judgement was often terribly wrong', said one entrepreneur who had burned through more than $20 million trying to launch an internet-based business. 'Unfortunately, I was never in doubt.'[40]

When a business fails, the company becomes **insolvent** and is placed into liquidation. A business is insolvent when it cannot pay its debts as and when they fall due. Australian laws relating to insolvency are governed by the *Corporations Act 2001*. On the other hand, in Australia, when a person cannot pay their debts when and as they fall due they can declare bankruptcy, or be declared bankrupt. The laws in Australia relating to bankruptcy apply to people, not companies, and are governed by the federal *Bankruptcy Act 1966* and later amendments. This distinction between person and company is important for an entrepreneur when considering business entity forms and decisions but the distinction may not be reflected in the use of the term 'bankruptcy' in law in all countries. For instance, in US law the term bankrupt can apply to a company or a person.

How do we define **business failure**? According to Shepherd, it occurs:

> … when a fall in revenues and/or rise in expenses are of such magnitude that the firm becomes insolvent and is unable to attract new debt or equity funding; consequently, it cannot continue to operate under the current ownership and management.[41]

business failure
When a fall in revenues and/or rise in expenses are of such magnitude that the firm becomes insolvent.

In other words, insolvency occurs when a venture's financial obligations are greater than its assets and the venture cannot meet its debt repayment obligations. Shepherd and colleagues observe three overarching reasons for business failure.

- *The liability of newness*: There are higher costs for new businesses in learning new tasks. Organisational conflicts are higher in new businesses. There are barriers to entry for new businesses. Competitors will sometimes commit unethical acts against new start-ups.
- *Overconfidence*: Entrepreneurs rank their chances of success at over 70 per cent. Perhaps there is a 'hubris theory of entrepreneurship'.
- *Lack of experience*: Entrepreneurs with more experience will generally possess the knowledge to perform more effectively the roles and tasks necessary for success.[42]

No entrepreneur intentionally seeks bankruptcy, but when there is no other avenue an entrepreneur can initiate proceedings for bankruptcy. Problems that lead to insolvency can occasionally arise out of the blue but here are several circumstances that may foreshadow impending failure:

- new competition enters the market
- other businesses seem to be selling products that are a generation ahead
- the research and development budget is proportionately less than the competition's
- the business is overstocked.[43]

Some of the more imminent warning signs that a business may be trading while insolvent include:

- poor cash flow
- increasing debt
- letters of payment demands, summonses, judgements or warrants
- problems selling stock or collecting debts
- overdue taxes or superannuation liabilities.[44]

To decrease your risk of insolvency it is recommended that you have a current business plan along with good, well-organised financial records.

The rate of bankruptcy differs from country to country. It's not unusual for some countries, such as New Zealand and the US, to have relatively high 'churn' or business failure, and that can lead to bankruptcy. Other countries, such as Thailand, South Korea and Japan, can have extraordinarily low rates of bankruptcy. However, entrepreneurs discontinue association with their businesses for many reasons, and the Global Entrepreneurship Monitor reveals that a substantial number of entrepreneurs plan to close or sell the business as an exit strategy or close to pursue other job or business opportunities.[45]

In various countries bankruptcy carries a social stigma,[46] as it tends to in Australia. Society sees it as a sign of financial irresponsibility, and failed entrepreneurs often find it difficult to obtain credit. The entrepreneur may suffer from loss of esteem and other negative social attitudes. The recovery from failure has been likened to the grieving process associated with losing a loved one and it is proposed that through this process an entrepreneur benefits through learning.[47] Moreover, at an industry level, business failure is part of the natural life cycle which improves the quality of the survivor pool, delivering significant and substantial cost benefits to the industry.[48] Even failure in entrepreneurship has its upside.

SUMMARY

The regulatory environment for Asia-Pacific entrepreneurs is varied and complex. Doing business in Australia or New Zealand is quite different from doing business in Singapore or other countries in our region. While the entrepreneur does not need to be expert in all the areas of law, they do hold the responsibility for ensuring that they, their businesses and their employees comply with such laws as business formation, contract enforcement, credit regulations, international trading regulations, investor protection, labour regulations, licensing and permits, and property laws.

There are international provisions available through the World Intellectual Property Organization (WIPO) that greatly speed up enforcement of provisions. There are numerous rogue states and overseas havens when it comes to intellectual property rights protection. The wise entrepreneur has protections in place to guard against profit rip-offs, and in this chapter we have outlined a number of legal IP rights.

A patent is an intellectual property right to a unique invention. Patent holders have certain rights that can be defended against infringement by others.

A copyright provides exclusive rights to creative individuals for the protection of their literary or artistic productions. This protection extends beyond the life of the author for periods of 50 or 70 years in most countries. In case of infringement, the author (or whoever holds the copyright) can initiate a lawsuit for infringement. This action can result in an end to the infringement and, in some cases, the awarding of financial damages.

A trademark is a name, mark, symbol or motto identified with a company's product(s) or services. When an organisation registers a trademark, it provides a stronger means of preventing others from using the trademark. Registration is for 10 years and is renewable every 10 years thereafter. In case of infringement, the trademark holder can seek legal action and damages.

New forms of business require new forms of intellectual property protection. On the internet it is important to protect domain names and trademarks.

Trade secrets can include business processes and information that may be unpatentable and whose protection is only possible with employer and employee cooperation. Prosecution is still difficult in many of these cases.

The chapter then turned to examine the major forms of legal organisation. The advantages and disadvantages of each form were highlighted and compared. In addition, the characteristics and tax considerations of partnerships were compared with those of corporations.

The specific forms of partnerships and corporations were then examined. In particular, the requirements and benefits of limited partnerships, incorporated limited partnerships and limited liability companies were presented.

Additional corporation classifications were reviewed and a section was devoted to the issues of insolvency and bankruptcy relevant to entrepreneurs.

KEY TERMS & CONCEPTS

CourseMateExpress
Review key terms with interactive flashcards.

- asset protection
- B-corporation accreditation
- benefit corporations (B-Corp)
- business failure
- business formation
- cooperative society
- copyright
- corporation
- cybersquatter
- design registration
- domain name
- environmental protection
- fair use doctrine
- incorporated company
- incorporated limited partnership (ILP)
- incorporation
- insolvent
- intellectual property (IP)
- intellectual property rights (IPR)
- investor protection
- labour regulations
- limited liability
- limited liability partnership (LLP)
- limited partnerships
- non-disclosure agreement
- non-profit organisation
- open innovation
- partnership
- patent
- piracy
- property laws
- proprietary limited company (Pty Ltd)
- public limited company
- regulatory body
- sole trader
- taxation
- trade secrets
- trademark
- trading trust
- unincorporated business
- unlimited liability

REVIEW & DISCUSSION QUESTIONS

1 Briefly discuss how the decision to start a business in different countries may be affected by the local legal and regulatory environment.
2 Before a decision is made regarding the types of intellectual property a business will seek to protect, what three pieces of business information should be researched and acknowledged?
3 In your own words, what is a patent, of what value is a patent to an entrepreneur and how long does that benefit last?
4 What are seven basic rules entrepreneurs should remember about securing a patent?
5 When can a patent be declared invalid? Cite two examples.
6 Explain why an entrepreneur might decide against patenting as a protection strategy and briefly describe the potential consequences of such a decision.
7 In your own words, what is copyright? What benefits does copyright provide?
8 How much protection does copyright afford the owner? Can any of the individual's work be copied without paying a fee? Explain in detail. If an infringement of copyright occurs, what legal recourse does the owner have?
9 In your own words, what is a trademark? Why are generic or descriptive names or words difficult or impossible to register as trademarks?
10 When might a trademark registration be invalidated? Explain.
11 What is a domain name? Give some examples of interesting cases of domain name infringement.
12 Under what circumstances would an entrepreneur choose to keep trade secrets rather than register a patent application? What organisational strategies might be needed to keep 'trade secrets' secret?
13 Name six types of legal business structures that are relevant to a non-profit entrepreneur.
14 Define each of the following: sole tradership, partnership, and corporation.
15 What are the specific advantages and disadvantages associated with each primary legal form of organisation?
16 Name three specific types of partners. How do they differ?
17 Explain the limited liability partnership.
18 How does a limited partnership work? Give an example.
19 What is a proprietary limited (Pty Ltd) company and why would an entrepreneur choose to adopt this legal form of entity over being a sole trader? What is the equivalent form of the Pty Ltd company in Singapore, Malaysia and India?
20 What is liquidation and how does it relate to insolvency?

EXPERIENCING ENTREPRENEURSHIP

Get it right

The following is a list of advantages and disadvantages associated with sole traderships, partnerships and corporations. Place an *S* next to those that relate to sole traderships, a *P* next to those that relate to partnerships and a *C* next to those that relate to companies. If the advantage or disadvantage applies to more than one type of organisational form, put all answers in the accompanying box. Answers are provided at the end of the chapter.

ADVANTAGES		DISADVANTAGES	
1 Limited liability		1 Unlimited liability	
2 Sole ownership of profits		2 Governmental regulation	

ADVANTAGES	DISADVANTAGES
3 Unlimited life	3 Lack of continuity
4 Ease of formation	4 Double taxation
5 Flexibility	5 Difficulty obtaining large sums of capital
6 Transfer of ownership	6 Cost of organising
7 Relative freedom from governmental control	7 Relatively limited viewpoint and experience
8 Greater ability and expertise	8 Activity restrictions

EXPERIENCING ENTREPRENEURSHIP

What kind of trademark?

For each of the following trademarks, indicate whether you think it is suggestive, fanciful, arbitrary or generic by placing an *S*, *F*, *A* or *G* alongside. Answers are provided at the end of the chapter.

1 BANANA BOAT for sunscreen lotion
2 REEBOK for shoes
3 ROACH MOTEL for insect traps
4 MERCURY SOFTWARE for software that speeds communication
5 PHOENIX VENTURES for an investing business that focuses on investing in failing companies and reviving these companies
6 ARETE COACHING for life coaches (*arete* is the Greek word for 'overall excellence')
7 QANTAS
8 AIR NEW ZEALAND

EXPERIENCING ENTREPRENEURSHIP

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Protecting your legal interests

Entrepreneurs need to know how to legally protect their interests in a property or work. The most effective way to gain legal protection is to obtain a copyright or a trademark. Two definitions – (1) and (2) – are given here. Place a *C* next to the one that defines copyright, and a *T* next to the one that defines a trademark. Then, on the list underneath – (a) to (j) – place a *C* next to each item that could be protected with copyright and a *T* next to each item that could be protected with a trademark. Answers are provided at the end of the chapter.

1 distinctive name, mark, symbol or motto identified with a company's product
2 an exclusive protection of a literary or an artistic production
   a Best-selling novel
   b Logo
   c Company's initials (such as IBM or ITT)
   d Motion picture
   e Word (such as Coke or Pepsi)

f Computer program
g Musical comedy
h Slogan
i Stage play
j Symbol

CASE STUDIES

CASE 10.1

GLORIA'S DECISION

When Gloria Talavera opened her boutique in Manila six years ago, she had only one full-time employee. Since then Gloria has added two general partners and greatly expanded the operation. Over the past year, it has become obvious that the group could open another boutique that would be equally successful. The problem is money. The partnership lacks funds for expansion.

Gloria's banker has suggested that the partnership borrow \$200 000 from the bank and pledge the business assets as collateral. The banker outlined how this strategy would get the money Gloria needed and that once the boutique was up and going, the money could then be repaid. The idea sounds fine to the partners, although they are concerned about the risk involved. If the second boutique does not do well, it could affect the success of the first boutique by siphoning off funds to repay the loan.

Gloria has been thinking about incorporating the business, selling shares and using these funds for expansion purposes. She has not shared this idea with her banker because she wants to give it more thought, but she intends to talk it over with her partners later in the week.

QUESTIONS

1 What are the benefits of incorporating a company to operate the business and raising money through the issue of shares? Is this a better idea than the banker's proposal of taking a \$200 000 loan? Why or why not?
2 What would you recommend to Gloria? Explain in detail.

CASE 10.2

A PATENT MATTER

Technological breakthroughs in the machine industry are commonplace. Thus, whenever one company announces a new development, some of the first customers are that company's competitors. The latter will purchase the machine, strip it down, examine the new technology and then look for ways to improve it. The original breakthroughs may be patented by the business that makes them, even though the technology is soon surpassed.

A few weeks ago, Tom Farrington completed the development of a specialised lathe machine that is 25 per cent faster and 9 per cent more efficient than anything currently on the market. This technological breakthrough was a result of careful analysis of competitive products. 'Until I saw some of the latest developments in the field,' Tom told his wife, 'I didn't realise how easy it would be to increase the speed and efficiency of the machine. But once I saw the competition's products, I knew immediately how to proceed.'

Tom has shown his machine to five major businesses in the industry, and all have placed orders with him. Tom has little doubt that he will make a great deal of money from his invention. Before beginning production, however, Tom intends to get a patent on his invention. He believes his machine is so much more sophisticated and complex than any other machine on the market that it will take his competitors at least four years to develop a better product. 'By that time, I hope to have improved on my invention and to continue to remain ahead of them,' he noted.

Tom has talked to a lawyer about filing for a patent. The lawyer makes a few key observations. He says, 'Tom, patents are based on an inventive step; given that you say the improvements were obvious to you, it may also be to others and therefore, potentially, there will be insufficient inventiveness for this to be patentable. You also mentioned that you have forward orders; this suggests that you could be deemed to have already disclosed your invention and furthermore put it into commercial use prior to filing a patent. In both cases this is likely to invalidate your patent application.'

QUESTIONS

1 Given the nature of the industry, how valuable will a patent be to Tom? Explain.
2 If Tom does get a full patent, can he bring action against infringers? Will it be worth the time and expense? Why or why not? Are there any alternatives to a full patent application?
3 How could Tom have protected himself against invalidating his patent application when pitching his new machine to the five major suppliers? Describe how you would have approached this scenario differently to maximise your chances of a successful patent application and your projected returns.

CASE 10.3

ALL SHE NEEDS IS A LITTLE BREATHING ROOM

When Debbie Dawson incorporated her company twelve months ago, she estimated that it would be profitable within eight months. That is not what happened. During the first six months, she lost $18 000; during the next six months, she lost an additional $14 000. Debbie believes that the business is going to get better during the next six months and that she will be able to break even by the end of the second year. However, her creditors are not sure. Debbie's business owes the two largest creditors a total of $48 000. The others are owed a total of $38 000.

Debbie believes that, if she can postpone paying her creditors for a period of one year, her company will be strong enough to pay off all of its debts. On the other hand, if she has to pay the creditors now, she will be too weak financially to continue and will have to declare bankruptcy. 'I really think it's in everyone's best interest to give me 12 months of breathing room,' she explained to her husband. 'If they will do this, everyone is going to come out on top. Otherwise, we are all going to take a financial bath.'

Debbie has considered broaching the subject with her two major creditors. However, she is not sure whether this suggestion would be accepted or would be used as a basis for their bringing legal action against her. 'If they think I am trying to stall them, they just might demand repayment immediately and force me into bankruptcy,' she explained to a close friend. 'Of course, if they see things my way, that's a different story. In any event, I'm reluctant to pursue this line of action without talking to my attorney.'

Debbie hopes she and her lawyer, Mark, can work out a plan of action that will prevent her having to declare bankruptcy and liquidate the business. During her phone call to set up a meeting with Mark, she comments, 'If everyone remains calm and looks the situation over very carefully, I think they'll agree that my suggestion is a good one. After all, I'm not asking them to put any more money in the business, so the most they can lose is what they are owed currently. On the other hand, if they force my hand, they'll probably be lucky to get 40 cents on the dollar. If they wait, they could end up with all of their money. All I'm asking for is a little breathing room.' Mark suggests that they meet later in the week to talk about it. 'I'm sure we can think of something,' he tells her.

QUESTIONS

1 Under Australian law, is Debbie's business technically insolvent? If so, what are the consequences? If not, why not?
2 Is Debbie correct in saying she will need to declare bankruptcy? Explain your answer.
3 When selling the creditors on your recommendation, what argument(s) would you use?

ANSWERS TO 'GET IT RIGHT'

ADVANTAGES	DISADVANTAGES
1 C	1 S, P
2 S	2 C
3 C	3 S, P
4 S, P	4 C
5 S, P	5 S, P
6 C	6 C
7 S, P	7 S
8 C	8 C

ANSWERS TO 'WHAT KIND OF TRADEMARK?'

1 A
2 F
3 S
4 S
5 S
6 F
7 A
8 G

ANSWERS TO 'PROTECTING YOUR LEGAL INTERESTS'

1 T
2 C
   a C
   b T
   c T
   d C
   e T
   f C
   g C
   h T
   i C
   j T

ONLINE STUDY RESOURCES

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CHAPTER 11

BUSINESS PLANNING

It is well established that you can't raise money without a business plan… a business plan is a work of art in its own right. It's the document that personifies and expresses your company. Each plan, like every snowflake, must be different. Each is a separate piece of art. Each must be reflective of the individuality of the entrepreneur. Just as you wouldn't copy someone else's romancing techniques, so should you seek to distinguish your plan for its differences.

Joseph R. Mancuso,
How to Write a Winning Business Plan[1]

CHAPTER OBJECTIVES

1. To understand the variety of business plans and their intended audiences
2. To define a lean business plan and demonstrate its value
3. To appreciate when to use traditional, long-form business planning
4. To set forth the viewpoints of those who read a business plan
5. To understand the structure of an effective traditional business plan
6. To present some helpful hints for writing an effective business plan
7. To highlight points to remember in the presentation of a business plan

THE WHY AND WHEN OF BUSINESS PLANNING

There are many kinds of business planing and they have different names. Sometimes a business plan may be referred to as a venture plan, a loan proposal or an investment prospectus. Nowadays we even see napkin plans and 'one-pagers'. No longer is the business plan the *ne plus ultra* for start-ups and young ventures. Whatever its name, the business plan is the minimum document *required for a particular purpose*, be it a bank, venture capitalist (VC) your board of directors, or your team. The emphasis should always be on how it will be used, and for whom. Yet all business plans, as short or as long as they may be, describe the new (or existing) venture and tell us how the venture will exploit some opportunity.

Almost every entrepreneurship textbook describes how to write a traditional **business plan**. We too have included it at the end of this chapter. Traditionally, the business plan would be as much as 50 pages in length, cover a three-year period and cost the entrepreneur a significant amount of time and money. The table of contents of this type of formal business plan might be quite similar to the 'complete business plan outline' provided in Table 11.2. The long-form plan includes how the products and services will be provided; which markets will be served; what types of resources are required; the objectives to be achieved, including the strategies to be implemented; and the financial projections of growth and profit.[2]

business plan
The written document that details a proposed venture. It must illustrate current status, expected needs and projected results of the new business.

But something no one tells budding entrepreneurs is that *most entrepreneurs do not really need a full-blown, traditional business plan*. At least not in the beginning. What they need is a **lean business** plan. The lean plan could include your pretotyping experiments, lean marketing testing, accelerator proposals, **hackathon** exhibits, pitch events and prize challenges (see Table 11.1). Together with the business model, lean planning can forestall failure and show how to pivot. It is far cheaper not to begin an ill-fated business than to learn by experience much later, what your lean plan could have taught you at a cost of several hours of concentrated work.[3]

lean business plan
Basically a 'plan-as-you-go business plan'. Sometimes you will need a summary memo, sometimes you need an elevator pitch and at other times an executive summary.

hackathon
A social design-sprint event that brings together programmers, coders and many others to build or improve a software program.

A word of advice: Entrepreneurs must prepare their own plans. If an entrepreneurial team is involved, then all the key members should be part of writing the plan, and the leader should understand the contribution of each team member. Seeking the advice and assistance of outside professionals is always wise, but entrepreneurs need to understand every aspect of the business plan, because they are the ones who come under the scrutiny of financial sources. Thus, the business plan stands as the entrepreneur's description and prediction for their venture, and it must be defended by the entrepreneur – simply put, it is the entrepreneur's responsibility.[4]

There are several reasons why entrepreneurs should develop business plans, whether lean or long-form.

- *Communication tool*: The plan helps educate stakeholders about the business ideas and objectives of the enterprise.
- *A tool for raising money and resources*: External sources such as banks or venture capitalists frequently request a business plan with financial projections in order to convince investors.
- *Analytic and reflective tool*: Entrepreneurs can articulate their strategies and goals and can formulate the steps needed for implementation. This sometimes helps them create new alternatives.
- *Lessens uncertainty*: The plan helps lessen uncertainty and broaden opportunities, and can even act as a platform to conduct pivoting experiments at a limited cost.
- *An action plan*: Business planning shows the stages of venture development and identifies targets and milestones.
- *A reputation builder*: Planning is a way for young businesses to overcome the liability of newness during early stages.[5]

TABLE 11.1 THE MODERN LANDSCAPE OF LEAN BUSINESS PLANNING

	BUSINESS MODEL COMPETITIONS	BUSINESS CONCEPT (OR IDEA) COMPETITION	ACCELERATOR COMPETITIONS	START-UP WEEKENDS AND HACKATHONS	DEMO DAYS AND PITCH EVENTS	PRIZE CHALLENGES
Reasons for conducting the competition	Universities: to foster student success Government: finance economic growth	For early-stage ventures not yet fully developed, not yet generating revenues and with no end product.	Evaluates the best ideas and entrepreneurs and offers them to enter 'acceleration' for eventual investment.	Encourages collaboration amongst entrepreneurs.	Showcases entrepreneurs and viable ventures to VCs and angel investors.	Solves big problems or address specific markets.
Judging	Faculty, local mentors, entrepreneurs, some investors	Very flexible judging criteria based on novelty, first-mover	Seed-stage angel investors, successful entrepreneurs	Local entrepreneurs, local business leaders	Seed angel investors, VCs, successful entrepreneurs	Professional full time or volunteer committee; sometimes judged by 'the crowd'
Structure	Business plans submitted and reviewed. Live evaluation of finalists.	Brief idea submitted through video or short questionnaire; application review; preliminary judging; final presentation of two-minute pitch; awards	Basic application submitted. Live pitch/demo at an event.	Collaboration with peers over a long weekend on a technical prototype. Demo and pitch in front of judges.	Successive rapid pitches in front of judges and audience.	Varies. Often successive judging/pitch competitions.
Entrance requirements / criteria	Business plan	Very low barriers to participation	Application, team, pitch/demo	Hands-on development skills	Pitch, basic product demo	Innovative prototype/ product
Ideal outcomes (for the entrepreneur)	Cash prize, recognition	Cash prize, recognition	Seed-capital, participation in a program, start-up development	Team formation, prototype development, idea validation, cash prize/ services	VC/angel investment, visibility, traction	Cash prize, customer validation/ adoption, visibility

Source: Cornell, C. J. ''The Metamorphosis of Business Plan Competitions'' presented at the Cogswell Polytechnical College. Accessed November 18, 2017. https://venturewell.org/open2014/presentation/the-metamorphosis-of-business-plan-competitions/. Copyright 2014 by C.J. Cornell. Used by permission.

CONTRARIAN VIEWS ON BUSINESS PLANNING

traditional business plan A bank or investment-ready document of generally 30–40 pages and with three- to five-year financial projections, as opposed to a lean business plan.

Researchers have recognised that a traditional business plan is less important for new start-ups than once thought. Bhide found that most entrepreneurs spend little effort on their initial traditional business plan. Among the companies he studied, 41 per cent had launched with no plan; 26 per cent had just a rudimentary road map (maybe on a napkin or a one-pager; see Figure 11.1 for Groupon's first 'business plan'); another 5 per cent had worked up financial projections for investors. Only 28 per cent had a formal business plan.[6] Analysing almost 3000 small Australian businesses, Gibson and colleagues found

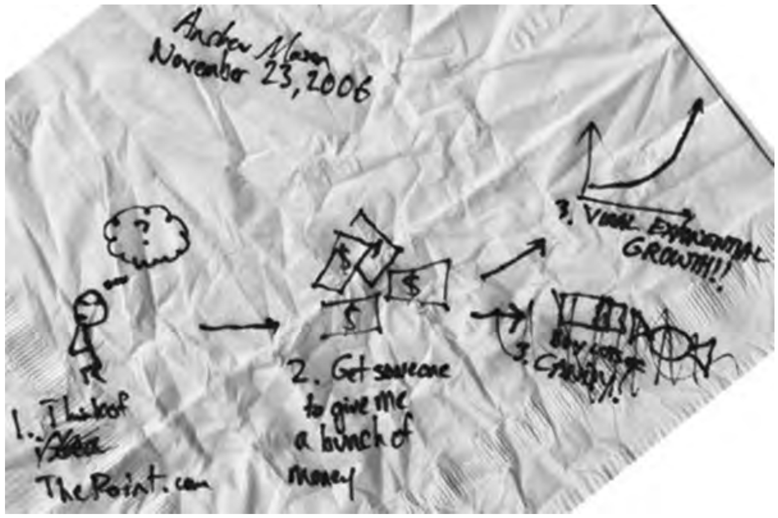


FIGURE 11.1 GROUPON'S ORIGINAL BUSINESS PLAN ON A NAPKIN

Sources: Staff, I. (2006, June 12). Back of the napkin business model. *Investopedia*. https://www.investopedia.com/terms/b/backofthenapkin.asp; Blank, S. (2011, March 29). Napkin entrepreneurs. https://steveblank.com/2011/03/29/napkin-entrepreneurs/; Yarow, J. (n.d.). Groupon's original business plan. *Business Insider*. http://www.businessinsider.com/groupon-business-plan.

no relationship between business planning and business performance. Overall, these authors believe that small businesses are best to delay planning until after a period of growth.[7] This contradicts what most textbooks (including ours in the past) have maintained. In essence, traditional business planning by start-ups does not appear warranted.[8]

The most important problems with traditional, long-form business plans are:

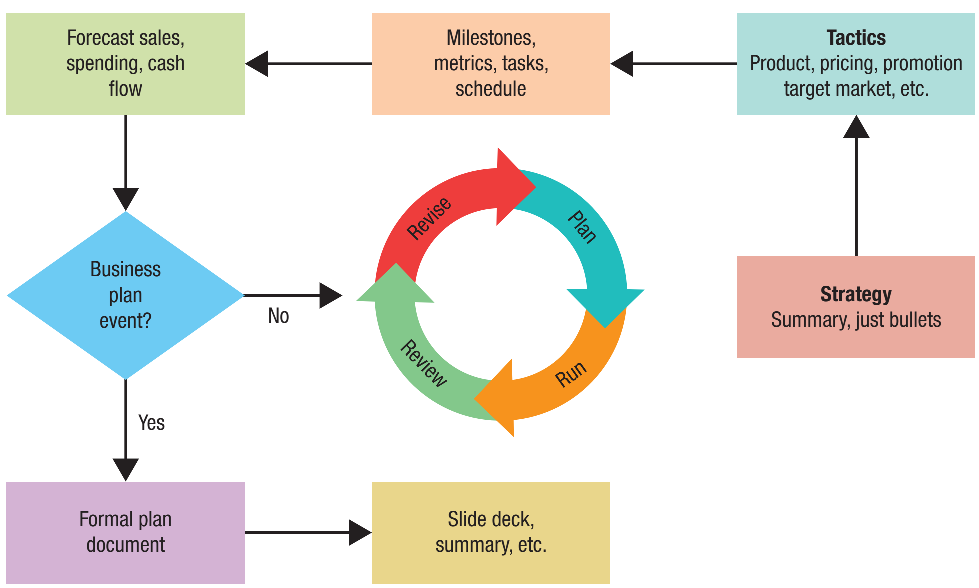
- *The world is uncertain.* How can a start-up know who the customer is or what the business model should be? It is impossible to predict the future; there will be both positive and negative deviations. Most entrepreneurs need time for product development or setting up sales. You need a plan that will adapt to the new reality.
- *The planning period is too long.* How can you possibly guess what will be happening in three years? The easiest way to improve a business plan is to shorten the planning period. In lean planning you focus on the next few months. Lean plans may look only at the next three months, and then add a new month after each month ends. This makes it more likely that you can successfully pivot based on learning during the project. Your ambitions and freedom to pivot may deviate from the fixed view of the investor.
- *Planning is arduous, and entrepreneurs have no time.* The effort and unpredictability of traditional planning is enormous. Most start-uppers don't have time for a formal business plan until they need to deal with banks, investors or public support agencies.
- *Many entrepreneurs follow these plans uncritically* without pivoting, and without asking questions such as: Has the market changed? Did the product turn out the way we thought it would?
- *They are useless for internal use*. They may have some utility for bankers and VCs, but with incomplete knowledge, usually implementation is poorly described, so most entrepreneurs do not even have an internal plan.
- *Unclear responsibilities.* Traditional plans cloud responsibilities in situations where things frequently change. The lean plan, without the burden of needing to be presented to investors, allows the entrepreneur to divide up responsibility, and to change it quickly.[9]

Gumpert's 2003 book *Burn Your Business Plan!* argued that writing a business plan unnecessarily wastes time and, in fact, could be counterproductive. With the wide availability of inexpensive product development and pretotyping tools (see Figure 7.2), entrepreneurs can go from concept to product to market without needing significant capital, or any external capital at all. Reaching customers and large markets can be as simple as creating a website and using online social networking tools. Gumpert urged entrepreneurs instead to focus on key hands-on tasks that are more likely to impress professional investors – tasks such as preparing an effective oral presentation, writing a clear and compelling synopsis, developing a website that captures a business model and assembling hard-hitting financial projections. 'Business plans are the equivalent of "intellectual push-ups". Nice exercise, but not necessarily relevant to anything in the real world'.[10]

THE NEED FOR LEAN BUSINESS PLANNING

The whole planning scene is changing. New bottom-up and practitioner-oriented approaches and software to business planning are emerging to fill the shortcomings outlined above. The lean plan is the 'contrarian's business plan'. This approach, outlined in Figure 11.2, builds upon the lean start-up movement and offers an alternative approach to the traditional business plan. A business plan can be as long as a short novel or as short as a Venn diagram showing where markets overlap. Many companies just skip the plan and go straight to market. (Still, you are going to get nowhere with banks and private investors without a full, traditional plan.)

FIGURE 11.2
LEAN BUSINESS PLANNING STEPS



Source: Adapted from Berry, T. (2015). *Lean business planning: Get what you want from your business*. Melbourne, Fla.: Motivational Press; Berry, T. (2014, January 2). Lean business planning in a nutshell. https://leanplan.com/lean-business-planning-process/; Berry, T. (2015, May 8). An overview of lean business planning. https://articles.bplans.com/an-overview-of-lean-business-planning/; U.S. Small Business Administration (2016). Fundamentals of lean business planning. https://www.sba.gov/blogs/fundamentals-lean-business-planning.

One leading proponent of lean business planning is Tim Berry and his company Palo Alto Software. Since 1988, Palo Alto Software has created business planning tools such as LivePlan[11], Business Plan Pro, Sales & Marketing Pro and the course 'Start, Run and Grow Your Business'.[12]

Berry's approach to lean business planning comprises three words: *form follows function*. In design and architecture, this means that the shape of an object should be based upon its intended purpose. In lean planning, it means write/plan only what you will use. As Berry puts it, it means creating a 'plan-as-you-go business plan'.[13] Sometimes you will need a formal plan, other times a summary memo. Sometimes you need an **elevator pitch**, other times an executive summary. Still other times you will need your plan as a management tool within the business.

elevator pitch
The brief oral presentation for selling a business plan to potential investors (named for the analogy of riding an elevator and having only two minutes to get your story across to another person in the elevator).

Before you plan, answer these questions. What kind of entrepreneur are you? Are you going for financing? Is it management, strategy and implementation that is driving you? Are you pitching to an angel investor? Going for a bank loan? Just trying to manage your business better? Or has a competitor appeared on your horizon?

LEAN STRATEGY

Let's examine Berry's model in detail. You cannot do everything, nor do you want to, so (starting at middle-right 'Strategy;) limit your strategy only to what is needed and what is essential. As Porter says, 'The essence of strategy is choosing what not to do.'[14] Berry suggests that a good two-page pitch is a great way to communicate your core strategy. (You can find templates at sites like bplans.com and liveplan.com.) It is like a movie trailer without a movie. It is best to start with your summary/pitch, then develop your lean plan, then redo the summary/pitch so that it stands out as an infographic or a Prezi (see Figure 11.3).[15]

LEAN TACTICS

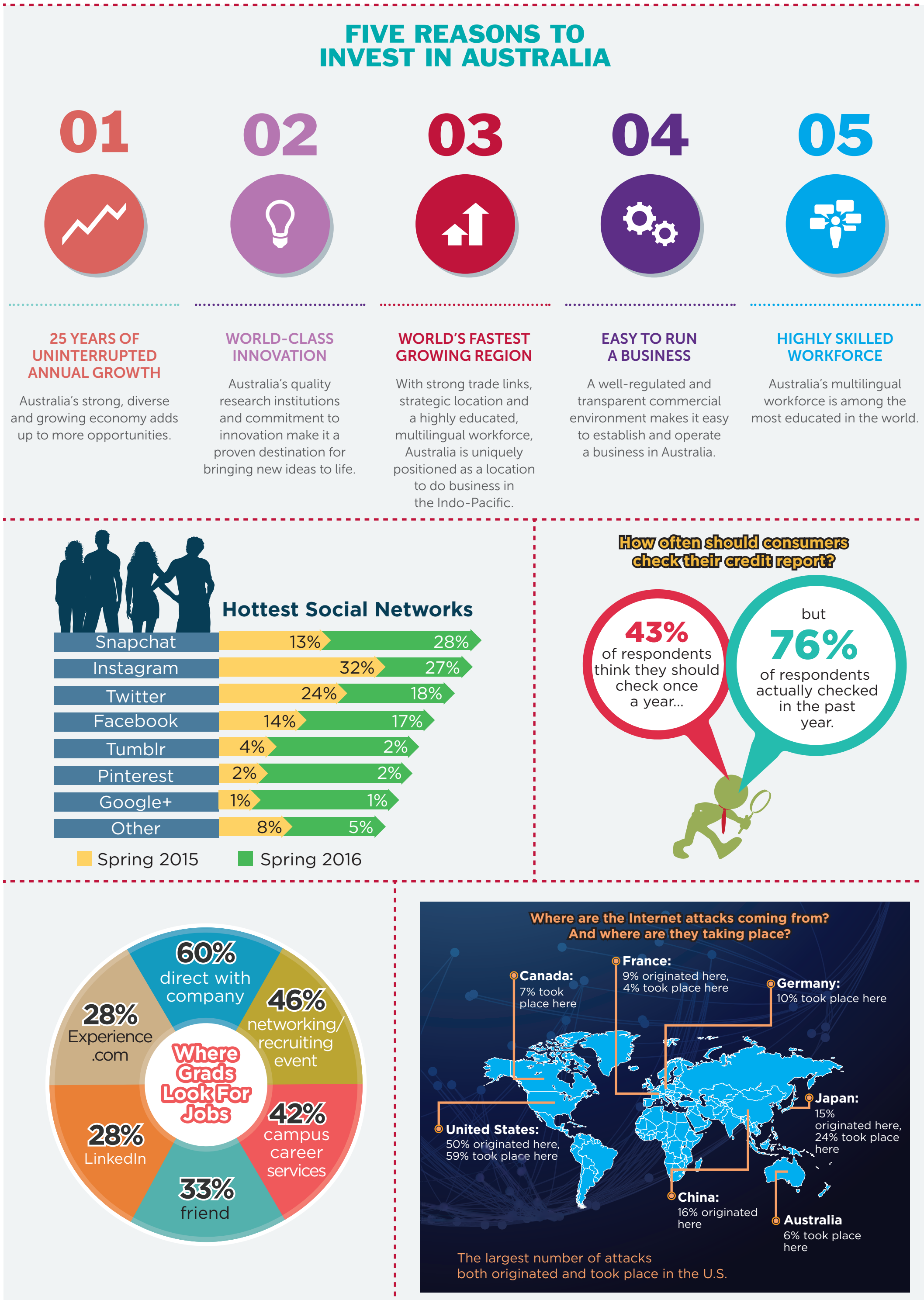
Moving through Figure 11.2 strategy leads to execution through tactics such as marketing, service, pricing, promotion, channels, financial administration, product development and so forth. These must align perfectly to your strategy. Each can be simple, ideally just bullet points. When and if you reach the full formal, traditional business plan, you will need to flesh these out in detail.

- *Marketing tactics*: In Chapter 5, you identified your customer pains, value propositions, product-market fit and problem-solution fit. Marketing is essentially getting your customers to know, like and trust you – what Ries, Blank and others call 'customer development'.[16] Can you locate your customers and help them find you? Can you present your product or service in a way that matches their pains and frustrations? In the marketing section, you can include media that work for your target market, benefits list, features list, web presences (including mobile and social media), content marketing, advertising, packaging, channels of distribution, margins through channels, channel gatekeepers, affiliate marketing, social media, platforms, metrics, paid posts, events, affiliate marketing, promotion (media strategies, interviews, blog posts)…
- *Product/service tactics*: Here you decide on packaging, pricing, sourcing, manufacturing, development, intellectual property and so forth. In lean planning, these are all bullet points. Here you would include: product descriptions and product lists, technology, patents, trade secrets, protection, price lists, menus, new versions and configurations, new products (or services), product (or service) updates, bundling, sources and costs, vendors, suppliers, packaging, liability problems, registration for legal requirements, registration in lists of providers.
- *Other tactics*: Tactics also may include finance, personnel, team building, logistics, funding needs, raising investment, use of funds, borrowing, loans, credit lines, management team recruitment, compensation and benefits.

LEAN ESSENTIALS

Make sure you are executing your tactics correctly by boiling them down to specific assumptions, milestones and performance measurements. Track results and compare them to expectations. Develop

FIGURE 11.3 EXAMPLE STRATEGY PITCH



Source: "Australia in Brief," Australian Government Department of Foreign Affairs and Trade. Accessed August 5, 2018. http://dfat.gov.au/about-us/publications/Pages/australia-in-brief.aspx. CC BY 3.0 AU. https://creativecommons.org/licenses/by/3.0/au/.

accountability dates, budgets, **metrics**, milestones, forecasts, sales, spending and cash flow. And, if you are starting a new business, also track your starting costs.

metrics
Assumptions and calculations used for any revenue projections.

- Begin with *assumptions*. You might comment that you assume the market does not change and that no new competition enters the market. You might also include interest rates, tax rates and so forth.
- Next are *milestones,* dates you use to manage responsibilities, track results, and review the plan. It is also important to schedule advertising, social media, website development and inbound marketing goals. Pay attention to the metrics you use. You can pick from the financial performance measures suggested in Chapter 12.
- Beyond this are the *forecasts.* Websites such as LivePlan manage the calculations and formats for presentations in figures and tables. Obviously, forecasts need to be corrected regularly as a review milestone.
- Along with the revenue forecast (see Figure 11.4), you need to plan and manage *costs,* including *expenses* (used to generate revenue) and *assets* (capital equipment); and operating expenses. Finally comes the *cash flow*. Only black or grey market businesses run on cash only (under the table).

FIGURE 11.4 EXAMPLE OF A REVENUE FORECAST TABLE

START-UP BIKE SHOP	FY2015	FY2016	FY2017
Revenue			
New Bicycles	$ 272 000	$ 300 000	$ 325 000
Accessories and Parts	$ 67 980	$ 72 000	$ 75 000
Clothing	$ 81 600	$ 87 000	$ 93 000
Repair and Service	$ 37 950	$ 45 000	$ 52 500
University Patrol Service Contr…	$ 6 000	$ 6 000	$ 6 000
Total Revenue	**$465 530**	**$510 000**	**$551 500**
Direct Cost			
New Bicycles	$ 184 960	$ 204 000	$ 221 000
Accessories and Parts	$ 33 990	$ 36 000	$ 37 500
Clothing	$ 40 800	$ 43 500	$ 46 500
Repair and Service	$ 7 590	$ 9 000	$ 10 500
University Patrol Service Contr…	$ 300	$ 300	$ 300
Total Direct Cost	**$267 640**	**$292 800**	**$315 800**
Gross Margin	$ 197 890	$ 217 200	$ 235 700
Gross Margin %	**43%**	**43%**	**43%**

Source: Berry, T. (2008a). The plan-as-you-go business plan. Entrepreneur Press; Berry, T. (2008b, January 3). Plan-as-you-go business planning. Retrieved from https://timberry.com/the-plan-as-you/. Palo Alto Software.

ENTREPRENEURIAL EDGE

HOW TO AVOID START-UP WARS

Feuds among co-founders are the leading cause of early start-up death. Founders are often confronted with the dilemma of how to carve up ownership. What to do if your CEO develops mental illness? What to do if there is emotional, psychological or mental stress? Here are three cautionary tales.

- In 2018, Melbourne-based Matt Berriman – co-founder of fast-growth adtech start-up Unlockd – stepped away from leadership in his company's 'best interests' due to his admitted bipolar mental health disorder. How would you they divide up the share? In Australia, it is common that co-founders are issued with shares in the company in early days. What if a co-founder is unable to continue? What if the relationship works well for years, then cannot continue? By the way, '[e]ntrepreneurs . . . reported experiencing a significantly greater prevalence and diversity of mental health differences than the comparison participants.'[17]
- Meredith Perry and Nora Dweck were roommates at the University of Pennsylvania, where they brainstormed about ideas and inventions. Perry came up with the idea of a 'wireless power charger using ultrasound', so they created 'uBeam', and presented themselves as equal partners. Together, they won the 'PennVention' award. Dweck moved on to do the needed IP protection while Perry took care of the website and logo. Perry then sent Dweck a company Operating Agreement. Pressed for time, Dweck signed and then shockingly discovered the document specified an 80/20 split in Perry's favour. Perry threatened to dissolve uBeam if Dweck persisted in demanding a greater share. Dweck sued Perry for 50% of the company.
- Reggie Brown, Bobby Murphy and Evan Spiegel attended Stanford University and joined the same fraternity. Together they invented Snapchat, a mobile app that allows users to send disappearing photo and text messages to each other. But Reggie was frozen out by the others and he sued, alleging that he deserved one-third equity in Snapchat.

To avoid such equity wars, Demmler and Foundrs have developed ways to quantify the elements of the decision-making process so that it is as logical and fair as possible. The approach looks at various components of the start-up. For example, who came up with the idea? Who prepared the plan? Is one of the founders essential to the domain expertise? Who has risked resources already? See the Foundrs Equity Calculator (cited in the sources). Here are some questions to ask:

- Who had the original idea and told the others?
- Who prepared the business plan and financials?
- Who has technical domain expertise in this field?
- Who is already working on the start-up and wants to join full time once funding is secured?
- Who is willing to work full time for free for as long as it takes until revenue can pay salaries?
- Who wrote the marketing copy, blog or other content for the website?
- Who, if they left the start-up, would severely impact chances of raising funding?
- Who, if they left the start-up, would severely impact the development schedule?
- Who, if they left the start-up, would prevent rapid generation of revenue?
- Who owns the intellectual property that undergirds the business?
- Who is maintaining the spreadsheet with budget estimates?
- Who has paid for basic business expenses like business cards, web hosting and images?
- Who has been pitching to investors and creating fundraising proposals?

Sources: Foundrs.com. (n.d.). Co-founder equity calculator. http://foundrs.com/; Shontell, A. (n.d.). These leaked videos could lead to a huge payday for ousted Snapchat co-founder. from http://www.businessinsider.com/snapchat-lawsuit-video-depositions-2013-11; Start-upFreak.com. (n.d.). Calculate the founder's pie based on individual contribution. http://gizmo.startupfreak.com/founder-pie/; Stormon, C. (2014, April 22). Splitting equity. http://startfast.net/2014/04/splitting-equity/; Berriman, M. (2018, February 13). OPEN LETTER: My mental health battle & why I'm stepping aside as CEO of Unlockd. https://medium.com/@mattberriman/open-letter-my-mental-health-battle-why-im-stepping-aside-as-ceo-of-unlockd-7fa9a9e79148; Freeman, M., Johnson, S., Staudenmaier, P., & Zisser, M. (2015). *Are entrepreneurs "touched with ˚re"?* (Pre-publication manuscript). http://www.michaelafreemanmd.com/Research.html; Kiernan, S. (2018, February 21). CEO of Australian startup Unlockd steps down to treat mental health. *CRN Australia*. http://www.crn.com.au/news/ceo-of-australian-startup-unlockd-steps-down-to-treat-mental-health-485222; Smith, P. (2018, February 14). 'Agonising decision' as Unlockd founder Matt Berriman steps down as CEO to address bipolar disorder. *Australian Financial Review*. http://www.afr.com/technology/agonising-decision-as-unlockd-founder-matt-berriman-steps-down-as-ceo-to-address-bipolar-disorder-20180213-h0w20y.

TRADITIONAL BUSINESS PLANNING

Now that we have looked at the lean business plan, it's time to seize the bull by the horns and look at the full-blown, long-form, traditional business plan. If you are a real going concern, you will need this for many purposes.

BENEFITS OF THE TRADITIONAL BUSINESS PLAN

The time and effort involved in writing a proper traditional business plan forces you to view the venture critically and objectively. It helps you to quantify objectives and measurable benchmarks. It is also a communication tool to proselytise to your markets and to potential sources of funds. Your stakeholders get a lot out of a business plan. The business plan provides the financial details and plans for securing a share of the market. It gives potential investors the opportunity to consider if your company can service a debt. It helps identify critical risks and crucial events with a discussion of contingency plans. For people with no prior knowledge of the entrepreneur or the venture, the business plan provides a useful guide for assessing the individual entrepreneur's planning and managerial ability.

For the entrepreneur, the following benefits are gained:

- The time, effort, research and discipline needed to put together a formal business plan force the entrepreneur to view the venture critically and objectively.
- The competitive, economic and financial analyses included in the long-form business plan subject the entrepreneur's assumptions about the venture's success to close scrutiny.
- Because all aspects of the business venture must be addressed in the plan, the entrepreneur develops and examines operating strategies and expected results for outside evaluators.
- The business plan quantifies objectives, providing measurable benchmarks for comparing forecasts with actual results.
- The completed business plan provides the entrepreneur with a tool for communication to outside financial sources as well as an operational tool for guiding the venture toward success.[18]

The potential sponsors and funders who read the plan derive the following benefits from the business plan:

- The business plan provides the details of the market potential and plans for securing a share of that market.
- Through prospective financial statements, the business plan illustrates the venture's ability to service debt or provide an adequate return on equity.
- The plan identifies critical risks and crucial events with a discussion of contingency plans that provide opportunity for the venture's success.
- By providing a comprehensive overview of the entire operation, the business plan gives financial sources a clear, concise overview of the necessary information for a thorough business and financial evaluation.
- For a financial source with no prior knowledge of the entrepreneur or the venture, the business plan provides a useful guide for assessing the individual entrepreneur's planning and managerial ability.[19]

CourseMateExpress

There was a huge flaw in Billie's design. Did she do proper business planning? Read about it on CourseMate Express.

WHO READS THE FULL PLAN?

Although numerous professionals may be involved with reading the business plan – such as venture capitalists, bankers, angel investors, potential large customers, lawyers, consultants and suppliers – there are *three main viewpoints* entrepreneurs need to clearly understand when preparing the plan.[20]

- The first viewpoint is, of course, the entrepreneur's, because he or she is the one developing the venture and clearly has the most in-depth knowledge of the technology or creativity involved. This is the most common viewpoint in business plans, and it is essential. However, too many plans emphasise this viewpoint and neglect the viewpoints of the potential market and customers as well as the investors.
- The second viewpoint is the customers. You must have a 'market-driven' company that convincingly demonstrates the benefits to users (the target group of customers) and the existence of a substantial market. Too many entrepreneurs tend to de-emphasise in-depth marketing information in their business plans.[21] Establishing an actual market (determining who will buy the product or use the service) and documenting that the anticipated percentage of this market is appropriate for the venture's success are valuable criteria for the business plan.
- The third viewpoint is that of the 'other' market, namely the investor, which is focused on the financials. Sound financial projections are necessary if investors are to evaluate the worth of their investment. This is not to say that an entrepreneur should fill the business plan with spreadsheets of figures. In fact, many venture capital firms employ a 'projection discount factor', which merely represents the belief of venture capitalists that successful new ventures usually reach approximately 50 per cent of their projected financial goals.[22] However, a three- to five-year financial projection is essential for investors in making their judgement of a venture's future success.

five-minute reading
A process venture capitalists use when they are reviewing a business plan for potential investment.

Most potential sponsors or funders give your business plan a **five-minute reading**. The following six steps represent the typical business plan reading process that many venture capitalists use (less than one minute is devoted to each step):

- Step 1: Determine the characteristics of the venture and its industry.
- Step 2: Determine the financial structure of the plan (amount of debt or equity investment required).
- Step 3: Read the latest balance sheet (to determine liquidity, net worth and debt/equity).
- Step 4: Determine the quality of entrepreneurs in the venture (sometimes the most important step).
- Step 5: Establish the unique feature in this venture (find out what is different).
- Step 6: Read over the entire plan lightly (this is when the entire package is scanned for a casual look at graphs, charts, exhibits and other plan components).[23]

Is it unjust to expect just a five-minute reading? Well, that's the nature of the process for many funders. To be fair, other sources may devote more time to analysing the plan. But keep in mind that these people read through numerous business plans in a sitting, so knowing their reading process is valuable for developing your plan.

HOW TO STRUCTURE YOUR LONG-FORM PLAN

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A detailed business plan usually includes anywhere from 8 to 12 sections (depending on the idea, the industry and the technical details). The ideal length of a plan is 25 pages, although, depending on the need for detail, it may range from 20 to more than 50 pages, especially if an appendix is included. The typical structure is outlined in Table 11.2, though obviously there will be occasions when you will need to deviate from this.

TABLE 11.2 COMPLETE BUSINESS PLAN OUTLINE (CBPO)

Section I: Executive summary		
A	Objectives	
B	Values, vision and mission	
C	How we measure our success	
D	Start-up summary	
E	Investment offering	
Section II: Business description		
A	General description and business rationale	
B	Industry background	
C	Goals and potential	
D	Uniqueness of product or service	
Section III: Marketing		
A	Marketing vision	
B	Market research and analysis:	
	1	Target market (customers)
	2	Market size and trends
	3	Competitor analysis
	4	Remarkable difference
C	Marketing plan:	
	1	Market strategy
	2	Branding elements
	3	Price rationale
	4	Marketing materials
	5	Advertising and promotions
	6	Web plan
	7	Sales strategy and forecast
Section IV: Research, design and development		
Section V: Operations		
A	Location:	
	1	Advantages
	2	Zoning
	3	Taxes
B	Proximity to supplies	
C	Access to transportation	

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Section VI: Management	
A	Management team: key personnel
B	Legal structure: stock agreements, employment agreements, ownership
C	Board of directors, advisers, consultants
Section VII: Financial Plan	
A	Start-up funding
B	Important assumptions
C	Break-even analysis:
	1 Profit and loss
	2 Cash flow
D	Balance sheet
E	Business ratios
Section VIII: Critical risks	
A	Potential problems
B	Obstacles and risks
C	Environmental risks
D	Alternative courses of action
Section IX: Harvest strategy	
A	Transfer of assets
B	Continuity of business strategy
C	Successor
Section X: Milestone schedule	
A	Timing and objectives
B	Deadlines and milestones
C	Relationship of events
Section XI: Investment offering	
Section XII: Appendix or bibliography	

Source: Adapted from Kuratko, D. F., & McDonald, R. C. (2013). *The entrepreneurial planning guide.* Bloomington: Copyright 2013 by Kelley School of Business, Indiana University.

EXECUTIVE SUMMARY

Many people who read business plans (bankers, venture capitalists, investors) like to see a summary of the plan that features its most important parts. Write the summary *last* – only after the entire business plan has been completed. Since the summary is the first and sometimes the only part of a plan that gets read, it must represent the quality of the entire report. And this should be done in such a way that the evaluator or investor will choose to read on. This is where you briefly also list the values, vision and mission of the company. What are the core values that guide your company? What is your guiding vision?

Since this may be the only thing a potential funder reads, you also need to include two more very important items:

- A start-up summary, which explains the expenses you take on before you start the business; the assets you want to have in the company as it starts; and how you intend to finance these, which means borrowing money and bringing in new investments.

BUSINESS DESCRIPTION

Think of this as 'introducing' your company to someone. Identify the venture's name, with any special significance (for example, family name, technical name). Quickly present your industry's background in terms of current status and future trends. Now describe the new venture thoroughly along with its proposed potential. Drawings and photographs may be included. Don't fail to mention the new venture's potential advantages over the competition. This discussion may include patents, copyrights and trademarks, as well as special technological or market advantages. How long have you been in business? Who owns the company? Is that ownership shared?

Describe your industry. What common traits best describe the industry? How do businesses in this industry make, buy, sell and deliver their products or services? How do customers for this industry make their buying decisions?

Finally, you need to explain what you actually sell. Describe the main features of each product or service. What does the product do to fulfil the concrete needs of your customers?

MARKETING SEGMENT

In the marketing segment you must provide convincing evidence that a market exists, that sales projections *can be achieved* and that the competition can be beaten. This part is critical because almost all subsequent sections of the plan depend on the sales estimates developed here. Present market research and analyses that will convince investors that the venture's sales estimates are accurate and attainable.

The following aspects of marketing should be addressed when developing a comprehensive exposition of the market.

Marketing vision

Here is where you sum up your goals, purpose and vision. Business goals might include annual revenue, number of new customers and so on. Strategic goals can include capturing a certain market share, being seen as the industry leader, being acquired or obtaining a level of customer satisfaction. Try to fill this statement with as much passion as possible. Don't hesitate also to list your personal goals.

Market size and trends

Tell us about your niche, that is, all the people who have a need for or whose 'pain' can be solved by the product or service. Address the bases of customer purchase decisions – price, quality, service, personal contacts or some combination of these factors. Next, list potential customers who have expressed interest in the product or service, together with an explanation of their interest. If it is an existing business, the current principal customers should be identified and the sales trend should be discussed. A review of market trends should be included and any differences between past and projected annual growth rates should be explained. The sources of all data and methods used to make projections should be indicated. If any major customers are willing to make any pre-release purchase commitments, they should be identified.

Competitor analysis

Tell us about the strengths and weaknesses of the competing products or services. Compare competing products or services on the basis of price, performance, service, warranties and other pertinent features. What are the advantages and disadvantages of competing products and services and why they are not meeting customer needs? Any knowledge of competitors' actions that could lead to new or improved products and an advantageous position also should be presented. Finally, review competing companies or companies that you want to emulate. Each competitor's share of the market, sales and distribution and production capabilities should be discussed. Attention should be focused on profitability and the profit trend of each competitor. Who is the pricing leader? Who is the quality leader? Who is gaining? Who is losing? Have any companies entered or dropped out of the market in recent years?

Remarkable difference

How do you differentiate yourself in a short, powerful claim? What is the core message to quickly communicate this difference? Here is a list of possible differentiators: unique product; unique service; market niche; special offer; solution to specific problem; message of value; unique habit; unique packaging; outrageous guarantee; outstanding customer service; unique way of doing business.

Marketing strategy

What is your **marketing strategy**? The marketing strategy is a business's approach to marketing its products and services expressed in broad terms, which forms the basis for developing a marketing plan. Your marketing philosophy and approach is developed from market research and evaluation data and should include: (1) customers to be targeted by the initial intensive selling effort, (2) groups to be targeted for later selling efforts, (3) methods of identifying and contacting potential customers in these groups, (4) the features of the product or service (quality, price, delivery, warranty and so on) to be emphasised to generate sales and (5) any innovative or unusual marketing concepts that will enhance customer acceptance (for example, leasing where only sales were previously attempted).

marketing strategy
The general marketing philosophy of the company, which should include the kinds of customer groups to be targeted by the initial intensive selling effort; the customer groups to be targeted for later selling efforts; methods of identifying and contracting potential customers in these groups; features of the product or service (quality, price, delivery, warranty) to be emphasised to generate sales; and innovative or unusual marketing concepts that will enhance customer acceptance.

Branding elements

Any time a client or potential client comes into contact with your business, they are experiencing your business' brand or style. What are the visual elements that will help support your marketing strategy? Even if these are going through revisions, show the details of your image as it stands.

Pricing rationale

The price point must be *right* in order to penetrate the market, maintain a market position and produce profits. Discuss a number of pricing strategies and choose one convincingly. Compare it to major competitors. Discuss the gross profit margin between manufacturing and final sales costs and show that this margin is large enough to allow for distribution, sales, and warranty and service expenses; for amortisation of development and equipment costs; and for profit. Justify any price increases over competitors based on newness, quality, warranty or service.

Marketing materials

State that you have created ways to reach your target market using physical and electronic means. Don't stop at printed materials. Think about all the ways your ideal client might research a business like yours. List the contents of your marketing kit plus any case studies you have collected. These do not go in the body of the plan, but perhaps in an appendix. For manufactured products, prepare your product sheets and promotional literature; plans for trade shows, advertisements, direct mailings, social media and internet; and a list of potential advertising agencies that you will interview. For products and services in general, a discussion of the contemplated advertising and promotional campaign to introduce the product and the kind of sales aids to be provided to dealers should be included.

Advertising and promotions

The schedule and cost of promotion and advertising should be presented and, if advertising will be a significant part of the expenses, an exhibit showing how and when these costs will be incurred should be included. Your advertising must be targeted, direct response and measurable. Once you have an idea of the different advertising options, their cost and their relevance to your target markets, create an advertising plan based on your desired results and budget.

Web plan

Your website can educate, persuade and motivate your prospects to take action. But it can also provide a much richer set of benefits. What do you need your website to do for you?

Sales strategy and forecast

You want your sales plan to explain the steps you follow to close a sale. How will you reward your salespeople; will they receive a commission for each sale? How will you process and track the order once it's received? How will you keep in contact with your customers throughout the sales process? Next comes your sales forecast. Put into words how you decided on the numbers in your sales forecast. What growth rates are you expecting? Why are you projecting your sales at this level? Why not less or more? What are the main driving forces behind the sales forecast? How does it relate to your market analysis, your main target segments, your sales strategy and your marketing strategy? Is your sales forecast believable? Why? What events might turn the sales forecast downward? What kind of things are you assuming will happen to make sure the sales happen?

ENTREPRENEURSHIP IN PRACTICE

HOW TO GATHER COMPETITIVE INTELLIGENCE IN THE ASIA-PACIFIC

In many countries (such as Australia and New Zealand) it is relatively easy to get information on publicly held companies. Most information is in the public domain on the internet, such as annual reports, sales reports and company profiles from commerce departments or brokerage houses. But in developing countries of the Asia-Pacific, competitor intelligence – information on competitors, their products and how they do business – is not easy to come by. You need to engage in a little 'espionage' to gather competitor intelligence. Here's how:

- Check with your own government agencies, such as commerce or trade, to see if any printed information is available.
- Ask those who have contact with your customers, such as the sales force; they are the eyes and ears of your social enterprise. They interface directly with customers and often have contact with competitors' salespeople.
- Survey competitors' customers; find out what their perceptions and preferences are about the products/services and the company they are purchasing from.
- Talk directly to the competitors' senior management or owners. You might be surprised by what information you can gain simply by asking, especially if you are a small social enterprise. A competitor who does not see your enterprise as a threat may give you information (and maybe some free advice, too).

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- Contact low-level employees working for competitors, such as support staff, guards or chauffeurs. They are usually happy to be asked to share their opinions and observations and often do so readily. Chauffeurs and secretaries, especially, may be privy to conversations with important decision makers.
- Competitors' former employees are a good source of information; the more disgruntled they were at the time they left, the better for you.
- Ask your staff members whether they have worked for the competition. You might be surprised at how often this is the case and how often they are overlooked as internal resources.
- Ask people in your industry what they know about your competitors. For instance, your raw material suppliers might also sell to your competitors. Maybe they have seen a competitor's site and facilities during a previous delivery.
- Network with friends and family members; if you ask enough people you are bound to find someone who knows something. For example, in a hotel restaurant, an employee met a personal friend of the major competitor. The conversation yielded a lot of information on the family's business philosophy and strategy. One tidbit disclosed was that the company's matriarch and president had died the prior week – was this an opportunity or a threat?

A note on ethics: Gather competitive intelligence in an ethical manner. Don't misrepresent who you are or your intentions. For example, don't call a competitor posing as a job applicant, market researcher or supplier. Companies are good about protecting domains that are proprietary, but you will be surprised at how much information is forthcoming when you merely ask. Besides, the bulk of the information you will need for your competitive analysis is not industry trade secrets.

Source: Alter, S. K. (2000). *Managing the double bottom line: A business planning reference guide for social enterprises* (Revised, updated edn). Washington, DC: P A C T Pub, 115. http://www.setoolbelt.org/resources/96.

RESEARCH, DESIGN AND DEVELOPMENT

If appropriate, be sure to cover aspects of research, design and development in terms of cost, time and special testing. Investors need to know the status of the project in terms of prototypes, lab tests and scheduling delays. Blueprints, sketches, drawings and models are often important. It is equally important to identify the design or development work that still needs to be done and to discuss possible difficulties or risks that may delay or alter the project. In this regard, a developmental budget that shows the costs associated with labour, materials, consulting, research, design and the like should be constructed and presented.

OPERATIONS

Describe the location of the new venture in terms of labour availability, wage rate, proximity to suppliers and customers and community support. In addition, you should touch on local taxes and zoning requirements and the support of area banks for new ventures. Discuss any specific needs, such as warehouse storage and offices, as well as equipment needs (special tools, machinery, computers and vehicles). Other factors that might be considered are the suppliers (number and proximity) and the transportation costs involved in shipping materials. Finally, cost data associated with any of the operation factors should be presented. The financial information used here can be applied later to the financial projections.

ENTREPRENEURSHIP IN PRACTICE

COMMON BUSINESS PLANNING MISTAKES

Entrepreneurs endure uncertainty in almost everything they do. From hiring the right employees to finding reliable suppliers, building a business requires an entrepreneur to handle significant pressure on a daily basis. Given the variability inherent in any new venture, a business plan is crucial for effective management. In spite of the importance of business planning, few activities are more

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daunting for entrepreneurs than formalising their thoughts on paper. In order for entrepreneurs to stay driven to succeed, they have to remain optimistic, so the fear of discovering some insurmountable obstacle while planning leads some management teams to avoid the process altogether. Whether the business is a start-up or a well-established corporation, a business plan, when done correctly, serves as the company's blueprint to ensure that all parties involved are in agreement regarding the business's overarching purpose. Here we present some of the common mistakes that entrepreneurs make when developing their plan.

Overall mistakes

- Entrepreneurs are unable to clearly articulate their vision in the plan.
- Entrepreneurs fail to provide sufficient details regarding the implementation of their strategy.
- Entrepreneurs ineffectively present the goals and objectives that are most important to the business's success.
- Entrepreneurs do not convincingly present the basis for their strategy.
- Entrepreneurs do not improve their plan based on feedback from investors.

Executive summary

- Entrepreneurs are not precise about their needs and capabilities.
- Entrepreneurs waste words with fillers and superfluous information.

Management

- Entrepreneurs forget to include their previous successes and/or failures.
- Entrepreneurs dismiss the importance investors place on an experienced management team.

Marketing

- Entrepreneurs rely heavily on secondary market research rather than soliciting the opinions of their potential customers.
- Entrepreneurs claim the percentage of the market their company will own without research support.

Financials

- Entrepreneurs overlook and, in turn, underestimate their cash-flow requirements.
- Entrepreneurs inflate or understate their margins in order to arrive at their ideal profitability.

Source: Adapted from Henricks, M. (2007). Build a better business plan. *Entrepreneur*. http://www.entrepreneur.com/startingabusiness/businessplans/article174002.html; Sherman, A. J. (2007). *Grow fast, grow right: 12 strategies to achieve breakthrough business growth.* Chicago: Kaplan Publishing, 20–6; and Snider, J. (n.d.). Don't make these 5 business plan mistakes. https://articles.bplans.com/dont-make-these-5-business-plan-mistakes/.

MANAGEMENT

This segment identifies the key personnel, their positions and responsibilities, and the career experiences that qualify them for those particular roles. Two-page résumés should be provided for each member of the management team in an appendix. Also, this section is where the entrepreneur's role in the venture should be clearly outlined. Finally, any advisers, consultants or members of the board should be identified and discussed. The structure of payment and ownership (share agreements, consulting fees and so on) should be described clearly. The reader should easily grasp: (1) organisational structure, (2) management team and critical personnel, (3) experience and technical capabilities of the personnel, (4) ownership structure and compensation agreements and (5) board of directors and outside consultants and advisers.

FINANCIAL

The financial segment of a business plan must demonstrate the potential viability of the undertaking.

Start-up funding

Describe your start-up funding table, which is linked to your executive summary. Explain where your funding will come from, as investments and/or loans, and how this funding will cover the start-up requirements outlined in the start-up funding table.

Important assumptions

In the financial segment it is important to mention any assumptions used in preparing the figures. Nothing should be taken for granted. Also, it should include how the statements were prepared (by a professional accountant or by the entrepreneur) and who will be in charge of managing the business' finances. Assumptions include interest rates your business will use for loans (both short-term and long-term loans, which often have different interest rates), and the tax percentage that will be applied to your company's profits.

Break-even analysis

A break-even chart shows the level of sales (and production) needed to cover all costs. This includes costs that vary with the production level (manufacturing labour, materials, sales) and costs that do not change with production (rent, interest charges, executive salaries). The break-even point helps a business see how much sales is needed to cover costs and expenses in order to start making a profit. For a start-up company, you should compare the break-even point with your sales prospects.

Profit and loss (income) statement

This statement reports on the success (or failure) of your venture. Were revenues greater than expenses? If you are a new company, do you estimate losses in the first few months? At what point do you show a profit? Did you use a percentage increase for your sales? If so, what percentage did you use? Do you have any large one-time expenses planned, beyond your ongoing expenses? What are they, and when do they happen?

Cash-flow statement

The cash-flow statement may be the most important document since it sets forth the amount and timing of expected cash inflows and outflows. This section of the business plan should be carefully constructed.

Given a level of projected sales and capital expenditures over a specific period, the cash-flow forecast will highlight the need for and the timing of additional financing and will indicate peak requirements for working capital. Management must decide how this additional financing is to be obtained and on what terms, and how it is to be repaid. The total amount may be supplied from several sources – part by equity financing, part by bank loans and the balance by short-term lines of credit from banks. This information becomes part of the final cash-flow forecast.

The pro forma balance sheet

pro forma balance sheet A financial statement that projects the results of future business operations, excluding 'unusual and non-recurring transactions'. The term *pro forma* (Latin for 'as a matter of form') applies to practices that seek to satisfy the minimum requirements or to conform to convention.

Pro forma means 'projected', as opposed to actual. The **pro forma balance sheet** projects what the financial condition of the venture will be at a particular point in time. Pro forma balance sheets should be prepared at start-up, semi-annually for the first years and at the end of each of the first three years. The balance sheet details the assets required to support the projected level of operations and shows how these assets are to be financed (liabilities and equity). Investors will want to look at the projected balance sheets to determine if debt/equity ratios, working capital, current ratios, inventory turnover and so on are within the acceptable limits required to justify the future financings projected for the venture.

CRITICAL RISKS SEGMENT

In this segment potential risks should be identified, such as effect of unfavourable trends in the industry, design or manufacturing costs that have gone over estimates, difficulties of long lead times encountered when purchasing parts or materials and unanticipated new competition. As far as sustainability is concerned, regulatory risks are often cited, followed by weather-related physical risks and reputational risks.

In addition to these risks, it is wise to cover the what-ifs. For example, what if the competition cuts prices, the industry slumps, the market projections are wrong, the sales projections are not achieved, the patents do not come through or the **management team** breaks up?

management team
The founders of a new venture who plan on managing the company, as well as any advisers, consultants or members of the board.

Finally, suggestions for alternative courses of action should be included. Certainly, delays, inaccurate projections and industry slumps all can happen and people reading the business plan will want to know that the entrepreneur recognises these risks and has prepared for such critical events.

HARVEST STRATEGY SEGMENT

Every business plan should provide insights into the future harvest strategy. It is important for the entrepreneur to plan the orderly transition of the venture as it grows and develops. This section needs to deal with such issues as management succession and investor exit strategies. In addition, some thought should be given to change management – that is, the orderly transfer of the company assets if ownership of the business changes; continuity of the business strategy during the transition; and designation of key individuals to run the business if the current management team changes. With foresight, entrepreneurs can keep their dreams alive, ensure the security of their investors and usually strengthen their businesses in the process. For this reason, a written plan for succession of your business is essential. (See Chapter 14 on harvesting the value of a business.)

MILESTONE SCHEDULE

The **milestone schedule** segment provides investors with a timetable for the various activities to be accomplished. It is important to demonstrate that realistic timeframes have been planned and that the interrelationship of events within these time boundaries is understood. Milestone scheduling is a step-by-step approach to illustrating accomplishments in a piecemeal fashion. These milestones can be established according to any appropriate timeframe, such as quarterly, monthly or weekly. Be sure to coordinate the timeframe not only with early activities such as product design and development, sales projections, management team, production and marketing, but also with later activities such as:

milestone schedule
The section of a business plan that provides investors with timetables for the accomplishment of various activities, such as completion of prototypes, hiring of sales representatives, receipt of first orders, initial deliveries and receipt of first accounts receivable payments.

- incorporation of the venture
- completion of design and development
- completion of prototypes
- hiring of sales representatives
- product display at trade shows
- signing up distributors and dealers
- ordering production quantities of materials
- receipt of first orders
- first sales and first deliveries (dates of maximum interest because they relate directly to the venture's credibility and need for capital)
- payment of first accounts receivable (cash in).

These items are examples of the types of activities that should be included in the milestone schedule. The more detailed the schedule, the better the chance the entrepreneur can persuade potential investors that they have thought things out and that they are, therefore, a good risk.

APPENDIX AND/OR BIBLIOGRAPHY

The final segment is not mandatory (most plans have it), but it allows for additional documentation that is not appropriate in the main parts of the plan. Diagrams, blueprints, financial data, résumés of management team members and any bibliographical information that supports the other segments of the plan are all examples of material that can be included. It is up to the entrepreneur to decide which, if any, items to put into this segment. However, the material should be limited to relevant and supporting information.

HINTS AND TIPS FOR WRITING AN EFFECTIVE BUSINESS PLAN

Writing a business plan can be daunting. Yet business plan writing – both the lean plan and the traditional business plan – is a vital requirement for any entrepreneur or business seeking to increase their chances of survival. Here is a list of tips for writing that winning plan:

TABLE 11.3 HELPFUL HINTS FOR DEVELOPING BUSINESS PLANS

I Executive summary	Complete this part after you have a finished business plan. This is the most crucial part of your plan because you must capture the reader's interest. It should be no more than three pages long. Summarise what, how, why, where and so on. Explain how you fit in the framework that many countries are using to form policy approaches and objectives for the management of post-use materials. Explain the process your business might implement to reasonably estimate sustainability impacts, risks and opportunities.
II Business description segment	State the name of your business. Provide a background of the industry with history of your company (if any). Clearly describe the potential of the new venture. Clearly describe any unique or distinctive features of this venture.
III Marketing segment	Convince investors that sales projections and competition can be met. Use and disclose market studies. Identify target market, market position and market share. Evaluate all competition and specifically cover why and how you will be better than your competitors. Identify all market sources and assistance used for this segment. Demonstrate pricing strategy, since your price must penetrate and maintain a market share to produce profits. Thus the lowest price is not necessarily the best price. Identify your advertising plans with cost estimates to validate proposed strategy.
IV Operations segment	Describe the advantages of your location (zoning, tax laws, wage rates). List the production needs in terms of facilities (plant, storage, office space) and equipment (machinery, furnishings, supplies). Describe access to transportation (for shipping and receiving). Indicate proximity to your suppliers. Mention the availability of labour in your location. Provide estimates of operation costs – be careful; too many entrepreneurs underestimate their costs.
V Management segment	Supply résumés of all key people in the management of your venture. Carefully describe the legal structure of your venture (sole trader, partnership or corporation). Cover the added assistance (if any) of advisers, consultants and directors. Give information on how and how much everyone is to be compensated.
VI Financial segment	Give actual estimated statements. Describe the needed sources for your funds and the uses you intend for the money. Develop and present a budget. Create stages of financing for the purposes of allowing evaluation by investors at various points

continue

continue

VII Critical risks segment	Discuss potential risks before investors point them out – for example: *Price cutting by competitors* *Any potentially unfavourable industry-wide trends* *Physical, regulatory or reputational risks due to climate change* *Design or manufacturing costs in excess of estimates* *Sales projections not achieved* *Product development schedule not met* *Difficulties or long lead times encountered in the procurement of parts or raw materials* *Greater than expected innovation and development costs to stay competitive.* Provide some alternative courses of action.
VIII Harvest strategy segment	Outline a plan for the orderly transfer of company assets (ownership). Describe the plan for transition of leadership. Mention the preparations (insurance, trusts and so on) needed for continuity of the business.
IX Milestone schedule segment	Develop a timetable or chart to demonstrate when each phase of the venture is to be completed. This shows the relationship of events and provides a deadline for accomplishment.
X Appendix or bibliography	Provide relevant and supportive information that is not appropriate in the main parts of the plan.

UPDATING THE BUSINESS PLAN

The business plan should serve as a planning tool to help guide the start-up and execution of a new venture. Once the venture is started, the business plan is still a vital tool for planning continued growth and/or profitability. There are several reasons to update the business plan:

- *Financial changes*: Update your plan on at least a yearly basis to project financials and plan for fiscal needs.
- *Additional financing*: If continued capital is needed, an updated business plan needs to reflect the current numbers and not the ones projected before the venture was started.
- *Changes in the market*: Changes in the customer base and competition should be tracked and strategised with regard to how they might affect your venture.
- *Launch of a new product or service*: Updating the business plan is essential to assess the feasibility of any proposed new product or service and determine its viability.
- *New management team*: Any new members of the management team should develop their own plan to initiate strategies for growth.
- *Reflect the new reality*: Business plans are written based on estimated numbers and projections that may not be accurate after the venture has started. Business plans should be continually updated to reflect the new reality that the entrepreneur experiences.[24]

PRESENTATION OF THE BUSINESS PLAN: THE 'PITCH'

Once a business plan is prepared, the next major challenge is presenting the plan to either a single financial person or, in some parts of the country, a forum at which numerous financial investors have gathered. The oral presentation – commonly known as an elevator pitch (because of the analogy of riding an elevator and having only 2 minutes to get your story across to another person in the elevator) – provides the chance to sell the business plan to potential investors.

The presentation should be organised, well prepared, interesting and flexible. Entrepreneurs should develop an outline of the significant highlights that will capture the audience's interest. Although the outline should be followed, they also must feel free to add or remove certain bits of information as the presentation progresses – a memorised presentation lacks excitement, energy and interest.

An entrepreneur should use the following steps to prepare an oral presentation.

- Know the outline thoroughly.
- Use keywords in the outline that help recall examples, visual aids or other details.
- Rehearse the presentation to get a feel for its length.
- Be familiar with any equipment to be used in the presentation – use your own laptop.
- The day before, practise the complete presentation by moving through each slide.

SUGGESTIONS FOR PRESENTATION

Entrepreneurs are naturally anxious to tell (and sell) their story. However, most venture capitalists agree that the content should be focused and the delivery should be sharp. In the content of the presentation it is important to be brief and to the point, to summarise the critical factor or unique 'hook' of your venture upfront, and to use no more than 15 PowerPoint slides. Following are some key suggestions about the actual delivery of the pitch to prospective investors.

- Focus on the consumer pain for which your venture will be the solution. Investors want to know exactly what problem is being solved by your venture. Pinpoint the target of your solution.
- Demonstrate the **reachable market**. Instead of a dramatic potential market, outline the immediate reachable group of customers that will be targeted.
- Explain the business model. How this venture is designed to make money is critical to investors. Demonstrating a clear method of getting to the market for sales will indicate a successful beginning to the new venture.
- Tout the management team. Every investor wants to know the skills and ability of the venture's team to deliver and operationalise the concept. Emphasise the experienced people on your team as well as any technical advisors who are on board.
- Explain your metrics. Rather than using generic assumptions, such as the famous '1% rule' (when someone claims that they will simply get 1 per cent of a huge market with no research to back up the claim), highlight the metrics that were used to calculate any revenue projections.
- Motivate the audience. The entire purpose of a venture pitch is to move the audience to the next step – another meeting to discuss everything in detail. Therefore, you must remember that enthusiasm is hugely important. The investors must believe that you are excited before they can be excited.
- Why *you* and why *now*? The final point must answer the daunting questions in the minds of the investors: Why are you the right venture and why is this the right time for it to be launched? Be confident in yourself and your team. Always demonstrate a timeline to show the speed with which your venture plans to capture a significant market.[25]
- Maybe all you need is a dozen slides as your business plan! (see Table 11.4).

reachable market
The immediate reachable group of customers that will be targeted by a new venture.

WHAT TO EXPECT

Entrepreneurs should realise that the audience reviewing their business plan may be disinclined to listen to them. Venture capital sources pressure entrepreneurs in order to test both them and their venture. So, entrepreneurs must expect and prepare for a critical, sometimes sceptical, audience of financial sources. When you make your pitch and submit your business plan, the funder will listen and then glance at the plan briefly before making any initial comments. No matter how good you think your plan is, an investor is not going to look at it and say, 'This is the greatest business plan I've ever seen!' Do not expect enthusiastic acceptance or even polite praise. It's highly likely that the remarks will be critical, and even if they aren't they'll seem that way. Don't panic. Even if it seems like an avalanche of

TABLE 11.4 BEST PRACTICE FOR YOUR START-UP PITCH DECK

GUMPERT: 12 SLIDES	TIM BERRY: 11 SLIDES	KAWASAKI: 10 SLIDES
What is the opportunity?	Vision and value proposition	Title page
What gives you special advantages in solving the problem?	The problem	Overview of problem/opportunity
What makes you think that the people involved in your company are especially qualified to grow this business?	Target market and opportunity	Value proposition
What is the business model?	The solution	Secret sauce (ideally demonstrated in a demo)
What makes it scalable?	Revenue model or business model	Business model
How do you know you'll have customers?	Traction and validation/roadmap	Go-to-market plan
How do you connect to customers?	Marketing and sales strategy	Competitive analysis
What is the secret of your expected sales success?	Team	Management team
What have you learned from the competition?	Financials	Financial projections and key metrics
What are the risk factors?	Competition	Current status, accomplishments, timeline and use of funds
How will you make money?	Investment and use of funds	
How will you use the funds you raise?		

Sources: Gumpert, D. E. (2003). *Burn your business plan!: What investors really want from entrepreneurs*. Needham, MA: Lauson Publishing Co.; MakingIt! (n.d.). Impress potential investors in 12 steps. http://makingittv.com/BusinessArticleCustomerandClientRelations.htm; Profit Guide (2005, January 24). Ditch your business plan. http://www.profitguide.com/manage-grow/strategy-operations/great-ideas-ditch-your-business-plan-28596; Parsons, N. (2015, April 28). The 11 slides you need to have in your pitch deck. https://articles.bplans.com/what-to-include-in-your-pitch-deck/; Kawasaki, G. (2015, March 5). Guy Kawasaki – The only 10 slides you need in your pitch. https://guykawasaki.com/the-only-10-slides-you-need-in-your-pitch/; Pitchdecktemplate (n.d.). Guy Kawasaki template. https://slidebean.com/templates/guy-kawasaki-pitch-deck-template?rq=kawasaki; Raydar (2017, January 26). 10 (free) stock photos to boost your 'Guy Kawasaki 10 slides pitch deck' template. https://medium.com/@Raydar/10-free-stock-photos-to-boost-your-guy-kawasaki-10-slides-pitch-deck-template-83eb55c2fff7. See also Barnett, C. (n.d.). The ultimate pitch deck to raise money for startups. https://www.forbes.com/sites/chancebarnett/2014/05/09/investor-pitch-deck-to-raise-money-for-startups/.

objections, bear in mind that some of the best venture capital deals of all time faced the same opposition. Never expect results in 20 minutes. Each pitch will be a learning experience that will build your confidence for the next one.

Entrepreneurs must be prepared to handle questions from the evaluators and learn from the criticism. They should never feel defeated but rather should make a commitment to improving the business model for future review. The goal is not so much to succeed the *first* time as it is to *succeed*.

Table 11.5 outlines some of the classic questions that entrepreneurs should ask in order to revise, rework and improve their proposal. These questions are updated from the work of Mancuso, whose books have become classics.[26]

TABLE 11.5 WHAT TO DO WHEN A FUNDER TURNS YOU DOWN – 10 QUESTIONS

EVENT	QUESTION TO ASK
Confirm their decision	'That means you cannot participate in our funding at this time?'
Sell for the future	'Can we count you in for a future round of financing?'
Find out why you were rejected	'Why don't you want to participate in this deal?' (Timing? Fit? All filled up?)
Ask for advice	'If you were in my position, how would you proceed?'
Ask for suggestions	'Can you suggest a source who invests in this kind of deal?'
Get the name	'Whom should I speak to when I'm there?'
Find out why	'Why did you suggest that funding source, and why do you think this is the best person to speak to there?'
Work on an introduction	'Who would be the best person to introduce me?'
Develop a reasonable excuse	'Can I tell them what your decision to turn us down was based on?'

Adapted from: Mancuso, J. (1992). *How to write a winning business report*. Simon and Schuster.

SUMMARY

In the first part of this chapter, we brought Part 2, 'Designing resilient entrepreneurship', into the realm of lean business planning.

There are many kinds of business plans, and which one is chosen will depend on how it will be used, and for whom. Traditional business plans are less important for new start-ups because the world is uncertain, the typical planning period is too long and inflexible entrepreneurs get locked into their business plans uncritically. There is a wide array of planning tools today, ranging from napkin plans to full, bank-ready plans. Entrepreneurs develop business plans, whether lean or long-form, as communication tools, as an instrument to raise funding, as a tool for analysis and to lessen uncertainty, as an action plan and as a builder of the new venture's reputation.

Comprised mainly of bullet points, the lean plan is the 'contrarian's business plan'. It follows the principle of *form follows function* and takes the shape of its intended purpose and nothing more. Sometimes you need a full plan, other times you need a one-page summary memo. That's why lean planning is sometimes called 'plan-as-you-go'. A lean plan is comprised of strategy, tactics and essentials.

The next section then illustrated some of the major questions that must be answered in a complete and thorough business plan. The business plan was outlined, with every major segment addressed and explained. The chapter then presented some helpful hints for preparing a business plan, and concluded with a review of how to present a business plan to an audience of venture capitalists.

KEY TERMS & CONCEPTS

business plan
elevator pitch
five-minute reading
hackathon
management team
marketing strategy
metrics
milestone schedule
pro forma balance sheet
reachable market
traditional business plan

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Review key terms with interactive flashcards.

REVIEW & DISCUSSION QUESTIONS

1 What are the main differences between 'traditional' business planning and 'lean' business planning?
2 What are some of the new forms of business planning?
3 Why do traditional plans sometimes not achieve their objectives?
4 Why has lean business planning emerged as an alternative, particularly among young companies?
5 What do we mean when we say 'form follows function' in business planning? Use an architectural analogy to explain your answer.
6 Why do you think the summary/pitch in a lean plan is written first and last?
7 What are some of the dynamics of ownership and equity splits?
8 What are some of the benefits of traditional business planning? When would we use it?
9 Describe the five-minute reading process that venture capitalists follow when reading a business plan.
10 Briefly describe each of the major segments to be covered in a traditional business plan.
11 Under what circumstances would you suggest simply skipping a business plan?
12 Are there any novel or innovative entrepreneurship competitions at your university (see Table 11.1)?

EXPERIENCING ENTREPRENEURSHIP

The one-page idea

Assignment: Complete a one-page summary of a new idea opportunity. Use the following example for the 'Rod Mate' (a third hand for fishermen) as a template for your own one-page Executive Summary.

The product

The Rod Mate is the only rod holder that enables you to hold your outfit above your waist and out of the water and elements. It has five holding applications built in: around the neck, around the waist, behind the back, over the shoulder and pinned on the vest. It works with all type of fishing rods.

Product name, product benefit, product features, product usage and applications

The market demand

The American Sport Fishing Association reports that there are estimated 44 million US recreational anglers. Average annual angler-fishing tackle expenditure is $250 per year and avid anglers expend $450 annually. More people fish than play golf and tennis combined. Sport fishing is growing 12 per cent annually. While several other rod holders, deck mounts and float tube rod holders are on the market, none have the unique features of the Rod Mate.

Industry identification, size, consumer expenditures, market growth rate, product competitors

Product benefit

We've all seen those classic pictures of a proud angler showing off their prize catch and the tackle they caught it on, wearing a fly rod in their mouth rather than a big smile. Handling a prize game fish for release, or trying to record it in a photograph with tackle in hand sometimes demands the skill of a juggler with three hands. Meanwhile your expensive gear is taking a soaking in the salt or bouncing off the rocks in a trout stream. Rod Mate acts as a third hand, holding your rod securely and out of harm's way in one of five applications, while you release your catch, change fly or pose for that priceless photo of your catch and the tackle used to capture it.

Value description (pains it solves), appeal to emotions, value proposition

Marketing strategies

We are going to offer this product via advertisements in trade publications and TV infomercials to the average angler between 42 and 46 years old, offering a lifetime guarantee. The Rod Mate comes complete with webbed belt and side-release buckle plus a set of decorative fish replica pins valued at $24.95. We plan on getting our product into 294 different media markets within an 18-month period and then moving it into the big box retailers.

Marketing strategies, marketing channels, consumer profile, pricing information, pricing incentives, target markets, launch plan

Management team/founder

We have always wanted to start and own our own business. The founder brings 10 years of angling experience, having won the Illinois Sport-Fishing Fly-Casting competition in 1999. Our team includes three members. One brings real-world accounting experience with a 3.5 GPA in accounting. The second team member has operations experience as the daughter of a Chicago small business retail owner. Our third member worked for a boating after-market supplier. California's number-one angler, Jim Franco, serves on the advisory board, and our mentor is Dr. Smith, a new-venture formation expert.

Founder motivation, competitive instincts to excel, track record, industry experience and knowledge, entrepreneurial traits, brain

Value proposition

Rod Mate is the only fishing rod holder that allows the serious sport fisher to hold his outfit out of the water and gives him a 'third hand' to hold the rod in five different positions through its unique design, thus giving him an advantage over conventional equipment.

Opportunity benefits, chosen customer, impact, competitors

The one-page idea is based on a new product for the fishing industry. Adapted from Hackbert, P. H. (2006). The University of Illinois – Academy for Entrepreneurial Leadership, 3rd Annual Conference of the International Society for Exploring Teaching and Learning, 19–21 October.

EXPERIENCING ENTREPRENEURSHIP

The two-minute pitch

Now you will create a 120-second elevator pitch based on your one-page idea summary. We will continue using the Rod Mate as an example. Start by looking at your audience directly eye-to-eye, pointing at them with your finger, and asking something provocative or funny.

Power statement, attention grabber

'How many of you have you ever tried to do something and wished you had a third hand? Let me see a show of hands!'

Founder name, new-venture name, role or positioning of the company, mission

'Hi, I am [name] and I formed [company] to launch a new product for fishermen in the next year. This product is called Rod Mate, and it was designed to be a "third hand" for fishermen when they are fishing so they can catch more fish.'

Competitive advantage, pains its solves

'It solves the pains that fishermen have. It has five different positions you can use to hold your rod: behind your back, pinned to your vest, around your waist, over your shoulder or around your neck.'

Market size, market growth, annual consumer expenditure market segments

'Did you know that there are over 44 million fishermen in the US alone? Fishing is bigger than golf and tennis combined, growing 12 per cent per year. And fishermen spend an average of $250 per year on tackle – $450 for the avid angler.'

Marketing strategies, channels, launch plan

'We are going to offer this product via trade publication ads and infomercials advertising to the average angler between 42 and 46 years old, offering a lifetime guarantee in 294 different medias within 18 months across the US. We will then go to the big box retailers like Walmart for distribution.'

Your capabilities, industry knowledge and experience

'I am the right person to do this. I have experience in sport fishing and marketing. I have tested this product with potential customers and have found out there is a tremendous need for this product in the competitive sport fishing market.

Opportunity benefits, customer, impact, competitors

'Rod Mate is the only fishing rod holder that allows the serious sport fisher to hold his outfit out of the water and gives him a 'third hand' to hold the rod in five different positions through its unique design, thus giving him an advantage over conventional equipment.

'I'm looking for your investment and support. If you are interested, please take my one-pager and business card. Thank you very much for your attention.'

CASE STUDIES

CASE 11.1

GETTING IT RIGHT BY DOING IT WRONG

She had no business plan, but 10 years later she had become one of New Zealand's most successful entrepreneurs. When Brigit Blair set up Linden Leaves 12 years ago, she broke the golden rule by setting up without a business plan. 'A five-year plan?' she laughs. 'We didn't have a five-week plan.'

Over a decade later, Linden Leaves' range of New Zealand-made body care products are sold from Melbourne to London and many points in between. Christchurch-based Mrs Blair, 54, is well on the way to becoming a government business adviser's pin-up, the sort of entrepreneur the Government Jobs Ministry loves to champion.

'I launched without really knowing what I was getting into and without a business plan. I did everything wrong. For four years I exported only to Korea and Japan – probably the most difficult markets in the world. If I had really thought about it, I probably would never have taken the first step. Passion and a good deal of hard work go a long way, I guess.'

Source: King, D. (2004, July 1). Getting it right by doing it wrong. *The Dominion Post* (Wellington). Published by The Fairfax New Zealand Limited, copyright 2004.

QUESTIONS

1 Based on Brigit's experience, would you still recommend writing a business plan or would you just 'wing it'?
2 What were the secrets of Brigit's success without a business plan?

CASE 11.2

IT'S JUST A MATTER OF TIME

Pedro Santini has been a computer analyst for five years. In his spare time he has developed a word-processing software program that is more comprehensive and powerful than any on the market. Since he does not have a great deal of money, Pedro believes the first step in producing and marketing this product should be to get the necessary venture capital.

The software program has been written and trial-tested by Pedro and a handful of friends to whom he gave the material. Two of these friends are full-time typists who told him that the program is faster and easier to use than anything on the market. Pedro believes that these kinds of testimonials point out the profit potential of the product. However, he still needs to get financial support.

One of Pedro's friends has suggested a meeting with a venture capitalist. 'These guys have all sorts of money to lend for new ventures', the friend told Pedro. 'All you have to do is explain your ideas and sell them on giving you the money. They are always looking to back a profitable idea and yours is certain to be one of the best they have seen in a long time.'

Pedro agrees with his friend, but believes he should not discuss the matter with a venture capitalist until he has thought through answers to the various types of questions likely to be asked. In particular, Pedro believes he should be able to provide the venture capitalist with projected sales for the first three years and be able to explain the types of expenses that would be incurred. Once he has done this, Pedro feels he will be ready to talk to the individual. 'Right now', he told his friend, 'it's just a matter of time. I'd think that within seven to ten days I'll be ready to present my ideas and discuss financial needs.'

QUESTIONS

1 In addition to financial questions, what other questions is the venture capitalist likely to ask Pedro?
2 Would a business plan be of any value to Pedro? Why or why not?
3 How would you recommend Pedro get ready for his meeting with the venture capitalist? Be complete in your answer.

CASE 11.3

THE INCOMPLETE PLAN

When Katrina Bulaong drew up her business plan, she was certain it would help her get financing from her uncle, a famous Philippines industrialist. Katrina is in the throes of putting together a monthly magazine directed toward Philippine executive women. The objective of the periodical is to provide information useful to women who are pursuing careers. The first issue is scheduled to go to press in 90 days. Some of the articles included in this issue are 'Managing your time for fun and profit', 'What you need to know about dressing for success' and 'Money management: Do it like the experts'. A section is also devoted to successful women at work, entitled 'Women in the news'. Other features include a question-and-answer section that responds to letters and inquiries from readers (the first issue's questions were submitted by a group of women executives, each of whom had been asked to help get the column started by sending in a question), a stock-market section that reviews industries or companies and points out the benefits and risks associated with investing in them, and a column on the state of the economy and the developments or trends expected over the next 12 months.

Katrina's business plan consisted of six parts: a summary, a business description, a manufacturing segment, a management segment, a milestone schedule segment and an appendix. When her uncle returned it to her with a polite rejection letter, he wrote: 'Without a marketing segment, attention to critical risks and a financial segment, this plan is incomplete and cannot be favourably reviewed by me. If you would provide me with this additional information and submit the rewritten plan within the next 60 days, I will be happy to review the plan and give you my opinion within 10 working days.'

QUESTIONS

1. What should Katrina put in the marketing segment? What types of information will she need?
2. For the critical-risks assessment segment, what key areas does Katrina have to address? Discuss two of these.
3. For the financial segment, what suggestions would you make to Katrina regarding the kinds of information to include? Be as specific as possible.
4. Do you think there might be some family dynamics involved?

ONLINE STUDY RESOURCES

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- take it further activities
- revision quizzes
- video activities
- and more!

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PART THREE

ENTREPRENEURIAL CASE ANALYSIS

INCREASE: TRANSFORMING THE ECONOMY BY EMPOWERING MERCHANTS

Maru Buteler, INCREASE

THE SPARK

Matias was twenty years old and living in Argentina. One day he decided to sell his own car in order to build a bar on the beach. He knew the owner of an existing bar, so he made an agreement with him and started running the bar with the help of some friends.

Sebastian was a little bit older. He was thirty and working at an American start-up in the USA after building his first company, which helped foreign students during their stay in Argentina.

The entrepreneurs met during 2009 when Matias participated in a GSEA competition Sebastian was organising; however, they were living in different countries so communication was sporadic.

In early 2013 they again met briefly and spoke for the first time about a problem they had both seen and suffered from firsthand: it was a total nightmare for a business to check and control every sale or transaction made with a credit card, as the way these transactions were recorded depended largely on what bank the credit cards were affiliated with.

In Latin America, every credit card company takes a different amount of time to pay merchants. For example, credit card A may pay you 18 days after the transaction was made, while credit card B will make that same payment in 28 days. To make it even more complex, transactions made in instalments are paid to the merchant in 48 or 72 hours depending on the card provider, and of course you also have to take into account discounts and promotions as well as taxes and retentions. Lastly, it is not unusual to have rejected coupons that are automatically discounted, and merchants only have a 48-hour opportunity to claim that chargeback by presenting the data of that single transaction.

When one of the main newspapers in Argentina published an article pointing out that merchants who didńt control their payments lost up to 7% of their income, it was the final push Matias and Sebastian needed to narrow down the product they wanted to build – along with the fact that there were 500 000 POS terminals in the country. Knowing when and how much money is received each day is vital information for every merchant in order to make better decisions and therefore grow the business.

With that in mind, in 2014 Matias and Sebastian decided to start INCREASE, a platform that gives merchants and businesses a simple way to understand their income using payment analytics.

THE TEAM

In the first three years of the company, Sebastian and Matias went from 0 employees to 22 and from 0 clients to more than 6000.

First, they recruited three employees: the Chief Technology Officer, a salesperson, and a marketing director. They then recruited nine more staff in 2016: three developers, one administrative assistant, four salespeople and one customer support person. Finally, another nine employees were hired in 2017: three positions in customer support, one Chief Marketing Officer, one Chief Culture Officer, and four developers.

With the slogan ‘empowering businesses’, the team was able to provide their service to many different types of clients, from small businesses to big companies with more than 1000 POS terminals.

THE CLIENTS

The company's main targets are small and midsize businesses who have 1–30 POS terminals, and are involved in B2C business with customers paying by credit or debit card (in-store or via e-commerce). INCREASE also offers their services to bigger companies that need or want to empower their local managers.

Growth in client acquisition was progressive, going from 900 POS terminals in December 2015, to 5982 in December 2016, to 16 095 in December 2017.

In the last three years, the company has identified three main types of clients: the Gustavo segment, the Pablo segment and the Julieta segment.

THE MOMENTUM

By the end of 2017, business was going well and it was time to take it to the next level.

Sebastian, as the CEO, started the investment round that would allow the team to grow and achieve the ambitious goal of becoming a multi-product, multi-country company.

Within the first three months of 2018, eight bright new employees were recruited and went through a three-week induction program.

In the first week, the focus was on INCREASE as a company: its mission, values, methodologies, team members, clients and everything regarding the products and their key value proposition.

As an agile company, INCREASE works without a predefined structure. The company is organised in circles that have a purpose and might grow or disappear depending on the needs of every quarter. Each employee, each 'Increaser', contributes to at least two circles: a main circle, which usually represents 80% of their time, and a secondary circle for the other 20%.

The second week of the induction program was focused on on-the-job training in both main and secondary circles, working side by side with other members of the team.

Finally, the third week was meant to give the new members the opportunity to join in meetings with customers, partners and other meaningful stakeholders of the fintech industry.

Every employee at INCREASE has access to all company information, not only because everyone believes in transparency as a value, but because every single person needs to be able to share information in real time, 24-7. 'Ideas might come from everywhere and we better be prepared to make them happen', says Matias.

THE SPIRIT: 'VELOCIDAD CON SERENIDAD' (SPEEDINESS WITH SERENITY)

INCREASE was born to simplify merchants' lives so that they can grow. As an SaaS (software as a service) company, their ability to understand client needs is crucial. In doing so, they must not only be on top of the speed and quality of their products, but they also need to be highly attuned to every aspect of their client's business and market trends so that they continue adding value in a proactive way.

Keeping the balance between solving today's problems and being aware of and ready for the challenges of tomorrow is probably the one ability every entrepreneur should pay most attention to. Having one without the other means the start-up won't make it. Being able to adapt equals being able to properly assess situations and make decisions accordingly. That is why at INCREASE they take their values and skills very

TABLE 1 DISTRIBUTION OF TYPE OF CLIENTS BY JUNE 2017

CLIENT_TYPE	POS PER CLIENT	PERCEIVED VALUE	NUMBER OF CLIENTS	PERCEIVED CLIENTS	TOTAL VOLUME OF POS	PERCEIVED POS
Gustavo	1–4	30%	2004	85%	3080	32%
Pablo	5–29	50%	306	13%	3090	31%
Julieta	30+	20%	47	2%	3660	37%
Overall	**4.5**	**100%**	**2357**	**100%**	**9830**	**100%**

seriously. They are not just nice to have, they are a way of being.

The company believes that creating relevant and accessible fintech solutions that empower business owners in terms of their financial management will bring financial stability, professionalisation and transparency to how small and midsize businesses are run in Latin America.

INCREASE has a strong work ethic and a collaborative culture centred around six core values that they follow in all their business endeavours:

- People first
- Creation & pragmatism
- Positive atmosphere
- Transparency
- Constant progress
- Ownership

THE CHALLENGE

INCREASE believe learning agility is the key to sustainable growth, not just as human beings but as a company – a company that knows that there is no learning without motivation, and there's no motivation without a team that enjoys having a good time solving a huge challenge.

By the end of this year INCREASE will have recruited another 10 employees, meaning it will have doubled its employees during 2018. It will also be operating in at least two more countries in Latin America and reaching 10 per cent of the market in Argentina. Apart from its main product, INCREASE will also be offering another three products that are currently being used by some clients.

QUESTIONS

1. What would you say was the main driver that led Matias and Sebastian to start the company?
2. Do you think it was the right time for INCREASE to start an investment round? Why?
3. What consequences might there be in recruiting many employees in a short period of time?
4. Would you invest three weeks in an induction program? Do you agree that every employee should know every part of the company? What do you think about the total transparency policy?
5. Why do you think the company decided to start offering new products and start operations in new countries?
6. Regarding the type and distribution of clients INCREASE has, what would you recommend in terms of designing a strategy?
7. Which of the six values do you think is the most present in INCREASE's culture?

PART FOUR

FINANCIAL MATTERS FOR ENTREPRENEURIAL VENTURES

CHAPTER 12

FINANCIAL PERFORMANCE FOR ENTREPRENEURIAL VENTURES

Small company managers are too inclined to delegate to outside accountants every decision about their companies' financial statements. Indeed, it is most unfair to suppose that accountants can produce – without management's advice and counsel – the perfect statement for a company.
Instead, I contend, top managers of growing small companies must work with their independent accountants in preparing company financial statements to ensure that the right message is being conveyed …

James McNeill Stancill, *'Managing financial statements: Image and effect'*[1]

Companies must be prepared to respond to the growing demands for transparency and accountability, particularly with respect to their economic, social and environmental impact. This requires, first and foremost, that those who run the businesses be aware of the challenges and opportunities they face in the age of globalisation. Here, business schools can play a crucial role by ensuring that tomorrow's business leaders understand what responsible business means and how it can have positive effects for both the company's bottom line and the society in which it operates … Business success does not rely on financial success as an isolated ideal. Consideration should also be given to environmental and social issues.

UN Secretary General Ban Ki-moon[2]

CHAPTER OBJECTIVES

1. To understand the different dimensions of performance measurement and their importance/relevance to entrepreneurs
2. To explain how entrepreneurs measure financial performance
3. To explain the principal financial statements needed for any entrepreneurial venture – the balance sheet, income statement and cash-flow statement
4. To outline the process of preparing financial budgets, including operating budgets and cash-flow budgets
5. To explain how capital budgeting can be used in the decision-making process
6. To illustrate how to use break-even analysis
7. To describe ratio analysis and illustrate the meanings and uses of some of the important measures

THE DIMENSIONS OF PERFORMANCE MEASUREMENT

Today's entrepreneur operates in an environment characterised by strong competition and decreasing resources. Safeguarding of resources therefore becomes a top priority. In order to compete, the entrepreneur must accumulate and allocate resources effectively, and use them efficiently. Six kinds of resources are available: the *tangible* resources, financial, physical, and environmental, and the *intangible* resources, organisational, relational and human. In this chapter we focus on performance measurement of the tangible financial and physical resources.

One constant preoccupation is measuring economic performance in terms of sales revenue, operating budgets, cash flow and the like. Measuring (or 'accounting for') these falls within the realm of financial accounting, our first topic. Traditionally, companies report on these issues to their shareholders.

Increasingly, stakeholders and the public are expecting entrepreneurs to show that they are not merely delivering economic value, but also following socially and environmentally responsible paths. In response to these changing environments, the entrepreneur must come to grips with expanding traditional reporting to take into account environmental and social performance in addition to financial performance, which we will cover in this chapter. The term we will use for this is triple bottom line reporting. As the argument intensifies that the Earth's *carrying capacity* is becoming more at risk, governments around the world are coming closer to accepting the need for formal metrics for ecological and social loss or risk for companies. We first examine financial performance measures, and then discuss pro forma statements and tools such as break-even analysis, sensitivity analysis and ratio analysis.

stakeholder
A person, group, organisation or system that affects or can be affected by an organisation's actions.

MEASURING FINANCIAL PERFORMANCE

Financial information pulls together all the information presented in the marketing, distribution, manufacturing and management segments of the business. It quantifies all the assumptions and historical information concerning business operations.[3]

It should be remembered that entrepreneurs must make assumptions when numbers are derived and correlate these assumptions with information presented in other parts of the business operations. The set of assumptions on which projects are based should be clearly and precisely presented; without these assumptions, numbers will have little meaning. It is only after carefully considering such assumptions that the entrepreneur can assess the validity of financial projects. Because the rest of the financial plan is an outgrowth of these assumptions, they are the most integral part of any financial statement. See Table 12.1 for a financial glossary for entrepreneurs.

financial statement
An accounting term for an account or formal record that shows the financial activities of a firm, person or other entity.

TABLE 12.1 A BASIC FINANCIAL GLOSSARY FOR THE ENTREPRENEUR

Accrual system of accounting: A method of recording and allocating income and costs for the period in which each is invoiced or incurred, regardless of the date of payment or collection. For example, if you were paid $100 in April for goods you sold in March, the $100 would be income for March under an accrual system. (Accrual is the alternative and preferred system for accounting to the cash system.)
Assets: Anything of value that is owned by you or your business.
Balance sheet: An itemised statement listing the total assets, liabilities and net worth of your business at a given moment. Also called a *statement of condition*.
Break-even: The level of sales required to meet the firm's fixed costs and the expended variable costs associated with production. Until break-even is reached, the business will not generate sufficient cash to cover its current and ongoing expenses.
Capital: (1) The amount invested in a business by the proprietor(s) or shareholders; (2) The money invested or available for investment.

continue

continue

Cash flow: The schedule of your cash receipts and disbursements.

Cash system of accounting: A method of accounting whereby revenue and expenses are recorded when received and paid, respectively, without regard for the period to which they apply. (A cash system is the alternative to the accrual system.)

Collateral: Property you own that you pledge to the lender as security on a loan until the loan is repaid. Collateral can be a car, home, shares, bonds or equipment.

Cost of goods sold: The value of products sold to customers in a given period. This is determined by subtracting the value of the ending inventory from the sum of the beginning inventory and purchases made during the period. It excludes any non-product related expenses, such as marketing and other overhead expenses. Gross sales less cost of goods sold gives you gross profit.

Current assets: Cash and assets that can be easily converted to cash, such as accounts receivable and inventory; current assets should exceed current liabilities.

Current liabilities: Debts you must pay within a year (also called *short-term liabilities*).

Depreciation: Lost usefulness; expired utility; the diminution of service yield from a fixed asset or fixed asset group that cannot or will not be restored by repairs or by replacement of parts.

Equity: An interest in property or in a business, subject to prior creditors. An owner's equity in their business is the difference between the value of the company's assets and the debt owed by the company, multiplied by the percentage of the company they own. For example, if you borrow $30 000 to purchase assets for which you pay a total of $50 000, your equity is $20 000.

Expense: An expired cost; any item or class of cost of (or loss from) carrying on an activity; a present or past expenditure defraying a present operating cost or representing an irrecoverable cost or loss; an item of capital expenditure written down or off; a term often used with some qualifying expression denoting function, organisation or time, such as a selling expense, factory expense or monthly expense.

Financial statement: A report summarising the financial condition of a business. It normally includes a balance sheet and an income statement.

Fixed costs: Recurring costs that a firm must pay regardless of product sales. These costs must be met for the firm to stay in business regardless of whether sales occur or not.

Gross profit: Sales less the cost of goods sold. For example, if you sell $100 000 worth of merchandise for which you paid $80 000, your gross profit would be $20 000. To get net profit, however, you would have to deduct other overhead expenses incurred during the period in which the sales were made, such as rent, insurance, marketing and sales staff salaries.

Income statement: A statement summarising the income of a business during a specific period. Also called *profit and loss (P&L) statement*.

Interest: The cost of borrowing money. It is paid to the lender and is usually expressed as an annual percentage of the loan. That is, if you borrow $100 at 12 per cent interest, you pay 1 per cent ($0.01 \times \$100 = \$1$) interest per month. Interest is an expense of doing business.

Liability: Amount owing to your creditors. Liabilities can be in the form of a bank loan, accounts payable and so on. They represent a claim against your assets.

Loss: When a business' total expenses for the period are greater than the income.

Net profit: Total income for the period less total expenses for the period. (See also *gross profit*.)

Net worth: Same as *equity*.

Personal financial statement: A report summarising your personal financial condition. Normally it includes a listing of your assets, liabilities, large monthly expenses and sources of income.

Pro forma (e.g. pro forma balance sheet): A financial statement that projects the results of future business operations, such as a pro forma balance sheet, an income statement or a cash-flow statement. The term 'pro forma' is applied to practices that seek to satisfy the minimum requirements or to conform to convention. The pro forma is a statement of the company's financial activities, excluding 'unusual and non-recurring transactions'.

Profit: (See *net profit* and *gross profit*.) Usually refers to net profit.

Profit and loss statement: Same as *income statement*.

Time value of money: The idea that money available today is worth more than the same amount in the future due to its potential interest-earning capacity. Any amount of money is worth more the sooner it is received.

Variable cost: Costs that vary with the level of production or sales, such as direct labour, material and sales commissions.

Working capital: The excess of current assets over current liabilities.

In order for entrepreneurs to develop the key components of a financial segment, they should follow a clear process as described in the next section.[4]

UNDERSTANDING THE KEY FINANCIAL STATEMENTS

Financial statements are powerful tools that entrepreneurs can use to manage their ventures.[5] The basic financial statements an entrepreneur needs to be familiar with are the balance sheet, the income statement and the cash-flow statement. The following sections examine each of these in depth and provide a foundation for understanding the books of record that all ventures need.

THE BALANCE SHEET

A **balance sheet** is a financial statement that reports a business's financial position at a specific time. Many accountants like to think of it as a picture taken at the close of business on a particular day, such as 30 June. The closing date is usually the one that marks the end of the business year for the organisation.

The balance sheet is divided into two parts: the financial resources owned by the firm and the claims against these resources. Traditionally, these claims against the resources come from two groups: creditors who have a claim to the firm's assets and who can sue the company if these obligations are not paid, and owners who have rights to anything left over after the creditors' claims have been paid.

The financial resources that the firm owns are called **assets**. The claims that creditors have against the company are called **liabilities**. The residual **interest** of the firm's owners is known as **owners' equity**. When all three are placed on the balance sheet, the assets are typically listed on the left, and the liabilities and owners' equity are listed on the right.

An asset is something of value, a resource that the business owns. To determine the value of an asset, the owner/manager must do the following: (1) identify the resource, (2) provide a monetary measurement of that resource's value and (3) establish the degree of ownership in the resource.

Most assets can be identified easily. The value of tangible assets, such as cash, land and equipment, is evidenced through physical use. However, *intangible assets* also exist, whose value is not physically evident, but which are valuable nonetheless. Examples of intangible assets include intellectual property such as copyrights and patents (see also Chapter 10), databases and customer lists, organisational systems and processes, a firm's culture and so forth.

Liabilities are the debts of the business. These may be incurred either through normal operations or through the process of obtaining funds to finance operations. A common liability is a short-term account *payable*, in which the business orders and receives some merchandise, but has not yet paid for it. This often occurs, for example, when a company receives merchandise during the third week of the month and does not pay for it until it pays all of its bills on the first day of the next month. If the balance sheet was constructed as of the end of the month, the account still would be payable at that time.

Liabilities are divided into two categories: short term and long term. **Short-term liabilities** (also called **current liabilities**) are those that must be paid during the coming 12 months. **Long-term liabilities** are those that are not due and payable within the next 12 months, such as a mortgage on a building or a five-year bank loan.

Owners' equity is what remains after the firm's liabilities are subtracted from its assets – it is the claim the owners have against the firm's assets. If the business loses money, its owners' equity will decline. This concept will become clearer when we explain why a balance sheet always balances.[6]

balance sheet
An itemised statement listing the total assets, liabilities and net worth of your business at a given moment.

assets
Anything of value that is owned by you or your business.

liabilities
Amounts owing to creditors, such as a bank loan, accounts payable and so on. They represent a claim against your assets.

interest
The price paid for borrowed money or the return earned from money deposited or lent.

owners' equity
Assets minus liabilities.

short-term liabilities
Debts you must pay within a year. Includes cash owing for merchandise that the business has received, but has not yet paid for. This often occurs when a company receives merchandise during the third week of the month and does not pay for it until it pays all of its bills on the first day of the next month. Also called current liabilities.

current liabilities
See *short-term liabilities.*

long-term liabilities
Items or long-term debts on a balance sheet that fall due or require paying off beyond a timeframe of one year.

UNDERSTANDING THE BALANCE SHEET

To fully explain the balance sheet[7] and the other concepts in this chapter, we take the example of XYZ Chocolates Ltd, a Melbourne-based limited liability company and manufacturer of fine chocolates, bars and truffles.[8] It also runs a retail store. XYZ is a mixed product-services company; it produces chocolate products and carries out services such as events and education. It started operations in 2001 and is moving from the start-up to the growth phase in the Pacific-blended gourmet chocolates market.

Table 12.2 presents XYZ's balance sheet as of 31 December 2018. Note that the table has three sections: assets, liabilities and owners' equity. Within each of these classifications are various types of accounts. The following sections will examine each of these types of account.

TABLE 12.2 XYZ CHOCOLATES LTD BALANCE SHEET FOR THE YEAR ENDED 31 DECEMBER 2018

	ASSETS	
CURRENT ASSETS		
Cash		$200 000
Accounts receivable	$375 000	
Less: Allowance for uncollectable accounts	$25 000	$350 000
Inventory		$150 000
Prepaid expenses		$35 000
Total current assets		**$735 000**
FIXED ASSETS		
Land		$330 000
Building	$315 000	
Less: Accumulated depreciation of building (at 5% annually)	$80 000	(net) $235 000
Equipment	$410 000	
Less: Accumulated depreciation of equipment	$60 000	(net) $350 000
Total fixed assets including land		**$ 915 000**
Total assets		**$1 650 000**
LIABILITIES		
Current liabilities		
Accounts payable	$150 000	
Notes payable	$25 000	
Taxes payable	$75 000	
Loan payable	$50 000	
Total current liabilities		$300 000
Bank loan		$200 000
Total liabilities		**$500 000**

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OWNERS' EQUITY		
Contributed capital		
Common shares, $10 par, 40 000 shares	All sold	$400 000
Preferred shares, $100 par, 500 shares	Authorised, none sold	
Retained earnings		$750 000
Total owners' equity		**$1 150 000**
Total liabilities and owners' equity		**$1 650 000**

Current assets

current assets
Items on the balance sheet listed as assets, such as cash, accounts receivable, inventory and short-term investments, that can be converted to cash and/or used to pay current liabilities within 12 months.

cash
Coins, currency and cheques on hand, as well as money in cheque and savings accounts.

accounts receivable
Money that is owed to a company by a customer for products and services provided on credit. Treated as a current asset on a balance sheet.

allowance for uncollectable accounts
Accounts receivable judged to be uncollectable.

Current assets consist of XYZ's cash and other assets that are reasonably expected to be turned into cash, sold or used up during a normal operating cycle. The most common types of current assets are those shown in Table 12.2.

Cash refers to coins, currency and cheques on hand. It also includes money that the business has in its cheque and savings accounts.

Accounts receivable are claims that XYZ has against its customers for unpaid balances from the sale of merchandise or the performance of services. Many companies sell on credit and expect their customers to pay by the end of the month. Or, in many cases, they send customers a bill at the end of the month and ask for payment within a specified time, usually 7, 14 or 30 days.

The **allowance for uncollectable accounts** refers to accounts receivable judged to be uncollectable. How does a business know when receivables are not collectable? This question can be difficult to answer and cannot be definitive. However, one method for making the estimates is to use an accounts receivable aging schedule. To illustrate, let's first assume that the business asks all of its customers to pay within the first 10 days of the month following the purchase.

An examination of XYZ's aging accounts receivable shows that the following amounts are due to the firm:

NUMBER OF DAYS OUTSTANDING	AMOUNT OF RECEIVABLES
1–10	$325 000
11–20	$25 000
21–30	$20 000
31–60	$5 000
61–90	$7 500
91+	$17 500

In this case, the firm might believe that anything more than 60 days old will not be paid and will likely be written off as uncollectable. Note that in Table 12.2 the allowance for uncollectable accounts is $25 000, the amount that has been outstanding more than 60 days. When the amount increases from one period to the next, the amount of this increase is typically classified as an expense. When the company abandons any hope of collection of an account from a specific customer it will reduce both the accounts receivable balance and the balance in the allowance for uncollectable accounts.

inventory
Merchandise held by the company for resale to customers.

prepaid expenses
Expenses the firm already has paid, but that have not yet been used. For example, insurance paid on the company car every six months is a prepaid expense because it will be six months before the entire premium has been used.

fixed assets
Land, building, equipment and other assets expected to remain with the firm for an extended period.

investment
(1) In finance, the purchase of a financial product or other item of value with an expectation of favourable future returns; the use of money in the hope of making more money. (2) In business, the purchase by a producer of a physical good, such as durable equipment or inventory, in the hope of improving future business.

depreciation
Lost usefulness; expired utility; the diminution of service yield from a fixed asset or fixed asset group that cannot or will not be restored by repairs or by replacement of parts.

income
The difference between a business' total revenues and total expenses after taxes, depreciation and interest charges are deducted from the operating profit. Also called net profit and commonly referred to as the 'bottom line'.

accounts payable
Liabilities incurred when goods or supplies are purchased on credit.

Inventory is merchandise held by the company for resale to customers. For XYZ, this includes chocolate in blocks as well as flavourings and other ingredients. Current inventory in our example is $150 000, but this is not the entire inventory the firm had on hand all year. Naturally the company started the year with some inventory, purchased more and sold finished products that were either produced by combining and preparing the inventory (ingredients) or purchased wholesale for stock to customers. This balance sheet figure is the value of the inventory left at the end of the fiscal year.

Prepaid expenses are expenses the firm already has paid but that have not yet been used. For example, insurance paid on the company car for the next six months is a prepaid-expense entry because it will be six months before the entire premium has been used. As a result, each month the accountant would reduce the prepaid amount by one-twelfth of the annual amount. Sometimes supplies, services and rent are also prepaid, in which case the same approach is followed.

Fixed assets

Fixed assets consist of land, building, equipment and other assets expected to remain with the firm for an extended period. They are not totally used up in the production of the firm's goods and services within a single period. Some of the most common types are shown in Table 12.2.

Land is property used in the operation of the firm. This is not land that has been purchased for expansion or speculation; that would be listed as an **investment** rather than a fixed asset. Land is listed on the balance sheet at cost, and its value usually is changed only periodically. For example, every five years, the value of the land might be recalculated so that its value on the balance sheet and its resale value are approximately the same.

Building consists of the structures that house the business' manufacturing and retail operations. If the firm has more than one building, the total cost of all the structures is listed.

Accumulated **depreciation** of building refers to the amount of the building value that has been written off the books due to wear and tear. For example, referring to Table 12.2, the original cost of the building was $315 000, but accumulated depreciation is $80 000, leaving a net value of $235 000. The amount of depreciation charged each year is determined by the company accountant after checking with tax office rules. It is common to apply a standard depreciation percentage per year for new buildings, although an accelerated method is sometimes also used. In any event, the amount written off is a tax-deductible expense. Depreciation therefore reduces the amount of taxable **income** to the firm and helps lower the tax liability. In this way, the business gets the opportunity to recover part of its investment.

Equipment is the machinery used to produce the product – in the case of XYZ, finished chocolate goods. It is placed on the books at the original cost and then depreciated and listed as the *accumulated depreciation of equipment*. In our example, it is $60 000. The logic behind equipment depreciation and its effect on the firm's income taxes is the same as that for accumulated depreciation on the building.

Current liabilities

Current liabilities are obligations that will become due and payable during the next year or within the operating cycle. The most common current liabilities are listed in Table 12.2.

Accounts payable are liabilities incurred when goods or supplies are purchased on credit. For example, XYZ purchases much of its chocolate from a Swiss supplier. If XYZ buys on net 30-day terms, during those 30 days the bill for the goods will constitute an account payable.

A **note payable** is a promissory note given as tangible recognition of a supplier's claim or a note given in connection with an acquisition of funds. In XYZ's case this was a loan from the Swiss supplier for the roasting and milling machines that transform cocoa beans into chocolate. The Swiss company required that a note be given when XYZ bought merchandise and was unable to pay for it immediately.

note payable
See *promissory note*.

Taxes payable are liabilities owed to the government, such as the Goods and Services Tax (GST) in Australia or sales or value-added taxes (VAT) in some other countries. XYZ must collect the taxes and remit them to the tax agency.

taxes payable
The amount payable to governments or statutory bodies calculated as a percentage of income according to government-devised formulae.

A **loan payable** listed in current liabilities is the current instalment on a long-term debt that must be paid this year. The remainder is carried as a long-term debt. Note that, in Table 12.2, $50 000 of this debt will be paid in 2019 by XYZ.

loan payable
Current instalment on a long-term debt that must be paid this year; part of the current liabilities.

Long-term liabilities

As we have said, long-term liabilities consist of obligations that will not become due or payable for at least one year or within the current operating cycle. The most common are bank loans.

A **bank loan** is a long-term liability arising from a loan from a lending institution. Although it is unclear from the balance sheet in Table 12.2 how large the bank loan originally was, it is apparently being paid down at the rate of $50 000 annually. Thus, it will take four more years to pay off the loan balance.

bank loan
Long-term liability due to a loan from a lending institution.

Owning shares in a limited company

XYZ's founders have shares in the company, as do some other individuals who have purchased shares. Various kinds of shares can be sold by a company, the most typical being common shares and preferred shares. Only common shares have been sold by XYZ.

Common shares are the most basic form of corporate ownership. The owners of a limited company – whether private or public – are referred to as shareholders. An individual can become a part owner of the business by purchasing shares in that business. This ownership gives the individual the right to vote for individuals to serve on the board of directors. Usually, for every common share held, the individual is entitled to one vote. As shown in Table 12.2, the company has issued 40 000 common shares of $10 par value, raising $400 000. Although the term *par value* may have little meaning to most shareholders, it has legal implications. It determines the stated minimum value of capital that will be retained in the company. Shares must originally be sold for at least this value or the original owner of the shares can face liability to make up the difference. For legal reasons the total par value of the shares is maintained in the accounting records. However, it has no effect on the *market value* of the shares after issuance.

Preferred shares differ from common shares in that their holders have preference to the assets of the firm in case of dissolution. This means that after the creditors are paid, preferred shareholders have the next claim on whatever assets are left. The common shareholders' claims come last. Table 12.2 shows that 500 preferred shares were issued, each worth a par value of $100, but none have as yet been sold. Therefore, it is not shown as a number on the balance sheet.

Retained earnings

Retained earnings are the accumulated net income kept by the business over the life of the business to date. In Table 12.2, the retained earnings are shown as $750 000. Every year this amount increases by the profit the firm makes and keeps within the company. If XYZ declares dividends to its shareholders, they, of course, are paid from the total net earnings. Retained earnings are that which remain after the distribution.

retained earnings
Accumulated net income not distributed to owners over the life of the business to date. Every year this amount increases by the profit the firm makes and keeps within the company.

WHY THE BALANCE SHEET ALWAYS BALANCES

By definition, the balance sheet always balances. If something happens that increases or decreases one side of the balance sheet, it is offset by something on the other side. Hence, the balance sheet remains in balance. Before examining some illustrations, let us state the balance-sheet equation:

Assets = Liabilities + Owners' Equity

With this in mind, let us look at some examples of typical business transactions and their effect on the balance sheet.

A credit transaction

XYZ calls one of its suppliers and asks for delivery of $11 000 of chocolate calettes to be used in manufacturing. These arrive the next day, and XYZ takes possession of them. But the bill is to be paid within 30 days. How is the balance sheet affected? *Inventory* goes up by $11 000 on the assets side of the balance sheet and *accounts payable* rises by $11 000 on the liabilities side. The increase in current assets is matched by an increase in current liabilities.

Continuing this illustration, what happens when the bill is paid? XYZ issues a cheque for $11 000, and *cash* declines by this amount. At the same time, *accounts payable* decreases by $11 000. Again, these transactions offset each other, and the balance sheet remains in balance.

A bank loan

Table 12.2 shows that XYZ Chocolates Ltd had an outstanding bank loan of $200 000 in 2018. Assume that the company increases this loan by $110 000 in 2019. How is the balance sheet affected? *Cash* goes up by $110 000 (increasing the total assets), and the *bank loan* increases by the same amount (increasing the total liabilities). Again, balance is achieved. However, what if the firm uses this $110 000 to buy new machinery? In this case, *cash* decreases by $110 000 (reducing the cash assets) but *equipment* increases by the same amount (increasing equipment assets). Thus the total amount of assets remains unchanged, so no equivalent change is made on the liabilities or owners' equity side. Again, a balance exists. Finally, what if XYZ decides to pay off its bank loan? In this case, the first situation is reversed; *cash* and *bank loan* (long-term liabilities) decrease in equal amounts.

A sale of shares

Suppose that XYZ issues and sells another 40 000 *common* shares of $10 par value. How does this action affect the balance sheet? (This answer is rather simple.) *Common shares* increase by $400 000 and so does *cash*. Once more, a balance exists.

With these examples in mind, it should be obvious why the balance sheet always balances. Every entry has an equal and offsetting entry to maintain this equation:

Assets = Liabilities + Owners' Equity

In accounting language, the terms *debit* and *credit* denote increases and decreases in assets, liabilities and owners' equity. Unfortunately, there is not a one-to-one correspondence between the words. The following chart relates debits and credits to increases and decreases.

CATEGORY	A TRANSACTION INCREASING THE AMOUNT	A TRANSACTION DECREASING THE AMOUNT
Asset	Debit	Credit
Liability	Credit	Debit
Owners' equity	Credit	Debit

Applying this idea to the preceding examples results in the following:

	DEBIT	CREDIT
Credit transaction		
Inventory	$11 000	
Accounts payable		$11 000
Bank loan		
Cash	$110 000	
Bank loan		$110 000
Shares sale		
Cash	$400 000	
Common shares		$400 000
Total	$511 000	$511 000

THE INCOME STATEMENT

The **income statement** is a financial statement that shows the change that has occurred in a firm's position as a result of its operations over a specific period.[9] This is in contrast to the balance sheet, which reflects the company's position at a particular point in time.

The income statement, sometimes referred to as a '**profit and loss statement**' or 'P&L', reports on the success (or failure) of the business during the period. In essence, it shows whether sales revenues were greater than or less than expenses. These *revenues* are the monies the small business has received from the sale of its goods and services. The *expenses* are the costs of the resources used to obtain the revenues. These costs range from the cost of materials used in the firm's products to the salaries it pays its employees.

Most income statements cover a one-year interval, but it is not uncommon to find monthly, quarterly or semi-annual income statements. All of the revenues and expenses accumulated during this time are determined and the net income for the period is calculated. Many firms prepare quarterly

income statement
Also called profit and loss (P&L) statement, a statement summarising the income of a business during a specific period. The income statement illustrates the projected operating results based on profit and loss.

profit and loss statement
Also known as an income statement, a financial record or account of all of a firm's revenues and all of the expenses and costs incurred by the firm in achieving those revenues, which shows the level of profit or loss produced by the firm over a period of time.

income statements, but construct a balance sheet only once a year. This is because they are far more interested in their profits and losses than in examining their asset, liability and owners' equity positions. However, it should be noted that the income statement drawn up at the end of the year will coincide with the firm's fiscal year, just as the balance sheet does. As a result, at the end of the business year, the organisation will have both a balance sheet and an income statement. In this way, they can be considered together and the interrelationship between them can be studied. A number of different types of income and expenses are reported on the income statement. However, for purposes of simplicity, the income statement can be reduced to three primary categories: (1) revenues, (2) expenses and (3) net income.

ENTREPRENEURIAL EDGE

HOW TO EVOLVE FROM CEO TO CFO

For most entrepreneurs, managing the financial and accounting side of their business is not a core skill set. Many times, it's easier to focus on other seemingly cooler aspects like marketing, sales and product development. But a solid accounting infrastructure gets the money in the bank . . . and sets up a business for success.

For those who are for growth, here are some things to think about.

Do a daily bank reconciliation

You need to know your bank balance every day. The good news is that with Cloud accounting apps, your bank transactions arrive in your accounting system automatically every day, making it super easy to complete your bank reconciliation. Doing this daily will force you to look at every transaction that is running through your business, so you'll quickly learn that the small numbers add up and notice when the big numbers hit.

Look at your debtors and creditors every day

It's crucial to take the time and energy to collect your debts and get paid. Make sure you offer a number of payment options, including online. You also need to know what your current outstanding bills are. When you get an invoice from a supplier, enter this into your accounting system, so you don't forget it and you know how much it is and when it's due. In aggregate, your payables position must be understood. Never get behind with your creditors.

Learn how to read a profit and loss statement and a balance sheet

These are without a doubt the two most important financial reports for any business, wherever you are. The best way to build your understanding is to start looking at them. Assess different reporting periods (like Dec11 versus Jan12). A good rule of thumb is to run sales reports weekly and a P&L and balance sheet monthly. That's the minimum. Ask your accountant to not just prepare the reports, but explain what each means to your business. It's better that you learn how to read basic financial information, that way you can ask smarter questions.

Map your business processes into a financial flowchart

Your product is in demand, but you can't buy in fast enough to meet the demand. This is an entrepreneur's nightmare. Because the cash-flow cycle is different for every business, you need to map it, find the bottlenecks and unleash opportunities to free up your cash to allow your business to grow. Get a whiteboard and start drawing a picture of your business process: ordering, selling, payments and receipts. Understand how long your sales process takes and how long before you get the cash. Once you do the maths, you might be surprised about how long it takes. Think of ways to reduce the cycle. For example, you might like to offer a small discount for early payment (that's another article in itself!).

continue

continue

Build a basic cash-flow forecast

If you want to know how fast you can run, you need to glance back. Create a monthly cash-flow summary report for the past 6–12 months. This will give you a feel for your cash-flow cadence, letting you look at the trends and take note of the big items. Its big value is that it lets you estimate future cash flow. Update the cash-flow forecast every month, based on the latest knowledge you have of your business. This shows you how fast you can run, when you can hire the next person, when you can increase inventory levels, when to implement that marketing plan and so on.

Think about how new capital will let you run faster

Growing businesses burn cash faster than you'd believe. Cash is the big handbrake, so think about how you can get some more. Really successful entrepreneurs are always considering raising capital. Consider ways to make your existing reserves last longer. Making smart decisions in your business means you need to know the financial impact before you decide. Test strategies and try things out before making the final decision and committing resources. This reduces risks but also creates a culture in your business of smart, informed risk taking.

Knowledge is power: Understand your tax obligation and how to reduce it

We all have to pay taxes. Paying taxes is the only expense in your business that will not help you build your business. It is critical to be aware of the ever-evolving tax requirements, deductions and policies.

Once you understand your tax obligations and options, it's best to upload them into your cash-flow forecast and as payable items in your accounting system. Claim all the expenses you can and create a solid structure that minimises tax and limits liability – ask your accountant for help.

While accounting is a specialty area best handled by experts, if you want to be successful in business, you need to take responsibility for making sure you understand the numbers.

Source: Adapted from Sutherland, J., *How to evolve from CEO to CFO*. Forbes, copyright 2012. http://www.forbes.com.

Revenues are the gross sales the business made during the particular period under review. Revenue often consists of the money actually received from sales, but this need not be the case. For example, sales made on account are still recognised as revenue, as when XYZ Chocolate Ltd sells $500 of chocolate corporate gifts to a customer today, delivers them tomorrow and will receive payment two weeks from now. From the moment the goods are delivered the company can claim an increase in revenue.

Expenses are the costs associated with producing goods or services. For example, in the preceding paragraph, the expenses associated with the sale would include the costs of acquiring, selling and delivering the merchandise. Sometimes these are expenses that will be paid later. For example, the people who make the chocolate may be paid every two weeks, so the actual outflow of expense money in the form of salaries will not occur at the same time as the work is performed. Nevertheless, it is treated as an expense.

Net income is the excess of revenue over expenses during the particular period under discussion. If revenues exceed expenses, the result is a **net profit** before interest and taxes, sometimes referred to as PBIT. If the reverse is true, the firm suffers a *net loss*. At the end of the accounting period, all of the revenues and expenses associated with all of the sales of goods and services are added together, then the expenses are subtracted from the revenues. In this way, the firm knows whether it made an overall profit or suffered an overall loss.

revenues
Gross sales the business made during the particular period under review.

expenses
An expired cost; any item or class of cost of (or loss from) carrying on an activity; a present or past expenditure defraying a present operating cost or representing an irrecoverable cost or loss; an item of capital expenditures written down or off; a term often used with some qualifying expression denoting function, organisation or time, such as a selling expense, factory expense or monthly expense.

net income
The excess of revenue over expenses during a particular period. If revenues exceed expenses, the result is a net profit. If the reverse is true, the firm suffers a net loss.

net profit
Sometimes referred to as the 'bottom line', the difference between the revenue (or income from sales) and all associated business expenses, including production or service delivery costs, sales, marketing, payroll, overheads, interest and taxes.

UNDERSTANDING THE INCOME STATEMENT

Let's now turn to XYZ's income statement. To explain the income statement fully, it is necessary to examine one and determine what each account is. Table 12.3 illustrates five major sections: (1) sales revenue, (2) cost of goods sold, (3) operating expenses, (4) interest expenses and (5) estimated income taxes.

TABLE 12.3 XYZ CHOCOLATES LTD INCOME STATEMENT FOR THE YEAR ENDED 31 DECEMBER 2018

Sales	
Sales revenue	$1 750 000
Less: sales returns and allowances	–$50 000
Net sales	**$1 700 000**
Cost of goods sold	
Inventory, January 2018	$150 000
Purchases	$1 050 000
Goods available for sale	$1 200 000
Less: inventory, December 2018	–$200 000
Net cost of goods sold	**$1 000 000**
Gross profit (net sales – net costs)	**$700 000**
Operating expenses	
Selling expenses	$150 000
Administrative expenses	$100 000
Total operating expenses	**$250 000**
Operating income	**$450 000**
Interest and taxes	
Interest expense	$20 000
Income before income taxes	$430 000
Estimated income taxes	$172 000
Net profit after taxes	**$258 000**

Revenue

Every time XYZ sells a chocolate or hosts an event, it obtains revenue. This is often referred to as *gross revenue* or *sales revenue*. However, it is usually an overstated figure, because the company finds that some of its goods are returned or some customers take advantage of prompt-payment discounts.

In Table 12.3, XYZ's sales revenue is $1 750 000. However, the company also has returns and allowances of $50 000. These returns are common for companies that operate on a 'satisfaction or your money back' policy. (XYZ keeps tabs on these returns and allowances to see if the total is high in relation to the total sales revenue. If so, the firm will know that something is wrong with what it is selling and it can take action to correct the situation.) Deducting the sales returns and allowances from the sales revenue, the company finds its *net sales.* This amount must be great enough to offset the accompanying expenses in order to ensure a profit.

Cost of goods sold

As the name implies, the cost of goods sold section reports the cost of all the inputs (sugar, cream, chocolate, flavourings, etc.) of the merchandise that XYZ has sold during the accounting period. Simply put, the cost of goods sold for a given period equals the beginning inventory plus any purchases the firm makes minus the inventory on hand at the end of the period. Note that in Table 12.3 the beginning inventory was $150 000 and purchases totalled $1 050 000. This gave XYZ goods available for sale of $1 200 000. The ending inventory for the period was $200 000, so the cost of goods sold was $1 000 000. This is what it cost the company to acquire the inventory it sold. When this cost of goods sold is subtracted from net sales the result is the **gross profit**. The gross profit is the amount available to meet selling, administration and other operating expenses and to provide some net income for the firm's owners. When expressed as a percentage of the gross revenue, we call this the **gross margin**.

gross profit
Sales less the cost of goods sold. For example, if you sell $100 000 worth of merchandise for which you paid $80 000, your gross profit would be $20 000.

gross margin
The percentage difference between revenue (or income from sales) and the costs associated with producing the goods or services of a business before deduction of administration and overheads, interest and taxes.

Operating expenses

The major expenses, exclusive of the costs of goods sold, are classified as **operating expenses**. These represent the resources expended, except for inventory purchases, to generate the revenue for the period. Expenses often are divided into two broad subcategories: selling expenses and administrative expenses.

Selling expenses result from XYZ's activities in displaying, selling, delivering and installing its products or performing a service. Expenses for displaying a product include rent for storage space, depreciation on fixtures and furniture, property insurance and utility and tax expenses. Sales expenses, salaries, commissions and advertising also fall into this category. Costs associated with getting the product from the store to the customer are also considered selling expenses. Finally, if a firm installs a product for the customer, all costs – including the parts used in the job – are considered in this total. Taken as a whole, those are the selling expenses.

Administrative expenses is a catch-all term for operating expenses not directly related to selling or borrowing. In broad terms these expenses include the costs associated with running the firm. They include salaries of XYZ's managers, expenses associated with operating the office, general expenses that cannot be related directly to buying or selling activities and expenses that arise from delinquent or uncollectable accounts.

When these selling and administrative expenses are added together the result is *total operating expenses*. Subtracting them from the gross profit gives the firm its *operating income.* Note that, in Table 12.3, selling expenses are $150 000, administrative expenses are $100 000 and total operating expenses are $250 000. When subtracted from the gross profit of $700 000, the operating income is $450 000.

operating expenses
The major expenses of a firm, exclusive of costs of goods sold. These represent the resources expended, except for inventory purchases, to generate revenue. (See also *selling expenses*, *administrative expenses*.)

selling expenses
Expenses from displaying, selling, delivering and installing products or performing a service.

administrative expenses
An overhead cost associated with managing business affairs not directly attributable to sales, marketing, production or service delivery.

Interest expense

The **interest expense** (also known as the financial expense) is the cost of borrowings on long-term loans, also known as debt servicing. In Table 12.3, this expense is $20 000. Additionally, many companies include their costs of short-term borrowing obligations as part of their interest expense.

interest expense
Interest expense on long-term loans, also known as debt service.

Estimated income taxes

Companies often pay estimated taxes in advance, then, at some predetermined time (for example, 30 June), the books are closed, the cost of borrowings (the interest paid) is deducted and the actual taxes are determined. The firm then settles any additional tax payments if earnings were higher than estimated, or can seek a refund if earnings were less than estimated. When interest and taxes are

cash-flow statement
A financial statement that sets forth the amount and timing of actual and/or expected cash inflows and outflows.

accrual system of accounting
A method of recording and allocating income and costs for the period in which each is involved, regardless of the date of payment or collection. For example, if you were paid $100 in April for goods you sold in March, the $100 would be income for March under an accrual system. (Accrual is the alternative to the cash system of accounting.)

operating cash flows
Cash generated from or used in the course of business operations of the firm. The net operating cash flows will be positive for most firms, because their operating inflows (primarily from revenue collections) will exceed operating outflows (for example, payment for raw materials and wages).

subtracted from the income before interest and taxes, the result is the *net profit after taxes* (NPAT). In our example, XYZ Chocolates made $28 000.

THE CASH-FLOW STATEMENT

The **cash-flow statement** (also known as *statement of cash flows*) shows the effects of XYZ's operating, investing and financing activities on its cash balance. The principal purpose of the statement of cash flows is to provide relevant information about the company's cash receipts and cash payments during a particular accounting period. It is useful for answering such questions as:

- How much cash did the firm generate from operations?
- How did the firm finance fixed-capital expenditures?
- How much new debt did the firm add?
- Was the cash from operations sufficient to finance fixed-asset purchases?

The statement of cash flows is a supplement to the balance sheet and income statements. One of the limitations of the income and balance sheet statements is that they are based on accrual accounting. In the **accrual system of accounting**, revenues and expenses are recorded when an obligation is incurred – not when cash changes hands. For example, if XYZ makes a sale on credit, under accrual accounting the sale is recognised, but cash has not been received. Similarly, a tax expense may be shown in the income statement, but it may not be paid until later. The statement of cash flows reconciles the accrual-based figures in the income and balance sheet statements to the actual cash balance reported in the balance sheet.

The statement of cash flows is broken down into operating, investing and financing activities. Table 12.4 provides an outline of a statement of cash flows. **Operating cash flows** refer to cash generated from or used in the course of the ordinary business operations of the firm. The net operating cash flows will be positive for most firms, because their operating inflows (primarily from revenue collections) will exceed operating outflows (for example, payment for raw materials and wages).

TABLE 12.4 FORMAT OF STATEMENT OF CASH FLOWS

Cash flows from operating	$50 000
Cash flows from investing activities	–$10 000
Cash flows from financing activities	$5 000
Net increase (decrease) in cash	**$45 000**
Cash at beginning of period	$400 000
Cash at end of period	**$445 000**

investing activities
An item on the cash-flow statement that reports cash-flow effects from long-term investing activities, such as purchase or sale of plant and equipment. The net cash flow from investing activities can be either positive or negative.

Investing activities refer to cash-flow effects from long-term investing activities, such as the purchase or sale of plant and equipment. The net cash flow from investing activities can be either positive or negative. A firm such as XYZ that is still in the growth phase would be building up fixed assets (installing new equipment or building new plants) and therefore would show negative cash flows from investing activities. On the other hand, a firm that is shrinking in size by divesting unprofitable divisions may realise cash inflows from the sale of assets and therefore would show a positive cash flow from investing activities.

Financing activities refer to cash-flow effects of the financing decisions of the firm, including the sale of new securities (such as shares and bonds), repurchase of securities and payment of dividends. Note that payment of interest to lenders is *not* included under financing activities. Accounting convention in determining the statement of cash flows assumes that interest payments are part of operating cash flows. Once the cash flows from the three different sources – operating, investing and financing – are identified, the beginning and ending cash balances are reconciled.

Up until now we have been examining XYZ's cash-flow statement. While this is most frequently used by those analysing the firm (for example, a bank or venture investor), the *cash budget procedure* is actually more useful to start-up entrepreneurs and growing firms and will be covered in the next section.

ENTREPRENEURSHIP IN PRACTICE

WATCHING YOUR ACCOUNTS RECEIVABLE

One of the primary issues that plagues start-up companies is poor cash flow, and one of the largest contributors to this problem is uncollected accounts receivable. When the economy is in decline, the first tactic that most businesses will employ is to stretch out the payments on their accounts payable as long as they can, which presents an issue for their vendors. Most entrepreneurs offer credit to their customers to encourage business, but when those customers choose not to pay off that credit in a timely manner, the entrepreneur's business can face a cash deficit, making payments to its own vendors problematic. In some cases entrepreneurs are left with no choice but to take on credit cards that charge excessive interest rates just to keep their business afloat.

Avoiding this situation takes significant forethought on the part of the management team. A good rule of thumb is to always secure funding before your company needs it. You will usually find cash when in dire straits, but the cost of that capital can be significant. Securing an operating line of credit and keeping tabs on your accounts receivable will help prevent expensive mistakes when the going gets tough.

Here are five tips for making sure that you are paid what is coming to you.

Develop a process.

Customers will stretch out their payments to you if they think they can get away with it; do not let them. Being consistent when dealing with your customers will let them know that you take collecting your receivables seriously. Establish a payment due date and enforce it. If you let your customers slide, you will be sending them the message that they can pay when they want to, which might work fine when your company is flush with cash, but will be a significant burden if your business hits a lull.

Make some noise.

Once you have provided a product or service, you are entitled to get paid. You should not feel guilty about contacting your customers about a delinquent payment. After all, you have upheld your end of the deal. Your customers are going to pay the vendors who are the most committed to getting paid. If you choose to sit idle, you may never get your money.

Get paid up front.

When in doubt, there is no better way to ensure payment than by mandating that your customers pay up front; this is especially useful when working with new clients. You can always charge a percentage so that you and your customers are sharing the burden of responsibility. In the event that you choose to issue credit to a customer, make sure to perform a credit check first.

Find an advocate.

Find out who is responsible for issuing payments in each of your respective customers' businesses so that you get to know them. The order in which payments are submitted will usually be at the discretion of this individual, so you stand a greater chance of being at the top of that list if they know you.

continue

continue

Know when to walk away.

Contrary to traditional thinking, customers are not always right and they are not always profitable. The time spent collecting fees from a customer and the cost of carrying the credit for that customer might outweigh the margins that customer's business is generating. If that turns out to be the case, do not be afraid to discontinue the relationship. Often the costs far outweigh what appears on your financial statements, given that time spent on troublesome customers could be spent acquiring new business. To prevent such issues from burdening your company, conduct annual audits of your customers and consider eliminating those that cost you money.

Cash-flow management is a process that never ends for an entrepreneur.

Liquidity is an important metric when considering the health of your business; if you are allowing your customers to postpone their payments, you could be putting your company's life in jeopardy.

Source: Adapted from Prince, C. J. (2008, January). Time bomb. *Entrepreneur*. Entrepreneur Media, Inc., copyright 2008. http://www.entrepreneur.com/magazine/entrepreneur/2008/january/187658.html; and Khanna, R. (2010). Tips on managing your accounts receivable. Toolbox.com, copyright 2010. http://finance.toolbox.com/blogs/montreal-financial/tips-on-managing-your-accounts-receivable-42717.

PREPARING FINANCIAL BUDGETS

budget
A statement of estimated income and expenses over a specific period of time.

operating budget
A detailed projection of all estimated income and expenses during a given future period.

cash-flow budget
A budget that provides an overview of inflows and outflows of cash during a specified period of time. (See also *budget*.)

capital budget
A type of budget used to plan expenditures on assets whose returns are expected to last beyond one year. (See also *budget*.)

sales forecast
The projected or predicted pattern or estimate of sales at some future point or period.

linear regression
The process of fitting the best possible straight line through a series of points.

One of the most powerful tools the entrepreneur can use in planning financial operations is a **budget**.[10] The **operating budget** is a *statement* estimating income and expenses over a specified future period of time. Another common type of budget is the **cash-flow budget**, which is a statement of the estimated cash receipts and expenditures over a specified period of time. It is typical for a firm to prepare both types of budgets by first computing an operating budget and then constructing a cash-flow budget based on the operating budget. A third common type of budget is the **capital budget**, which is used to plan expenditures on assets whose returns are expected to last beyond one year. In this section we will examine all three of these budgets: operating, cash flow and capital. We will then discuss the preparation of pro forma financial statements from these budgets.

THE OPERATING BUDGET

The operating budget is made up of a variety of forecasts, including sales forecasts, expense forecasts, production forecasts and operating forecasts.

Sales forecasts

Typically, the first step in creating an operating budget is the preparation of the **sales forecast**.[11] An entrepreneur can prepare the sales forecast in several ways. One way is to implement a statistical forecasting technique such as simple linear regression. Simple **linear regression** is a method of estimating the expected value of one variable Y given the values of some other variable or variables x. 'Linear' refers to the assumption that a linear relationship (straight line) exists between Y and x:

$$Y = a + bx$$

Y is a dependent variable (it is dependent on the values of a, b and x), x is an independent variable (it is not dependent on any of the other variables), a is a constant (in regression analysis, Y is dependent on the variable x, all other things held constant) and b is the slope of the line (the change in Y divided by the change in x). For estimating sales, for instance, Y is the variable used to represent the expected sales and x is the variable used to represent some factor on which sales might be dependent (such as advertising expenditures or foot traffic past the store).

When using regression analysis, the entrepreneur draws conclusions about the relationship between, for example, product sales and advertising expenditures. Here is an example of how Hanna Frederick, XYZ's managing director, used regression analysis.

Hanna began with two initial assumptions: (1) If no money is spent on advertising, total sales will be \$200 000, and (2) for every dollar spent on advertising, sales will be increased by two times that amount. Relating these two observations yields the following simple linear regression formula:

$$S = \$200\,000 + 2A$$

where:

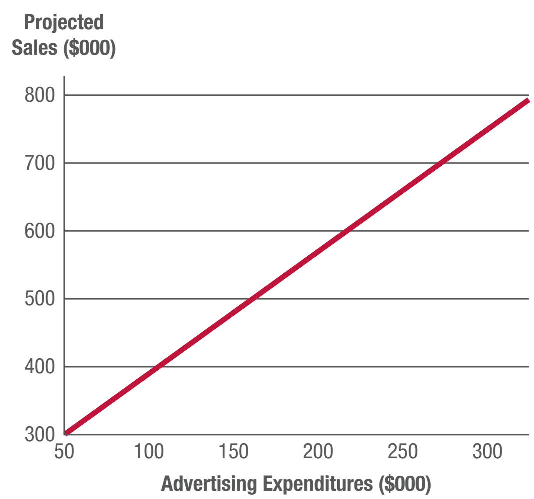
$$S = \text{Sales (projected)}$$

$$A = \text{Advertising expenditures}$$

Note that it is often easier to substitute more meaningful letters into an equation. In this case, the letter *S* was substituted for the letter *Y* simply because the word 'sales' starts with that letter. The same is true for the letter *A* for advertising, which was substituted for the letter *x*.

In order to determine the expected sales level, Hanna must insert different advertising expenditures and complete the simple linear regression formula for each different expenditure. Figure 12.1 demonstrates the results.

FIGURE 12.1
REGRESSION ANALYSIS



Simple Linear Regression ($000)

A	2A	S = \$200 + 2A
\$ 50	\$100	\$300
100	200	400
105	300	500
200	400	600
205	500	700
300	600	800

Another commonly used technique for the preparation of a sales forecast is the estimation that current sales will increase by a certain percentage over the prior period's sales. This percentage is based on a trend line analysis that usually covers the five preceding sales periods and assumes that seasonal variations will continue to run in the same pattern. Obviously, because it needs five preceding sales periods, trend line analysis is used for established ventures, but it could also draw upon industry data as a benchmark for a new venture's growth.

Here is an example of how XYZ used trend line analysis to forecast sales.

After considerable analysis of the company's and the industry's sales history, Hanna decided to use trend line analysis and estimated that sales would increase 5 per cent during the next year, with the seasonal variations following roughly the same pattern. Since she has a personal computer with Microsoft Excel, Hanna chose to input last year's sales figures into a spreadsheet and instruct the computer to increase the sales value each month by 5 per cent. The results are shown in Table 12.5.

TABLE 12.5 XYZ'S SALES FORECASTS FOR 2018 ($000)

	JAN	FEB	MAR	APR	MAY	JUN
Sales	300	350	400	375	500	450
× 1.05	315	368	420	394	525	473
	JUL	**AUG**	**SEP**	**OCT**	**NOV**	**DEC**
Sales	475	480	440	490	510	550
× 1.05	499	504	462	515	536	578

Expense (purchase) forecasts

cost of goods sold (COGS)
The value of products sold to customers in a given period, determined by subtracting the value of the ending inventory from the sum of the beginning inventory and purchases made during the period. Gross sales less cost of goods sold gives gross profit.

After a business has forecast its sales for the budget period, expenses must be estimated. The first type of expense that should be estimated is the **cost of goods sold (COGS)**, which follows sales on the income statement. For retail firms this is a matter of projecting purchases and the corresponding beginning and desired ending inventories. Many firms prefer to have a certain percentage of the next month's sales on hand in inventory.

Here is how Hanna determines her company's expected purchases and inventory requirements:

For determining the purchase requirements, Hanna believes her gross profit will represent 15 per cent of her sales dollar. This is based on analysis of the past five years' income statements. Consequently, cost of goods sold will represent 85 per cent of the sales for the current month. In addition, Hanna wants to have approximately one week's inventory on hand. Thus, the ending inventory is estimated to be 25 per cent of next month's sales. The results are shown in Table 12.6.

A manufacturing firm, on the other hand, will need to establish its production budget, a material purchases budget based on the production budget and the corresponding direct labour budget. The production budget is management's estimate of the number of units that need to be produced in order to meet the sales forecast. This budget is prepared by working backward through the cost of goods sold section. First, the predicted number of units that will be sold during that month is determined. Then the desired ending-inventory balance is added to this figure. The sum of these two figures is the number of units that will be needed in inventory. Once the inventory requirements have been determined, the entrepreneur must determine how many of these units will be accounted for by the beginning inventory (which is the prior month's ending inventory) and how many units will have to be produced. The production requirement is calculated by subtracting the period's beginning inventory from the inventory needed for that period.

TABLE 12.6 XYZ'S PURCHASE REQUIREMENTS BUDGET FOR 2018 ($000)

	JAN	FEB	MAR	APR	MAY	JUN	JUL	AUG	SEP	OCT	NOV	DEC
Sales revenue	**315**	**368**	**420**	**394**	**525**	**473**	**499**	**504**	**462**	**515**	**536**	**578**
Cost of goods sold												
Beginning inventory	63	74	84	79	105	95	100	101	92	103	107	116
Purchases	263	305	331	341	410	383	400	395	380	416	437	413
Cost of goods available	**326**	**379**	**415**	**420**	**515**	**478**	**500**	**496**	**472**	**519**	**544**	**529**
Ending inventory	74	85	79	105	95	100	101	92	102	107	116	66
Cost of goods sold	**252**	**294**	**336**	**315**	**420**	**378**	**399**	**403**	**370**	**412**	**428**	**462**
Gross profit	**63**	**74**	**84**	**79**	**105**	**95**	**100**	**101**	**92**	**103**	**108**	**116**

Cost of goods sold = Current period sales × 0.80
Ending inventory = Next month's sales × (0.80)(0.25) (since inventory is carried at cost)
Cost of goods available = Cost of goods sold − Ending inventory
Beginning inventory = Prior month's ending inventory or current month's sales × (0.80)(0.25)
Purchases = Cost of goods available − Beginning inventory
Gross profit = Sales − Cost of goods sold

For example: Tom B. Good, president and founder of Dynamic Manufacturing, has decided to implement a budget to help plan for his company's growth. After Tom received the unit sales forecast from his sales manager, he examined last year's product movement reports and determined that he would like to have 11 per cent of the next month's sales on hand as a buffer against possible fluctuations in demand. He also has received a report from his production manager that estimates his ending inventory for this year at 12 000 widgets, which also will be the beginning inventory for the budget period. Table 12.7 shows the results.

TABLE 12.7 DYNAMIC MANUFACTURING'S PRODUCTION BUDGET WORKSHEET FOR 2018 ($000)

	JAN	FEB	MAR	APR	MAY	JUN	JUL	AUG	SEP	OCT	NOV	DEC
Projected sales (units)	**125**	**136**	**123**	**143**	**154**	**234**	**212**	**267**	**236**	**345**	**367**	**498**
Desired ending inventory	14	12	14	15	23	21	27	24	35	37	50	26
Available for sale	**139**	**148**	**137**	**158**	**177**	**255**	**239**	**291**	**271**	**382**	**417**	**524**
Less: Beginning inventory	12	14	12	14	15	23	21	27	24	35	37	50
Total production requirements	**127**	**134**	**125**	**144**	**162**	**232**	**218**	**264**	**247**	**347**	**380**	**474**

After the production budget has been calculated, the materials required for producing the specified number of units can be determined from an analysis of the bill of materials for the product being manufactured. In addition, by examining the amount of direct labour needed to produce each unit, management can determine the amount of direct labour that will be needed during the forthcoming budget period.

Operating expenses

fixed costs
Part of the operating budget, costs that do not change in response to changes in activity for a given period of time, such as rent, depreciation and certain salaries. (See also *variable costs*, *mixed costs*.)

The last step in preparing the operating budget is to estimate the operating expenses for the period. Three of the key concepts in developing an expense budget are fixed, variable and mixed costs. A **fixed cost** is one that does not change in response to changes in activity for a given period of time. Rent, depreciation and certain salaries are examples. A **variable cost** is one that changes in the same direction as, and in direct proportion to, changes in operating activity. Shipping supplies and sales commissions are examples. **Mixed costs** are a blend of fixed and variable costs. An example is utilities, since part of this expense would be responsive to changes in activity and the rest would be a fixed expense, remaining relatively stable over the budget period. Mixed costs can present a problem for management in that it is sometimes difficult to determine how much of the expense is variable and how much is fixed.

After the expenses have been budgeted, the sales, cost of goods and expense budget are combined to form the operating budget. Table 12.8 outlines XYZ's anticipated expenses for the budget year and the completed operating budget for the period. Each month represents the pro forma, or projected, income and expenses for that period.

TABLE 12.8 XYZ'S EXPENSE AND OPERATING BUDGET FOR 2018 ($000)

REVENUE												
Sales revenue	315	368	420	394	525	473	499	504	462	515	536	578
COST OF GOODS SOLD												
Beginning inventory	63	74	84	79	105	95	100	101	92	103	107	116
Purchases	263	305	331	341	410	383	400	395	380	416	437	413
Cost of goods available	**326**	**379**	**415**	**420**	**515**	**478**	**500**	**496**	**472**	**519**	**544**	**529**
Ending inventory	74	85	79	105	95	100	101	92	102	107	116	66
Cost of goods sold	**252**	**294**	**336**	**315**	**420**	**378**	**399**	**403**	**370**	**412**	**428**	**462**
Gross profit (revenue – COGS)	**63**	**74**	**84**	**79**	**105**	**95**	**100**	**101**	**92**	**103**	**108**	**116**
OPERATING EXPENSES												
Rent	2	2	2	2	2	2	2	2	2	2	2	2
Payroll	32	37	42	39	53	47	50	50	46	51	54	58
Utilities	5	5	5	5	5	5	5	5	5	5	5	5
Taxes	3	4	4	4	5	5	5	5	5	5	5	6
Supplies	16	18	21	20	26	24	25	25	23	26	27	29
Repairs	2	2	2	2	2	2	2	2	2	2	2	2
Total expenses	**60**	**68**	**76**	**72**	**93**	**85**	**89**	**89**	**83**	**91**	**95**	**102**
Net profit (gross profit – expenses)	**3**	**6**	**8**	**7**	**12**	**10**	**11**	**12**	**9**	**12**	**12**	**14**

In order to identify the behaviour of the different expense accounts, XYZ decided to analyse the past five years' income statements. Following are the results of the analysis:

- Rent is a constant expense and is expected to remain the same over the next year.
- Payroll expense for sales personnel changes in proportion to sales, since the more sales the store has, the more people it must hire to meet increased consumer demands.
- Utilities are expected to remain relatively constant over the budget period. This is because the food coolers will be running at the same level even though the sales levels may vary.
- Taxes are based primarily on sales and payroll and are therefore considered a variable expense.
- Supplies will vary in proportion to sales. This is because most of the supplies (cash register tape, packaging, etc.) will be used to support sales.
- Repairs are relatively stable and are a fixed expense. Hanna has maintenance contracts on the equipment in the store and the cost is not scheduled to rise during the budget period.

variable costs
Part of the operating budget, costs that vary with the level of production or sales, such as shipping supplies and sales commissions. These costs change in the same direction as, and in direct proportion to, changes in operating activity, for example, direct labour, direct materials and sales commissions. (See also *fixed costs*, *mixed costs*.)

mixed costs
Part of the operating budget, a blend of fixed and variable costs. An example is utilities, since part of this expense would be responsive to change in activity and the rest would be a fixed expense, remaining relatively stable over the budget period. (See also *fixed costs*, *variable costs*.)

THE CASH-FLOW BUDGET

After the operating budget has been prepared the entrepreneur can proceed to the next phase of the budget process, the cash-flow budget. This budget, which is often prepared with the assistance of an accountant, provides an overview of the cash inflows and outflows during the period. By pinpointing cash problems in advance, management can make the necessary financing arrangements.[12]

The first step in the preparation of the cash-flow budget is the identification and timing of cash inflows. For the typical business, cash inflows will come from three sources: (1) cash sales, (2) cash payments received on account and (3) loan proceeds. Not all of a firm's sales revenues are cash. In an effort to increase sales, most businesses will allow some customers to purchase goods on account. Consequently, part of the funds will arrive in later periods and will be identified as cash payments received on account. Loan proceeds represent another form of cash inflow that is not directly tied to the sales revenues. A firm may receive loan proceeds for several reasons – for example, the planned expansion of the firm (new building and equipment) or meeting forecasted cash-flow needs stemming from growth. During times of high growth the rate of expenses related to forecast sales can exceed the rate of revenue from current sales, which leaves a **working capital** gap and consequently a need to fund the forecast cash-flow shortfall. If a firm becomes unable to pay debts as and when they fall due, the firm is said to be an insolvent trader, an illegal position for which proprietors and directors can be prosecuted.

working capital
Otherwise known as operating liquidity, the difference between short-term (or current) assets and short-term (or current) liabilities. It is a measure of the financial health of a business that demonstrates that a firm has sufficient surplus of cash generated from its operations to pay its debts as they fall due.

Some businesses have a desired minimum balance of cash indicated on the cash-flow budget, highlighting the point at which it will be necessary to seek additional financing. Table 12.9 provides an example of how XYZ prepared its cash-flow budget.

XYZ's Hanna Frederick has successfully completed her operating budget and is now ready to prepare her cash-flow worksheet. After analysing the sales figures and the cash receipts, Hanna has determined that 80 per cent of monthly sales are in cash. Of the remaining 20 per cent, 15 per cent is collected in the next month and the final 5 per cent is collected in the month following (see the cash receipts worksheet in Table 12.9). Hanna's purchases are typically paid during the week following the purchase. Therefore, approximately one-quarter of the purchases are paid for in the following month. Rent expense is paid a month in advance. However, since it is not expected to go up during the budget period, the monthly cash outlay for rent remains the same. All the other expenses are paid in the month of consumption (see the cash disbursement worksheet in Table 12.9). Finally, the cash-flow worksheet is constructed by taking the beginning cash balance, adding the cash receipts for that month and deducting the cash disbursements for the same month.

TABLE 12.9 XYZ'S CASH-FLOW BUDGET

	XYZ'S CASH RECEIPTS WORKSHEET FOR 2018 ($000)											
	JAN	**FEB**	**MAR**	**APR**	**MAY**	**JUN**	**JUL**	**AUG**	**SEP**	**OCT**	**NOV**	**DEC**
Sales	315	368	420	394	525	473	499	504	462	515	536	578
Current month	252	294	336	315	420	378	399	403	370	412	428	462
Prior month	82	47	55	63	59	79	71	75	76	69	77	80
Two months ago	26	28	16	18	21	19	26	24	24	25	24	26
Cash receipts	360	369	407	396	500	476	496	502	470	506	529	568
	XYZ'S CASH DISBURSEMENTS WORKSHEET FOR 2018 ($000)											
	JAN	**FEB**	**MAR**	**APR**	**MAY**	**JUN**	**JUL**	**AUG**	**SEP**	**OCT**	**NOV**	**DEC**
Purchases	263	305	331	341	410	383	400	395	380	416	437	413
Current month	197	228	248	256	307	287	300	296	285	312	328	309
Prior month	98	66	76	83	85	102	96	100	99	95	104	109
Purchase payments	295	294	324	339	392	396	396	396	384	407	432	419
Operating expenses	60	68	76	72	93	85	89	89	83	91	95	102
XYZ's cash-flow worksheet for 2018 ($000)												
Cash payments	**355**	**362**	**400**	**412**	**485**	**481**	**485**	**485**	**467**	**498**	**527**	**521**
Beginning cash	122	127	134	141	127	141	143	154	170	173	181	184
Add: Receipts	360	369	407	396	500	476	496	502	470	506	529	568
Cash available	482	496	541	537	627	617	639	656	640	679	710	752
Less: Payments	355	362	400	411	485	481	485	485	467	498	527	521
Ending cash	**127**	**134**	**141**	**126**	**142**	**136**	**154**	**171**	**173**	**181**	**183**	**231**

ENTREPRENEURSHIP IN PRACTICE

CHARACTERISTICS OF CREDIBLE FINANCIALS

Although every section of a business plan has its purpose, the financial section bears the most scrutiny. The financial statements of a business are deserving of this attention for two reasons: (1) the management team has significant discretion in how the financials are constructed, and (2) potential investors reviewing a business plan will be interested in the financial viability of the company's strategy. Following are the characteristics that convincing financial statements have in common.

Holistic

An income statement tells only part of the financial story of your business; the balance sheet and cash-flow statement are necessary to fill in the remaining details. Investors and lenders are interested in every detail of your company's financial health, so never exclude relevant information, such as the amount of and the timeline for the cash you will need.

continue

continue

Precise

Although investors will carefully analyse your financial statements, helping them to pinpoint the important details will ensure that they do not lose patience searching through your plan. To aid the readers of your plan, focus your sales and COGS numbers on major product lines. In addition, pay attention to how you label your line items to ensure that your readers will understand what you are trying to communicate. For instance, 'costs' are what you pay for what you are selling, while 'expenses', such as payroll and rent, are overhead charges you would have without sales.

Realistic

When you tailor your figures to achieve a predetermined revenue goal, you will have trouble justifying your numbers when questioned. Instead, build your financials by starting with your costs and sales in your local market to anchor your figures in reality. In addition, your projections beyond the first year should be annual or quarterly.

Simple

Significant volatility in your industry should be noted, such as your business being impacted by seasonality; however, bogging down your plan with lengthy explanations regarding the probability of your projections will only serve to confuse the reader. Including clarifying statements, such as 'most likely', and supporting addendums, such as your break-even analysis, will be sufficient.

Accurate

Investors know that your plan will change repeatedly as you build your business; however, overlooking simple expenses, such as interest payments, can cast doubt on your attention to detail. Once you have your financial statements completed, verifying the finer points, such as the accuracy of the interest and tax rates, will show that you are able to take your business from plan to implementation.

Sources: Adapted from Berry, T. (2007, May). *The facts about financial projections*. http://www.entrepreneur.com/startingabusiness/ businessplans/ businessplancoachtimberry/article178210.html; Casparie, J. (2006, April). *Realistic projections that attract investors*. http://www.entrepreneur.com/money/ financing/raisingmoneycoachjimcasparie/article159516.html; 5 tips for coming up with financial projections for your business plan (2012). National Federation of Independent Business, copyright 2012.

PRO FORMA STATEMENTS

The final step in the budget process is the preparation of **pro forma statements**, which are projections of a firm's future financial statements. *Pro forma* comes from Latin, meaning 'according to form'. In the normal accounting cycle, the income statement is prepared first and then the balance sheet. Similarly, in the preparation of pro forma statements, the pro forma income statement is followed by the pro forma balance sheet.

pro forma statement
A financial statement projecting anticipated income, expenses and cash flow for some specified future period.

In the process of preparing the operating budget, the firm will have already prepared the pro forma income statements for each month in the budget period. Each month presents the anticipated income and expense for that particular period. To prepare an annual pro forma income statement, the firm combines all months of the year.

The process for preparing a pro forma balance sheet is more complex. The last balance sheet prepared before the budget period began, the operating budget and the cash-flow budget are all needed in preparing a pro forma balance sheet. Starting with the beginning balance sheet balances, the projected changes as depicted on the budgets are added to create the projected balance sheet totals.

After preparing the pro forma balance sheet, the entrepreneur should verify the accuracy of their work with the application of the traditional accounting equation:

$$\text{Assets} = \text{Liabilities} + \text{Owners' Equity}$$

If the equation is not in balance, the work should be rechecked. Table 12.10 provides a brief account of the process of preparing pro forma financial statements for XYZ Chocolates Ltd.

TABLE 12.10 XYZ'S PRO FORMA STATEMENTS

	XYZ'S COMPARATIVE PRO FORMA INCOME STATEMENTS FOR 2018 ($000)											
	JAN	FEB	MAR	APR	MAY	JUN	JUL	AUG	SEP	OCT	NOV	DEC
Sales	315	388	420	394	525	473	499	504	462	515	536	578
Cost of goods sold	252	294	336	315	420	378	399	403	370	412	428	462
Gross profit	**63**	**74**	**84**	**79**	**105**	**95**	**100**	**101**	**92**	**103**	**108**	**116**
Total operating expenses	60	68	76	72	93	85	89	89	83	91	95	102
Net profit	**3**	**6**	**8**	**7**	**12**	**10**	**11**	**12**	**9**	**12**	**12**	**14**
	XYZ'S COMPARATIVE PRO FORMA BALANCE STATEMENTS FOR 2018 ($000)											
	JAN	FEB	MAR	APR	MAY	JUN	JUL	AUG	SEP	OCT	NOV	DEC
Assets												
Cash	127	134	141	126	142	136	154	171	173	181	183	231
Accounts receivable	91	89	102	100	125	121	123	126	117	126	133	142
Inventory	74	84	79	105	95	100	101	92	103	107	116	66
Prepaid rent	2	2	2	2	2	2	2	2	2	2	2	2
Building and equipment	350	350	350	350	350	350	350	350	350	350	350	350
Less: Accumulated depreciation	−350	−350	−350	−350	−350	−350	−350	−350	−350	−350	−350	−350
Total assets	**294**	**309**	**324**	**333**	**364**	**359**	**380**	**391**	**395**	**416**	**434**	**441**
Liabilities												
Accounts payable	66	76	83	85	102	96	100	99	95	104	109	103
Capital	228	234	242	249	261	270	280	292	300	312	326	339
Total liabilities and equity	**294**	**310**	**325**	**334**	**363**	**366**	**380**	**391**	**395**	**416**	**435**	**442**

SENSITIVITY ANALYSIS

sensitivity analysis An analysis that evaluates to what extent under- or overestimated assumptions may influence cash needs and profitability and therefore the financial strength of the business.

One last thing an entrepreneur should do is conduct a **sensitivity analysis**, or a 'what if' analysis.[13] This can be done using spreadsheets and the integrated set of pro forma accounts, including the balance sheet and the income and cash statements. This analysis checks to see to what extent under- or overestimated assumptions may influence cash needs, profitability and the financial strength of the business.

A harsh test that may be imposed by some investors is to ask 'what if the costs and expenses estimated by the business are doubled while the forecast revenues are halved?' This is a form of sensitivity analysis to check to what extent the business remains viable when certain assumptions are challenged. It is far better for the entrepreneur to have already performed these tests around critical assumptions before an investor runs the numbers. Knowing the implications of changing assumptions will forearm the entrepreneur with answers to difficult investor questions and in practice will provide insight on key metrics to monitor that will raise red flags if some predetermined limits are hit.

At this point in the budget process, XYZ's Hanna Frederick has the information necessary to prepare pro forma financial statements. The first set she has decided to prepare are the pro forma income statements. To do this, Hanna simply copies the information from the operating budget (see the comparative income statements in Table 12.10 and compare with the operating budget). The next set of pro forma statements is the pro forma balance sheets. In order to compile these, she uses the following information along with the operating budget and the cash-flow worksheet she has prepared:

- cash – the ending cash balance for each month from the cash-flow worksheet
- accounts receivable – 20 per cent of the current month's sales plus 5 per cent of the preceding month's sales
- inventory – the current month's ending inventory from the pro forma income statements
- prepaid rent – the $2000 is expected to remain constant throughout the budget period and is always paid one month in advance
- building and equipment – no new acquisitions are expected in this area, so the amount will remain constant
- accumulated depreciation – in the interest of simplicity, we assume this will stay the same; all buildings and equipment are fully depreciated
- accounts payable – 25 per cent of current purchases
- capital – prior month's capital balance plus current month's net income. (No dividend payments are anticipated.)

CAPITAL BUDGETING

Entrepreneurs are usually required to make several investment decisions (that is, decisions to acquire assets with a life longer than one year) in the process of managing their businesses. These are commonly referred to as capital investments or capital expenditures (commonly referred to as '**capex**'). A technique the entrepreneur can use to help plan for capital expenditures is **capital budgeting**.[14]

capex
Short for 'capital expenditure'; refers to costs associated with buying machinery, equipment, property and other fixed assets that provide long-term benefit.

The first step in capital budgeting is to identify the cash flows related to a proposed investment and their timing. The inflows – or *returns*, as they are commonly called – are equal to net operating income before deduction of payments to financing sources, but after deduction of applicable taxes and with depreciation added back, as represented by the following formula:

capital budgeting
A budgeting process used to determine investment decisions, i.e. how to invest new capital to increase value in the company (for example, through machine replacement or R&D). It relies heavily on evaluation of cash inflows.

$$\text{Expected returns} = X(1 - T) + \text{Depreciation}$$

X is equal to the net operating income and *T* is defined as the appropriate tax rate. An illustration follows.

Hanna Frederick is faced with a dilemma. She has two mutually exclusive projects, both of which require an outlay of $1000. The problem is that she can afford only one of the projects. After discussing the problem with her accountant, Hanna discovered that the first step she needs to take is to determine the expected return on each project. In order to gather this information, she has studied the probable effect on the store's operations and has developed the data shown in Table 12.11.

Table 12.11 provides a good illustration of the expected returns for Hanna's two projects. At this point, however, the cash inflows of each year are shown without consideration of the **time value of money** (the idea that money available today has an earning potential in terms of interest and therefore will be worth more over a given time period). The cash outflow is used to refer to the initial cash outlay that must be made in the beginning (the purchase price). When gathering data to estimate the cash flows over the life of a project, it is imperative to obtain reliable estimates of the savings and expenses associated with the project.

time value of money
The idea that money available today is worth more than the same amount in the future due to its potential interest-earning capacity. Any amount of money is worth more the sooner it is received.

TABLE 12.11 XYZ'S EXPECTED RETURN WORKSHEET

		PROPOSAL A			
YEAR	X	(1 − T), WHERE T = .40	X(1 − T)	DEPRECIATION	X(1 − T) + DEPRECIATION
1	$500	0.60	$300	$200	$500
2	$333	0.60	$200	$200	$400
3	$167	0.60	$100	$200	$300
4	−$300	0.60	−$180	$200	$20
5	−$317	0.60	−$190	$200	$10
		PROPOSAL B			
YEAR	X	(1 − T), WHERE T = .40	X(1 − T)	DEPRECIATION	X(1 − T) + DEPRECIATION
1	−$167	0.60	−$100	$200	$100
2	$0	0.60	$100	$200	$200
3	$167	0.60	$100	$200	$300
4	$333	0.60	$200	$200	$400
5	$500	0.60	$300	$200	$500

Assumptions:
X = Anticipated change in net income
T = Applicable tax rate (0.40)
Depreciation = Depreciation (computed on a straight-line basis) = Cost/Life = 1000/5

The principal objective of capital budgeting is to maximise the value of the company. It is designed to answer two basic questions:

- Which of several mutually exclusive projects should be selected? (Mutually exclusive projects are alternative methods of doing the same job. If one method is chosen, the other methods will not be required.)
- How many projects, in total, should be selected?

The three most common methods used in capital budgeting are the payback method, the net present value (NPV) method and the internal rate of return (IRR) method. Each has certain advantages and disadvantages. In this section, the same proposal will be examined under each method to more clearly illustrate each technique.

PAYBACK METHOD

payback method
A method of capital budgeting that measures the length of time taken for the return on an investment to exactly equal the amount originally invested.

One of the easiest capital-budgeting techniques to understand is the **payback method** or, as it is sometimes called, the *payback period*. In this method the length of time required to 'pay back' the original investment is the determining criterion. The entrepreneur will select a maximum timeframe for the payback period. Any project that requires a longer period will be rejected and projects that fall within the timeframe will be accepted. Here is an example of the payback method used by XYZ:

Hanna has a decision to make. She would like to purchase a new cash register for her store but is unsure which of two proposals to accept. Each machine costs $1000. An analysis of the projected returns reveals the following information:

YEAR	PROPOSAL A	PROPOSAL B
1	$500	$100
2	$400	$200
3	$300	$300
4	$20	$400
5	$10	$500

After careful consideration, Hanna decides to use the payback method with a cut-off period of three years. In this case, she discovers that Proposal A would pay back her investment in two and one-third years; $900 of the original investment will be paid back in the first two years and the last $100 in the third year. Proposal B, on the other hand, will require four years for its payback. Using the decision criterion of the shorter payback period, Hanna chooses Proposal A and rejects Proposal B.

One of the problems with the payback method is that it ignores cash flows beyond the payback period. Therefore, it is possible that the project chosen will be less profitable over its total life than the alternative. Nevertheless, many companies, particularly entrepreneurial firms, continue to use this method for several reasons: (1) it is very simple to use in comparison to other methods; (2) projects with a faster payback period normally have more favourable short-term effects on earnings; and (3) if a business is short on cash, it may prefer to use the payback method because it provides a faster return of funds.

NET PRESENT VALUE

The **net present value (NPV)** method is a technique that helps to overcome some of the shortcomings of the payback method by recognising the future cash flows beyond the payback period. The concept works on the premise that a dollar today is worth more than a dollar in the future. How much more depends on the applicable *cost of capital* for the firm. The cost of capital is the rate used to adjust future cash flows to determine their value in present period terms. This procedure is referred to as *discounting the future cash flows*. The discounted cash value is determined by the present value of the cash flow.

net present value (NPV) method
A method used in decision-making that measures the equivalent lump-sum value of a stream of payments over time. In effect, the NPV represents the amount that would need to be invested at a commercial interest rate at the beginning of the period of payments in order to meet all the payments as they fell due.

To use this approach, the entrepreneur must find the present value of the expected net cash flows of the investment, discounted at the appropriate cost of capital, and subtract from it the initial cost outlay of the project. The result is the net present value of the proposed project. Many financial accounting and finance textbooks have tables (called present value tables) that list the appropriate discount factors to multiply by the future cash flow to determine the present value. In addition, financial calculators are available that will compute the present value given the cost of capital, future cash flow and year of cash flow. Finally, given the appropriate data, electronic spreadsheet programs can be used to determine the present value. After the net present value has been calculated for all of the proposals, the entrepreneur can select the project with the highest net present value. Here is an example of the net present value method used by XYZ Chocolates.

Not really satisfied with the results she has obtained from the payback method, Hanna has decided to use the NPV method. After conferring with her accountant, Hanna learns that the cost of capital for her firm is 11 per cent. She then prepares the information contained in Table 12.12.

TABLE 12.12 XYZ'S NET PRESENT VALUE

PROPOSAL A			
YEAR	**CASH FLOW**	**DISCOUNT FACTOR**	**PRESENT VALUE**
1	$500	0.9091	$454.55
2	$400	0.8264	$330.56
3	$300	0.7513	$225.39
4	$20	0.6830	$13.66
5	$10	0.6209	$6.21
			$1030.37
Less: Initial outlay			−$1000.00
Net present value			$30.37
PROPOSAL B			
YEAR	**CASH FLOW**	**DISCOUNT FACTOR**	**PRESENT VALUE**
1	$100	0.9091	$90.91
2	$200	0.8264	$165.28
3	$300	0.7513	$225.39
4	$400	0.6830	$273.20
5	$500	0.6209	$310.45
			$1065.23
Less: Initial outlay			−$1000.00
Net present value			$65.23

Since Proposal B has the higher net present value, Hanna selected Proposal B and rejected Proposal A.

ENTREPRENEURIAL EDGE

THE INDIAN ENTREPRENEUR AND THE CUNNING NPV

An Indian business entrepreneur ran a small warehouse and a van for hire delivering raw material to a factory 20 kilometres away. His vehicle was reasonably new but to save money he had hired an old driver with defective vision who was working for half the salary of a regular driver. The driver could do only four trips a day covering 80 kilometres.

When he calculated his profits, the entrepreneur realised this income was not adequate for his survival and for his son's university education. He could not even maintain his vehicle properly and it was frequently breaking down. To make ends meet he thought he had to sell the delivery business, fire the driver, sell off his vehicle, pay his son's university entrance fees and maintain his family by selling his wife's jewels and silver.

What price should he ask for the business? He decided he would take the earnings for the next few years, subtract the cost of running the vehicle and calculate the net present value (NPV) by discounting each year's earnings at around 10 per cent. Or was there another solution?

Ever the entrepreneur, he came up with a cunning plan. After some thought he decided to fire his aging driver and generously gave him a month's leave. He got the van tuned and repaired for better petrol consumption. Then he hired a competent driver at the full going rate and sent him on eight trips a day doing 160 kilometres of deliveries. After a fortnight he realised his earnings had gone up by two to three times because of more trips and fewer breakdowns. The service, the product and the vehicle were all the same, but were operated differently.

He worked out NPV on the basis of the new earnings but with the same discount rate as before. The value was now three times higher. If he had sold it on his earlier calculations, some clever buyer would have got a bargain and benefitted from the entrepreneur's first faulty calculation. Now, with an efficient, profitable business, he could sell the delivery service and the vehicle at the higher price based on the new NPV. He was able to pay for his son's education and also pay off some of his past debts.

Source: Adapted from How to polish & sell family silver (2002, August 29). *Financial Express* (Mumbai). Published by The Indian Express Ltd., copyright 2002. http://www.financialexpress.com/archive/how-to-polish-sell-family-silver/57971/.

INTERNAL RATE OF RETURN

The **internal rate of return (IRR) method** is similar to the net present value method in that the future cash flows are discounted. However, they are discounted at a rate that makes the net present value of the project equal to zero. This rate is referred to as the *internal rate of return* of the project. The project with the highest internal rate of return is then selected.

internal rate of return (IRR) method
A method of capital budgeting in which the future cash flows are discounted at a rate that makes the net present value of the project equal to zero. The internal rate of return represents the interest yield promised by a project over its useful life.

One of the major drawbacks to the IRR method is the difficulty that can be encountered when using the technique. Using the NPV method, it is quite simple to look up the appropriate discount factors in the present value tables. When using the IRR concept, however, the entrepreneur must begin with a net present value of zero and work backward through the tables. This means that the entrepreneur must estimate the approximate rate and eventually try to track the actual internal rate of return for the project. Although this may not seem too difficult for projects with even cash flows (that is, cash flows that are fairly equal over the business periods), projects with uneven cash flows (fluctuating periods of cash inflow and cash outflow) can be a nightmare. Unfortunately, reality dictates that most projects will probably have uneven cash flows. Fortunately, electronic calculators and spreadsheet programs are available that can determine the actual internal rate of return given the cash flows, initial cash outlays and appropriate cash-flow periods. Here is an example of the internal rate of return method used by XYZ Chocolates.

Having obtained different results from the payback period and the net present value method, Hanna is confused about which alternative to select. To alleviate this confusion, she has decided to use the internal rate of return to evaluate the two proposals and select the project with the higher internal rate of return. Accordingly, she has prepared the following tables with the help of her calculator:

PROPOSAL A (11.73% IRR)			
YEAR	**CASH FLOW**	**DISCOUNT FACTOR**	**PRESENT VALUE**
1	$500	0.8942	$447.11
2	$400	0.7996	$319.84
3	$300	0.7151	$214.53
4	$20	0.6394	$12.80
5	$10	0.5718	$5.73
			$1000.00
Less: Initial outlay			−$1000.00
Net present value			**$0.00**
PROPOSAL B (12.01% IRR)			
YEAR	**CASH FLOW**	**DISCOUNT FACTOR**	**PRESENT VALUE**
1	$100	0.8928	$89.27
2	$200	0.7971	$159.42
3	$300	0.7117	$213.51
4	$400	0.6354	$254.15
5	$500	0.5673	$283.65
			$1000.00
Less: Initial outlay			−$1000.00
Net present value			**$0.00**

Proposal B is selected because it has the higher internal rate of return. This conclusion supports the statement that the project with the higher net present value will also have the higher internal rate of return.

The XYZ Chocolates examples illustrate the use of all three capital-budgeting methods. Even though Proposal A showed great value by the first method (payback), under the other two methods (net present value and internal rate of return) Proposal B surfaced as the better proposal. It is important for entrepreneurs to understand all three methods and to use the one that best fits their needs. If payback had been Hanna's only consideration, then Proposal A would have been selected. When future cash flows beyond payback are to be considered, the net present value and the internal rate of return methods will determine the best proposal.

The budgeting concepts discussed so far are extremely powerful planning tools. But how can entrepreneurs monitor their progress during the budget period? How can they use the information accumulated during the course of the business to help plan for future periods? Can this information be used for pricing decisions? The answer to the third question is 'yes', and we will explore how in the following sections.

ENTREPRENEURSHIP IN PRACTICE

SERIAL OFFENDER ROD DRURY'S TOP PERFORMANCE MEASURES

Rod Drury is a technology entrepreneur raised in Hawkes Bay, New Zealand, and is of Ngai Tahu descent. Mr Drury is a very Kiwi kind of multimillionaire. He lives in a 'high tech townhouse' and skypes to board meetings in stubbies and jandals. Even before New Zealand had entered the 'knowledge economy',[15] in 1995 Drury established Glazier Systems, one of the country's first Microsoft software development houses. Selling Glazier in 1999 for about NZD$7.5 million, Drury went on to invest in the email package AfterMail, which he then sold for NZD$45 million. He once quipped that 'We built it up to sell it to get some money!' Meanwhile, he was instrumental in the famous pre-eBay platform called TradeMe. In 2006, Drury founded his most ambitious venture, Xero, a publicly listed Cloud-based 'software as a service' (SaaS) accounting software company, which he intends to take to NZD$1 billion.

Drury's magic vision is how he foresaw that bookkeeping and doing tax returns were dying professions. His goal was to give accountants the tools to advise clients, for example, whether they were paying more in leases than their competitors. Using Cloud data, Xero can tell if a company is spending more or less on advertising, staff, rent or stock than its competitors. Drury's approach has been so successful that even his competitor MYOB bought in.

At its tenth anniversary, champagne corks popped when Xero finally cracked the magic break-even number zero. At the time of writing, Xero's financial performance metrics are as follows:

- Xero has edged into the black for the first time, with an underlying profit of NZD$5.4 million, supported by annualised committed monthly revenue of NZD$416.9 million.
- 1 035 000 customers, with 500 000 added in two years
- Operating revenue has grown by 43 per cent year-on-year to NZD$295 million, an increase of NZD$88 million.
- Monthly revenue is NZD$360 million.
- Gross margin is 77 per cent.
- Total lifetime value of subscriber base is set at NZD$2.2 billion.

The cash-flow break-even milestone is a huge one, and will put the company in a good position with regard to capital requirements. Xero still has cash in the bank and has no real need to fundraise again.

To dive into Xero's metrics yourself, see its latest Annual Report at https://www.xero.com/us/about/investors/financial-info.

Sources: Hubbard, A. (2014). Market whizz-kid enjoys Kiwi lifestyle. http://www.stuff.co.nz/business/industries/9595921/Market-whizz-kid-enjoys-Kiwi-lifestyle; Kepes, B. (2017, May 12). Xero breaks through its glass ceiling: customers, revenue and cashflow. https://www.computerworld.com/article/3196033/software-as-a-service/xero-breaks-through-its-glass-ceiling-customers-revenue-and-cashflow.html; Pullar-Strecker, T. (2016). Xero ready for the revolution and is spinning its web with precision. http://www.stuff.co.nz/business/industries/84076721/xero-ready-for-the-revolution-and-is-spinning-its-web-with-precision; Pullar-Strecker, T. (2017a). Xero moves closer to break even as annual sales approach $300m. http://www.stuff.co.nz/business/industries/92369422/xero-moves-closer-to-break-even-as-annual-sales-approach-300m; Pullar-Strecker, T. (2017b). Xero passes million-customer milestone. http://www.stuff.co.nz/business/industries/91008134/xero-passes-millioncustomer-milestone; Radio New Zealand. (2017, November 9). Xero to delist from NZX. https://www.radionz.co.nz/news/business/343409/xero-to-delist-from-nzx; Swan, D. (2017, May 10). Xero edges towards break-even. http://www.theaustralian.com.au/business/technology/xero-edges-towards-breakeven/news-story/499f3091e2203950f8bd5951330afd29.

BREAK-EVEN ANALYSIS

In today's competitive marketplace, entrepreneurs need relevant, timely and accurate information that will enable them to price their products and services competitively and yet be able to earn a fair profit. **Break-even analysis** supplies this information.[16] After reviewing this section you can also practise your skills with the 'Experiencing entrepreneurship: The project proposal' exercise at the end of this chapter.

break-even analysis The method of determining the point at which a company makes neither a profit nor a loss. The break-even point for a product is the point where total revenue received equals total costs.

BREAK-EVEN POINT COMPUTATION

Break-even analysis is a technique commonly used to assess expected product profitability. It helps determine how many units must be sold in order to break even at a particular selling price.

Contribution margin approach

contribution margin approach
The percentage of each sale that remains after the variable costs are subtracted.

A common approach to break-even analysis is the **contribution margin approach**. The contribution margin is the difference between the selling price and the variable cost per unit. It is the amount per unit that is contributed to cover all other costs.[17] With this information, the entrepreneur can decide whether to add or drop a product line, how to price a product or service and how to structure sales commissions or bonuses. It starts by grouping together a business' fixed and variable costs.

Since the break-even point occurs where income equals expenses, the contribution margin approach formula is:

$$0 = (SP - VC)S - FC \text{ or } FC = (SP - VC)S$$

where:

$$SP = \text{Unit selling price}$$

$$VC = \text{Variable costs per unit}$$

$$S = \text{Sales in units}$$

$$FC = \text{Fixed cost}$$

This model also can be used for profit planning by including the desired profit as part of the fixed cost.

Graphic approach

Another approach to break-even analysis taken by entrepreneurial businesses is the graphic approach. To use this approach, the entrepreneur needs to graph at least two numbers: total revenue and total costs. The intersection of these two lines (i.e. where total revenues are equal to total costs) is the business' break-even point. Two additional costs – variable costs and fixed costs – also may be plotted. Doing so enables the entrepreneur to visualise the various relationships in the business' cost structure.

Handling questionable costs

Although the first two approaches are adequate for situations in which costs can be broken down into fixed and variable components, some companies have expenses that are difficult to assign. For example, are repairs and maintenance expenses fixed or variable? Can companies facing this type of problem use break-even analysis for profit planning? The answer is 'yes', thanks to a new technique designed specifically for entrepreneurial businesses. This technique calculates break-even points under alternative assumptions of fixed or variable costs to see if a product's profitability is sensitive to **cost behaviour**.

cost behaviour
The sensitivity of costs to changes in production or sales volume. Fixed costs are constant. Variable costs vary, but the cost per unit does not.

The decision rules for this concept are outlined below.

- If expected sales exceed the higher break-even point, then the product should be profitable, regardless of the other break-even point.
- If expected sales do not exceed the lower break-even point, then the product should be unprofitable.

Only if expected sales are between the two break-even points is further investigation of the questionable cost behaviour needed.

The concept works by substituting the cost in question (*QC*) first as a fixed cost and then as a variable cost. The break-even formulas presented earlier would have to be modified to determine the break-even levels under the two assumptions. Under the fixed-cost assumption, the entrepreneur would use the following equation:

$$0 = (SP - VC)S - FC - QC$$

To calculate the break-even point assuming QC is variable, the following equation would be used:

$$0 = [SP - VC - (QC/U)]S - FC$$

U is the number of units for which the questionable cost normally would be appropriate. What the entrepreneur is determining is the appropriate unit cost that should be used if the cost is variable. Here is an example of how an entrepreneur could use the technique:

XYZ's Hanna Frederick manufactures chocolate moulds for other companies. She has decided to use break-even analysis as a profit-planning tool for her company. She believes using this technique will enable her business to compete more effectively in the marketplace. From an analysis of the operating costs, Hanna has determined that the variable cost per unit is \$9, while fixed costs are estimated to be \$1200 per month. The anticipated selling price per unit is \$15. She also has discovered one cost she is unable to classify as either variable or fixed. It is a \$200 repair and maintenance expense allocation. This \$200 is appropriate for an activity level of 400 units; therefore, if the cost were variable, it would be \$0.50 per unit (\$200/400). Finally, sales are projected to be 400 units during the next budget period.

The first step in this process is to determine the break-even point assuming the cost in question is fixed. Consequently, Hanna would use the following equation:

$$0 = (SP - VC)S - FC - QC$$

$$= (15 - 9)S - 1200 - 200$$

$$= 6S - 1400$$

$$1400 = 6S$$

$$234 = S$$

Figure 12.2 provides a graphic illustration of the results. Notice that the final quantity is rounded up to the next unit, because a business normally will not sell part of a unit.

The next step in the process is to calculate the break-even point assuming the cost in question is variable. Hanna would use the following equation to ascertain the second break-even point:

$$0 = [SP - VC - (QC/U)]S - FC$$

$$= [15 - 9 - (200/400)]S - 1200$$

$$= (6 - 0.50)S - 1200$$

$$1200 = 5.50S$$

$$219 = S$$

Figure 12.3 presents a graphic illustration of the results.

FIGURE 12.2
XYZ CHOCOLATES' BREAK-EVEN ANALYSIS UNDER THE FIXED-COST ASSUMPTION

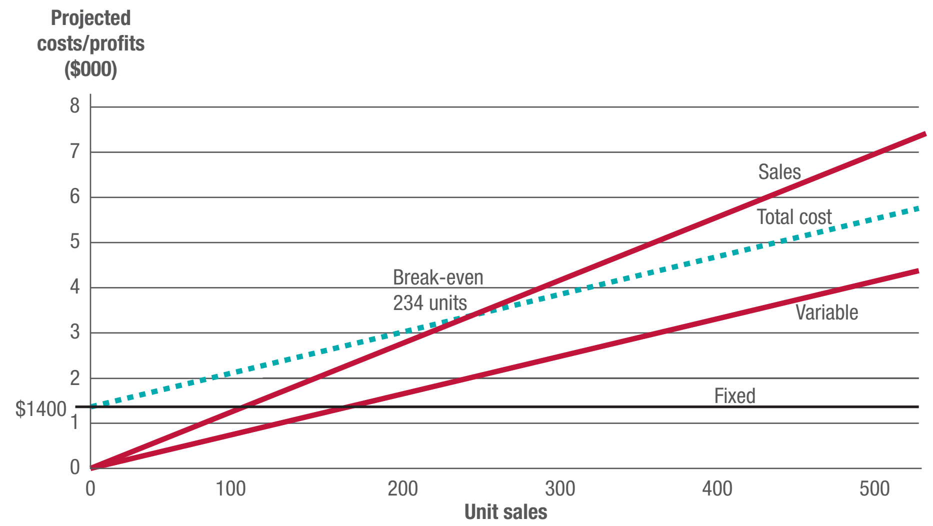
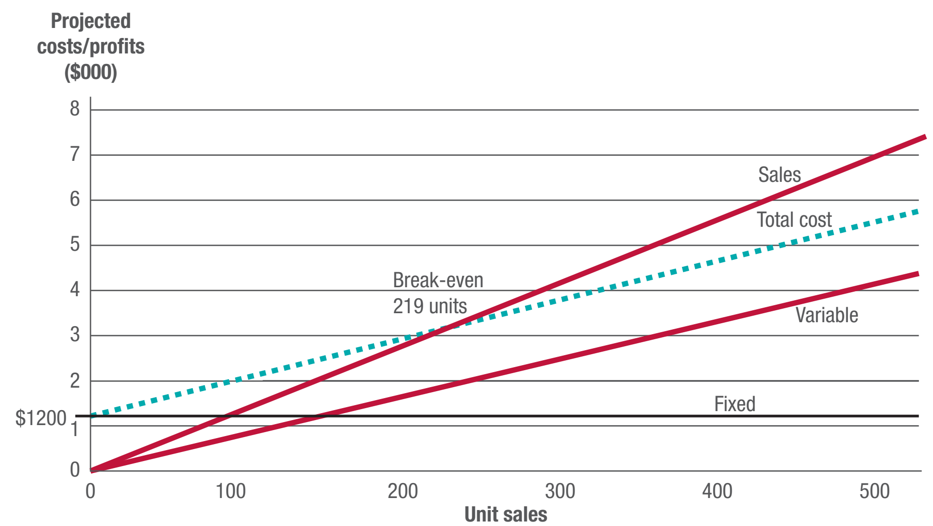


FIGURE 12.3
XYZ CHOCOLATES' BREAK-EVEN ANALYSIS UNDER THE VARIABLE-COST ASSUMPTION



Now that the two possible break-even points have been established, Hanna must compare them to her projected sales. The variable-cost sales of 400 units are greater than the larger break-even point of 234 units. Therefore, the product is assumed to be profitable regardless of the cost behaviour of the repair and maintenance expense. It does not matter whether the cost is variable or fixed; the business will still be profitable.

FINANCIAL RATIO ANALYSIS

Financial statements report both on a business' position at a point in time and on its operations over some past period. However, the real value of financial statements lies in the fact that they can be used to help predict the business' earnings and dividends. From an investor's standpoint, predicting the future is what **financial ratio analysis** is all about; from an entrepreneur's standpoint, financial ratio analysis is useful as a way to assess financial wealth and trends in profitability and liquidity, and, most importantly, as a starting point for planning actions that will influence the course of events.

An analysis of the business' ratios is generally the key step in a financial analysis. The **financial ratios** are designed to give you a good picture of your business' health and efficiency.

For example, Company A might have a debt of $6 250 000 and interest charges of $520 000, while Company B might have a debt of $62 800 000 and interest charges of $5 840 000. Which company is stronger? The true burden of these debts and the companies' ability to repay them can be ascertained (1) by comparing each business' debt to its assets and (2) by comparing the interest each must pay to the income it has available for interest payment. Such comparisons are made by ratio analysis.[18]

Table 12.13 shows important financial ratios useful for understanding relationships. The formulas for calculating each ratio are given, along with explanations of what each ratio means for business decision-making using a dollars-and-cents approach.

The top ones for entrepreneurs are: current ratio, inventory turnover, gross margin, return on investment and revenue per employee. These ratios provide the most effective tools for monitoring a venture's performance over time; however, it should be kept in mind that effective ratio analysis must be done in comparison with other businesses within the same industry in order to gain the broadest possible insights.

financial ratio analysis
A way of organising and interpreting information from financial data. This analysis quantifies relative performance by analysing the ratio of one performance measure against another and is used to manage a firm's performance by comparative analysis with industry standards or other benchmarks derived from similar firms.

financial ratio
A ratio of two reported levels or flows of a company, e.g. two financial flow categories: profit/revenue or earnings/equity.

TABLE 12.13 FINANCIAL RATIOS

RATIO NAME	HOW TO CALCULATE	WHAT IT MEANS IN DOLLARS AND CENTS
Balance Sheet Ratios		
Current	$\frac{\textit{Current Assets}}{\textit{Current Liabilities}}$	Measures solvency: the number of dollars in current assets for every $1 in current liabilities *Example:* A current ratio of 1.76 means that for every $1 of current liabilities, the firm has $1.76 in current assets with which to pay it.
Quick	$\frac{\textit{Cash} + \textit{Accounts Receivable}}{\textit{Current Liabilities}}$	Measures liquidity: the number of dollars in cash and accounts receivable for each $1 in current liabilities *Example:* A quick ratio of 1.14 means that for every $1 of current liabilities, the firm has $1.14 in cash and accounts receivable with which to pay it.
Cash	$\frac{\textit{Cash}}{\textit{Current Liabilities}}$	Measures liquidity more strictly: the number of dollars in cash for every $1 in current liabilities *Example:* A cash ratio of 0.17 means that for every $1 of current liabilities, the firm has $0.17 in cash with which to pay it.
Debt-to-worth	$\frac{\textit{Total Liabilities}}{\textit{Net Worth}}$	Measures financial risk: the number of dollars of debt owed for every $1 in net worth *Example:* A debt-to-worth ratio of 1.05 means that for every $1 of net worth the owners have invested, the firm owes $1.05 of debt to its creditors.
Income Statement Ratios		
Gross margin	$\frac{\textit{Gross Margin}}{\textit{Sales}}$	Measures profitability at the gross profit level: the number of dollars of gross margin produced for every $1 of sales *Example:* A gross margin ratio of 34.4% means that for every $1 of sales, the firm produces 34.4¢ of gross margin.

continue

continue

RATIO NAME	HOW TO CALCULATE	WHAT IT MEANS IN DOLLARS AND CENTS
Net margin	$\frac{\text{Net Profit before Tax}}{\text{Sales}}$	Measures profitability at the net profit level: the number of dollars of net profit produced for every $1 of sales *Example:* A net margin ratio of 2.9% means that for every $1 of sales, the firm produces 2.9¢ of net margin.
Overall Efficiency Ratios		
Sales-to-assets	$\frac{\text{Sales}}{\text{Total Assets}}$	Measures the efficiency of total assets in generating sales: the number of dollars in sales produced for every $1 invested in total assets *Example:* A sales-to-assets ratio of 2.35 means that for every $1 invested in total assets, the firm generates $2.35 in sales.
Return on assets	$\frac{\text{Net Profit before Tax}}{\text{Total Assets}}$	Measures the efficiency of total assets in generating net profit: the number of dollars in net profit produced for every $1 invested in total assets *Example:* A return on assets ratio of 7.1% means that for every $1 invested in assets, the firm is generating 7.1¢ in net profit before tax.
Return on investment	$\frac{\text{Net Profit before Tax}}{\text{Net Worth}}$	Measures the efficiency of net worth in generating net profit: the number of dollars in net profit produced for every $1 invested in net worth *Example:* A return on investment ratio of 16.1% means that for every $1 invested in net worth, the firm is generating 16.1¢ in net profit before tax.
Specific Efficiency Ratios		
Inventory turnover	$\frac{\text{Cost of Goods Sold}}{\text{Inventory}}$	Measures the rate at which inventory is being used on an annual basis *Example:* An inventory turnover ratio of 9.81 means that the average dollar volume of inventory is used up almost ten times during the fiscal year.
Inventory turn-days	$\frac{360}{\text{Inventory Turnover}}$	Converts the inventory turnover ratio into an average 'days inventory on hand' figure *Example:* An inventory turn-days ratio of 37 means that the firm keeps an average of 37 days of inventory on hand throughout the year.
Accounts receivable turnover	$\frac{\text{Sales}}{\text{Accounts Receivable}}$	Measures the rate at which accounts receivable are being collected on an annual basis *Example:* An accounts receivable turnover ratio of 8.00 means that the average dollar volume of accounts receivable is collected eight times during the year.
Average collection period	$\frac{360}{\text{Accounts Receivable Turnover}}$	Converts the accounts receivable turnover ratio into the average number of days the firm must wait for its accounts receivable to be paid *Example:* An average collection period ratio of 45 means that it takes the firm 45 days on average to collect its receivables.
Accounts payable turnover	$\frac{\text{Cost of Goods Sold}}{\text{Accounts Payable}}$	Measures the rate at which accounts payable are being paid on an annual basis *Example:* An accounts payable turnover ratio of 12.04 means that the average dollar volume of accounts payable is paid about 12 times during the year.
Average payment period	$\frac{360}{\text{Accounts Payable Turnover}}$	Converts the accounts payable turnover ratio into the average number of days a firm takes to pay its accounts payable *Example:* An accounts payable turnover ratio of 30 means that it takes the firm 30 days on average to pay its bills.

SUMMARY

We began by emphasising the need for performance measures in an entrepreneurial company. These traditionally have been limited to bottom-line indicators that tell the shareholder how well the company is doing financially without regard to other factors such as society or the environment.

We then described the principles of traditional financial accounting. Three principal financial statements are important to entrepreneurs: the balance sheet, the income statement and the cash-flow statement. The budgeting process facilitates financial statement preparation. Some key budget forecasts that entrepreneurs should prepare are the operating budget, the cash-flow budget and the capital budget. The operating budget typically has various kinds of forecasts, such as sales expense, production and operating forecasts. A cash-flow budget provides an overview of the inflows and outflows of cash during a specific period.

Pro forma financial statements then are prepared as projections of the business' financial position over a future period (pro forma income statement) or on a future date (pro forma balance sheet). The operating and cash-flow budgets often are used to prepare these pro forma statements, and a sensitivity or 'what if' analysis helps test key assumptions embedded in the forecasting models. The capital budget is used to help entrepreneurs make investment decisions. The three most common methods of capital budgeting are the payback method, the net present value (NPV) method and the internal rate of return (IRR) method.

Another commonly used decision-making tool is break-even analysis, which tells how many units must be sold in order to break even at a particular selling price. It is possible to use this analysis even when fixed or variable costs can only be estimated. Ratio analysis can also be a helpful analytical tool for entrepreneurs. Ratios are designed to show relationships between financial statement accounts.

CourseMateExpress

Review key terms with interactive flashcards.

KEY TERMS & CONCEPTS

accounts payable
accounts receivable
accrual system of accounting
administrative expenses
allowance for uncollectable accounts
assets
balance sheet
bank loan
break-even analysis
budget
capex
capital budget
capital budgeting
cash
cash-flow budget
cash-flow statement
contribution margin approach
cost behaviour
cost of goods sold (COGS)
current assets
current liabilities
depreciation
expenses
financial ratio
financial ratio analysis
financial statement
fixed assets
fixed costs
futures
gross margin
gross profit
income
income statement
interest
interest expense
internal rate of return (IRR) method
inventory
investing activities
investment
liabilities
linear regression
loan payable
long-term liabilities
mixed costs
net income
net present value (NPV) method
net profit
note payable
operating budget
operating cash flows
operating expenses
owners' equity
payback method
prepaid expenses
profit and loss statement
pro forma statement
retained earnings
revenues
sales forecast
selling expenses
sensitivity analysis
short-term liabilities
stakeholder
taxes payable
time value of money
variable costs
working capital

REVIEW & DISCUSSION QUESTIONS

1 What do we mean by performance measures? What are the traditional ones? Why do we need to look beyond these now?
2 Describe the purpose of the balance sheet, the income statement and the cash flow statement. Why are these three statements of accounts important for an entrepreneur to understand? Explain in detail.
3 What are the benefits of the budgeting process?
4 Describe two sales forecasting methods and explain how they are used.
5 Describe how an operating budget is constructed.
6 Describe how a cash-flow budget is constructed.
7 What are pro forma statements? How are they constructed? Be complete in your answer.
8 Describe how a capital budget is constructed.
9 One of the most popular capital-budgeting techniques is the payback method. How does this method work? Give an example.
10 Describe the net present value method. When would an entrepreneur use this method? Why? Make up an example similar to the one in 'Entrepreneurship in practice: The Indian entrepreneur and the cunning NPV'.
11 Describe the internal rate of return method. When and why would an entrepreneur use this method?
12 When would an entrepreneur be interested in break-even analysis? Explain how fixed, variable and mixed costs are used in the break-even analysis.
13 What is a sensitivity analysis and why should an entrepreneur seek to apply it? Explain.

EXPERIENCING ENTREPRENEURSHIP

How to read *The Economist* economic and financial indicators

Some people believe that *The Economist* is the greatest magazine in the world. It is required reading for every aspiring entrepreneur. The scope of reporting spans the globe, from the Tamil Tigers in Sri Lanka to the furniture industry of North Carolina. But it is the back few pages of each edition, called 'Weekly Indicators', that are the most important for globally oriented entrepreneurs. Using either the magazine itself or the website http://www.economist.com/markets/indicators/, study the following information and answer the questions below.

World markets

Market index: Market measures consist of weighted values of the components that make up certain lists of companies. The stock market index tracks the performance of certain stocks by weighting them according to their prices and the number of outstanding shares using a particular formula. The Commodities (Price) Index assigns weighted averages to such commodities as energy, precious metals, base metals or futures contracts known as 'softs'. In different columns you may also see *The Economist* 'Commodity Price Index' and the 'Markets' index.

futures
Financial contracts in which the buyer agrees now to buy a product (e.g. pork bellies) at a predetermined future date and price.

Output, prices and unemployment

Gross domestic product: A country's gross domestic product, or GDP, is one of several measures of the size of its economy. The most common approach to measuring and understanding GDP is the expenditure method:

$$\text{GDP} = \text{Consumption} + \text{Investment} + \text{Exports} - \text{Imports}$$

'Gross' means that depreciation of capital stock is included. Without depreciation (that is, with net investment instead of gross investment), it is the net domestic product. Consumption and investment in this equation are the expenditures on final goods and services. The exports minus imports part of the equation (often called net exports) then adjusts this by subtracting the part of this expenditure not produced domestically (the imports) and adding back in domestic production not consumed at home (the exports).

Industrial production: This is a key economic indicator that relates to the total output of all factories, mines and utilities. Monthly percentage changes in the index reflect the rate of change in output. Changes in industrial production are widely followed as a major indicator of strength in the manufacturing sector.

Consumer prices: This is what people are usually thinking of when they worry about inflation. This is the price paid by whomever finally consumes goods or services, as opposed to the price paid by companies at various stages of the production process (see, for example, factory prices).

Unemployment rate: This represents people who were not employed during that week, but who were actively seeking work, waiting to be called back to a job from which they were laid off or waiting to report within 30 days to a new payroll job. This is a measure of the number of workers that want to work but do not have jobs.

Foreign reserves: Foreign exchange reserves are the foreign currency deposits held by central banks and monetary authorities. These are assets of the central banks which are held in different reserve currencies, such as the dollar, euro and yen, and which are used to back its liabilities; for example, the local currency issued, and the various bank reserves deposited with the central bank by the government or financial institutions. The purpose of reserves is to allow central banks an additional means to stabilise the issued currency from excessive volatility, and protect the monetary system from shock, such as from currency traders engaged in buying an asset and quickly reselling (or 'flipping') it for profit. Large reserves are often seen as a strength, as they indicate the backing a currency has. Low or falling reserves may be indicative of an imminent bank run on the currency or default, such as in a currency crisis.

Money and interest rates

Money supply: This is the amount of money (coins, paper currency and cheque accounts) in circulation in the economy. If there is too much money in the economy, interest rates tend to go down while inflation tends to rise. Conversely, if there is too little money in the economy, interest rates tend to go up and prices and production tend to go down. This can cause unemployment and idle plant capacity.

Trade, exchange rates, budget balances and interest rates

Trade balance: The balance of trade figures is the sum of the money gained by a given economy from selling exports, minus the cost of buying imports. They form part of the balance of payments, which also includes other amounts such as the international investment position.

Current account balance: This very important figure is the difference between the nation's total exports of goods, services and transfers and its total imports of them. Current account balance calculations exclude transactions in financial assets and liabilities. The current account balance helps a country to evaluate its competitive strengths and weaknesses and to forecast the strength of its currency.

Currency units: This is the same as the exchange rate in US dollars over two time periods.

Budget balance percentage of GDP: This measures how much of the annual GDP is made up by the government's budget.

Interest rate: This is the cost of borrowing money, expressed as a percentage, usually over a period of one year. For example, when the mortgage balance is $100 000, and the interest rate is 6 per cent, one single annual payment will include $6000 interest.

Retail sales, producer prices, wages and exchange rates

Retail sales: Key components of retail sales include cars, building materials, furniture, department store sales, food store sales, petrol, clothing, restaurant sales and pharmacy sales. High retail sales are an indication of economic growth and an expanding economy. In commerce, a retailer buys goods or products in large quantities from manufacturers or importers, either directly or through a wholesaler, and then sells individual items or small quantities to the general public or end-user customers, usually in a shop/store. Retailers are at the end of the supply chain. Marketers see retailing as part of their overall distribution strategy.

Producer prices: This measure contains data on prices by stage of processing, sector, industry and commodity. Price increases that wholesalers and manufacturers are paying now cause consumer price increases in products and services later.

Wages/earnings: A wage is the amount of money paid for some specified quantity of labour. When expressed with respect to time (usually per hour), it is typically called the wage rate, and is specified in pre-tax amounts. It is often the main monetary item upon which the worker and the employer focus when negotiating an employment contract.

Trade-weighted exchange rate: This is a given country's exchange rate with the currencies of its trading partners weighted by the amount of trade done by the country in each currency. A trade-weighted currency index is a weighted average of a basket of currencies that reflects the importance of a country's trade (imports and exports) with these countries. Sometimes a trade-weighted currency index is taken as a crude measure of a country's international competitiveness.

Big Mac Index

'Burgernomics' is based on the theory of *purchasing-power parity* (PPP), the notion that a dollar should buy the same amount in all countries. Therefore, in the long run, the exchange rate between two countries should move toward the rate that equalises the prices of an identical basket of goods and services in each country. Our 'basket' is a McDonald's Big Mac, which is produced in about 120 countries. The Big Mac PPP is the exchange rate that would mean hamburgers cost the same in America as abroad. Comparing actual exchange rates with PPPs indicates whether a currency is undervalued or overvalued.

Questions

1 Which world share market is doing best right now?
2 Which stock (share) has dropped the most?
3 How is the price of cocoa tracking?
4 What are the trends in world oil prices?
5 What is the price of one barrel of West Texas Intermediate crude oil?
6 Which country has the highest predicted increase in GDP from this year to next?

7 Which country has the lowest GDP growth and which has the highest?
8 Which region of the world has the lowest industrial production?
9 Which country has the highest and which has the lowest trade balance?
10 Which country has the highest budget balance as a percentage of GDP? Based upon interest rates, where would you ideally invest your money?
11 Which country, Australia or New Zealand, is doing better in retail sales volume?
12 In which country, Australia or New Zealand, is a Big Mac sold at the best value?
13 Which country in the world has the 'worst' price for a Big Mac?
14 Make up five more questions that could be added to this exercise.

EXPERIENCING ENTREPRENEURSHIP

The project proposal

Bill Sergent has just received a request for a proposal from a large computer company. The company is looking for a supplier to provide it with high-tech components for a supercomputer being built for the Department of Defence. Bill's business, which is only eight months old, was founded by a group of scientists and engineers whose primary expertise is in the area of computers and high technology. Bill is thinking about making a reply to the request for a proposal, but first he wants to conduct a break-even analysis to determine how profitable the venture will be. Here is the information he will be using in his analysis:

- The computer company wants 12 different components built and the purchase price will be $10 000 per component.
- The total cost of building the first component will be $20 000.
- The cost of building each of the 11 other components will be $8000, $6000, $5000, $4000, $5000, $6000, $8000, $10 000, $28 000, $40 000 and $40 000, respectively.
- Bill's company will not accept any proposal that will give it less than a 10 per cent return on sales. On the basis of this information, complete the following break-even chart and then answer the two questions.

Questions

1 Should Bill bid on the contract? Why or why not?
2 If Bill has some room for negotiation with the computer company, what would you recommend he do? Why?

CASE STUDIES

CASE 12.1

IT'S ALL GREEK TO HER

When Regina McDermott opened her car repair shop in Melbourne, she thought her 15 years of experience with cars was all she **would** need. To a degree she was right. Within six months her shop had more work than it could handle, thanks to her widening reputation. Two years in from start-up, Regina decided she needed to invest in new diagnostic equipment to improve efficiency within the workshop.

Her accountant came to see her to discuss finance-related matters. One of these was the need for cash budgeting. 'I can work up a cash budget for you', he explained. 'However, I think you should understand what I'm doing so you will realise the importance of the cash budget and be able to visualise your cash inflows and outflows. I think you also need to make a decision regarding the new equipment you are planning to purchase. This machinery is state of the art, but, as we discussed last week, you can buy a number of different types of machinery. You are going to have to decide which is the best choice.'

Regina explained to her accountant that she was indifferent about which equipment to buy. The choices came down to three. There was the Hobmax ProSys Diagnostic for $5935, the AutoRep AS 555003 for $4995 or the Druthers Redline X30 for $3800. 'All of this machinery is good. Perhaps I should purchase the cheapest' she reasoned. Another factor to consider was the benefit she could leverage from each machine. The Hobmax was the most expensive but offered more utility that would likely improve her throughput in the shop by 20 per cent in routine maintenance and 15 and 10 per cent respectively for small repairs and large repairs. The Autorep was an easy-to-use machine but without some of the bells and whistles of the Hobmax, meaning it would increase her business by as much as 25 per cent for routine repairs but maybe only 5 per cent for small repair work and next to nothing for large repairs. The cheapest machine, the Druthers, was a specialised machine for routine maintenance only, and Regina could see up to a 40 per cent improvement in monthly throughput in that side of her business if she purchased this option.

At this point the accountant explained to her that she could use a number of ways to evaluate this type of decision. 'You can base your choice on the payback method – how long it takes to recover your investment in each of these pieces of equipment. You can base it on net present value by discounting future cash flows to the present. Or you can base it on internal rate of return, under which the cash flows are discounted at a rate that makes the net present value of the project equal to zero.'

Regina listened quietly and when the accountant was finished, she told him, 'Let me think about the various ways of evaluating my capital investment and I'll get back to you. Then, perhaps, you and I can work out the numbers together'. Regina began to wish she had taken more accounting courses while at university. As she explained to her husband, 'When the accountant begins to talk, it's all Greek to me. But maybe I could at least forecast my revenue with the improved throughputs and calculate a payback period for each option.'

Regina's Auto Repairs actual sales 2018 ($000)

	JAN	FEB	MAR	APR	MAY	JUN	JUL	AUG	SEP	OCT	NOV	DEC	TOTAL
Routine maintenance	4	5	6.5	5.5	6	8	7.5	6.5	6	6.5	7.5	7	76
Small repair work	3.25	4.5	5.5	4.5	5	7	6.25	6	5.7	5.6	6	6	65.3
Large repair work	2.5	3	4.25	3.5	4	5	4.5	4.25	4	4.2	4.5	4	47.7
Total per month	**9.75**	**12.5**	**16.25**	**13.5**	**15**	**20**	**18.25**	**16.75**	**15.7**	**16.3**	**18**	**17**	**189**

QUESTIONS

1 Using the 2018 sales figures as a trend, with a spreadsheet, develop a sales forecast for January to December with the increase in workflow enabled by each machine purchasing option. Regina has calculated that she obtains a net margin of 5, 9.5 and 15 per cent respectively for the routine maintenance work, small repair work and large repair work. Using these assumptions and assuming she buys the machine in December 2018 ready for January 2019, determine:
   - a Which machine purchase offers the best (shortest) payback in 2019 and how many months will it take for each option?
   - b Which option will generate the greatest revenue increase in terms of dollars under the assumptions Regina has applied?
   - c Which option provides the best forecast net percentage margin return on total revenue (net margin in dollars/total sales in dollars)?

2 How does the net present value method work? How would you explain this method to Regina?
3 How does the internal rate of return method work? How would you explain it to Regina?

CASE 12.2

THE CONTRACT PROPOSAL

Dennis Darby owns a small manufacturing business that produces electronic components for use in helicopters. Most of his business is a result of military and aircraft manufacturer contracts, although 10 per cent of revenues come from businesses that own or rent helicopters. The latter are typically large companies or leasing/rental businesses that work on a contractual basis for clients.

Dennis would like to increase his revenues from sales to private companies that own their own helicopters. Specifically, he would like to do more business with oil companies that maintain helicopter fleets for ferrying people to and from oil rigs in the Timor Sea off Darwin and other offshore locations. Early this week, Dennis received a request from an oil company for 120 electronic components. He turned the order over to his chief estimator, who estimates that the fixed costs associated with producing these components will be $35 000, the unit variable cost will be $400 and the unit selling price will be $800.

Dennis will not accept any order on which the return on sales is less than 20 per cent. Additionally, the estimator has told him that a $1000 expense can be classified as either fixed or variable. Dennis intends to take this information and make a decision whether to accept the contract from the oil company. He has to make a decision within the next three days.

QUESTIONS

1 What is the break-even point for this project? Will the company make money if it manufactures the components? Show your calculations.
2 If the project will be profitable, will it provide Dennis with the desired 20 per cent return? Explain.
3 Of what value is break-even analysis to Dennis? Be complete in your answer.

ONLINE STUDY RESOURCES

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CHAPTER 13

SOURCES OF FINANCE FOR ENTREPRENEURIAL VENTURES

Money is like a sixth sense without which you cannot make a complete use of the other five.[1]

W. Somerset Maugham

CHAPTER OBJECTIVES

1. To understand the appropriate sources of funds at various stages of venture development
2. To differentiate between debt and equity as methods of financing and to examine commercial loans, private placements and public stock offerings as sources of capital
3. To study the market for venture capital, to review venture capitalists' evaluation criteria for new ventures and to discuss 'best fit' selection of venture capitalists for a venture
4. To identify how informal investors differ from other parts of the funding community and examine the business angel market
5. To describe new forms of entrepreneurial capital, including impact investors, peer-to-peer lending and crowdfunding, cryptocurrencies and blockchain technology

SOURCES OF FINANCIAL CAPITAL

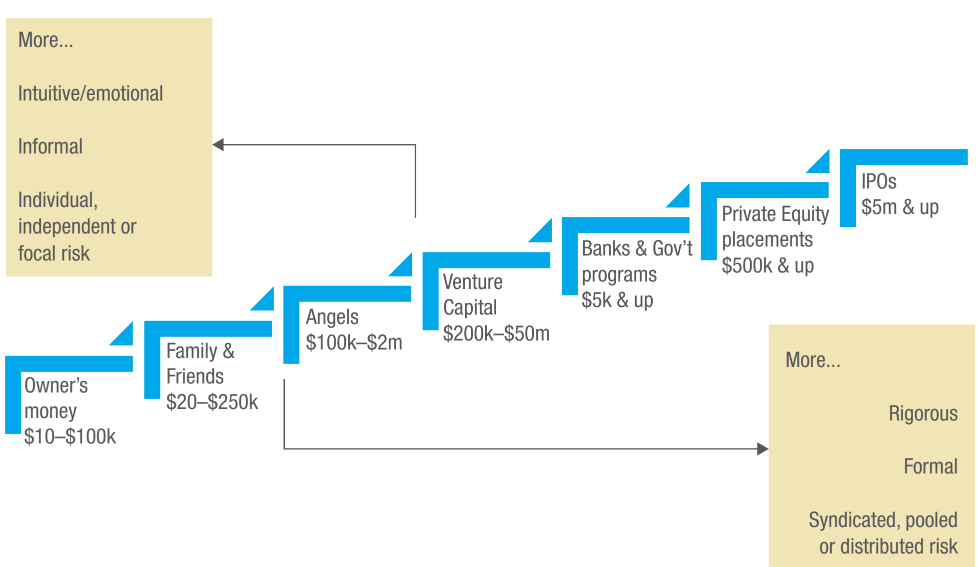
Every entrepreneur at some time will face the problem of where to find **capital**. The days of readily available money from cashed-up investors, if they ever existed, are certainly gone. This situation creates its own opportunity, though – one that can benefit both the funding community and the start-up venturer. Funding in the new era will not simply be thrown at companies in the hope that one in 10 is wildly successful. Today, funding goes only to entrepreneurs who thoroughly understand their customers' requirements and who can assure the funder from the beginning that every product delivers on its value.

capital
(1) The amount invested in a business by the proprietor(s) or shareholders. (2) The money available for investment or money invested.

But some entrepreneurs may not be aware that there are numerous possibilities for funding. Nor may they think about how combinations of financial packages, rather than a single source, may be more appropriate. It is important, therefore, to understand not only various sources of capital but also the expectations and requirements of each. Commercial loans, public offerings, private placements, convertible debentures, venture capital and informal risk capital are some of the major types of financing encountered in the search for capital. But what exactly are they, and what is expected of an entrepreneur applying for these funds?

As illustrated in Figure 13.1, entrepreneurs have a number of preferences for sources of capital as their ventures develop.[2] Be aware that as you move from left to right in Figure 13.1 the sources of finance are different based upon the riskiness of the venture and the stage of the business's development. Toward the left side are the more informal sources of capital, where investment decisions are influenced by intuition, emotional responses and individual preferences; these investors are generally more tolerant of the associated risk of early-stage and new venturing, and usually contribute smaller sums of money. Toward the right the sources become more formal, with greater investments guided by analysis, and a risk threshold associated with business growth and expansion that is generally lower and spread among various syndications, shareholders, or in the case of government, taxpayers.

FIGURE 13.1 WHO IS FUNDING ENTREPRENEURIAL START-UP COMPANIES?



Source: Adapted from Indiana Venture Center (2008). *Successful angel investing*. Copyright 2008.

financial capital Sometimes just called 'money', this is what entrepreneurs use to leverage other resources in the process of making products and services for the marketplace.

In this chapter, we examine the various sources of **financial capital** available to new ventures. We begin with an examination of the differences between debt and equity financing and the sources of capital available to new ventures through each form. We provide some insights into the approaches required of the entrepreneur. We do not neglect alternative forms of finance, and as such we cover micro-credit, impact investors, peer-to-peer lending and crowdfunding, and cryptocurrencies and blockchain technology.

DEBT VERSUS EQUITY

debt financing Financing in which you get a loan and go into debt. You are obliged to repay the loan at a predetermined interest rate.

equity financing The sale of some ownership in a venture in order to gain capital for start-up.

Entrepreneurs need both **debt financing** and **equity financing** – all at the right time. Equity financing is best in the early start-up stages, especially during research and development and during product development. The use of debt to finance a new venture involves a payback of the funds plus a fee (interest) for the use of the money (for example, to a bank). Equity financing involves the sale of some of the ownership (shares) in the venture. Debt places a burden of repayment and interest on the entrepreneurs, whereas equity financing forces the entrepreneur to relinquish some degree of control. In the extreme, the hard choice is usually: (1) to take on debt without giving up ownership in the venture, or (2) to relinquish a percentage of ownership in order to avoid having to borrow. In most cases, a combination of debt and equity proves most appropriate. Table 13.1 summarises the differences between equity and debt financing.

TABLE 13.1 HOW DIFFERENT FINANCE OPTIONS AFFECT PROFITABILITY AND CASH FLOW

EQUITY FINANCING		DEBT FINANCING	
ADVANTAGES	**DISADVANTAGES**	**ADVANTAGES**	**DISADVANTAGES**
Can provide a large injection of capital No interest payments No obligation to repay capital	Capital is usually only available in very large amounts It means 'selling' a part of your business to the investor Venture capitalists expect high returns on their investments (at least 25% p.a.) Investors may require you to buy them out at a future point	Amount borrowed can vary according to your needs As long as it is repaid, it will not affect your ownership of the company	Creates a debt obligation Interest will be charged, affecting profitability Collateral is usually required and banks will value your assets conservatively If you borrow from friends or relatives it can sour relations if the business fails

Source: Adapted from MSC Technopreneur Development Flagship (2002). *Funding guide and directory for the ICT/multimedia industry* (1st edn). Multimedia Development Corporation.

Most micro, small and medium enterprises do not ever seek any form of external financing, and of those that do, debt financing appears to be the preferred option. For instance, according to the Australian Innovation System Report, 'only 12 per cent of microbusinesses, 19 per cent of small businesses and 24 per cent of medium-sized enterprises sought debt or equity finance'.[3] Moreover, the report adds that of those businesses that sought external finance, 94 per cent sourced debt finance and only around 24 per cent looked for equity finance; clearly some sourced both. Perhaps debt financing is favoured because of its relative ease of access in Australia, where the success rate for debt finance falls between 88–95 per cent versus 50–53 per cent for equity finance.[4] This profile of Australian small-firm financing suggests that most businesses adopt low risk strategies, seek minimal expansion and/or have low growth ambitions. Most, therefore, are not entrepreneurial ventures.

DEBT FINANCING

Many new ventures find that debt financing is necessary. Short-term borrowing (one year or less) is often required for working capital and is repaid out of the proceeds from sales or other revenue. **Long-term debt** (term loans of one to five years or long-term loans maturing in more than five years) is used to finance the purchase of property or equipment, with the purchased asset serving as collateral for the loans. Commercial banks are the major source of debt financing for small business.[5]

long-term debt
Debts not payable within one year; usually loans maturing in the three- to five-year range that are used to finance the purchase of property or equipment, with the purchased asset serving as collateral for the loans.

Commercial banks

Although some banks will make unsecured short-term loans, most bank loans are secured by some form of collateral: fixed assets (such as your house), receivables (amount owed to you by customers), inventories in stock or other assets such as machinery and equipment. Commercial banks also make a large number of intermediate-term loans with term maturities of one to five years, requiring systematic payments over the life of the loan. All over the globe, whether in Australia, the US or almost anywhere else, banks are not really interested in your venture's future prospects and they do not really look at business plans indicating the viability of business growth and success. They do look at your capacity to meet debt repayments and the assets that will secure the debt in case you fail. Banks are not generally risk takers.

Banks these days though are becoming more competitive, and entrepreneurs may actually expect more from a bank than just a loan. Banks increasingly offer several services to a new venture, including payroll, letters of credit, international services, lease financing and money market accounts. Thai banks even offer manufacturing inputs to their entrepreneurs. Asian banks (outside of Singapore) have been slow to expand beyond credit.

While banks are unlikely to be too interested in the business plan, an entrepreneur needs to know their plan for repayment of the loan and how that influences their cash flow. To secure a bank loan, an entrepreneur typically will have to answer five questions, among others:

- *What do you plan to do with the money?* Do not plan to use funds for a high-risk venture. Banks seek the most secure venture possible.
- *How much do you need?* Some entrepreneurs go to their bank with no clear idea of how much money they need. All they know is that they want money. The more precisely the entrepreneur can answer this question, the more likely the loan will be granted.
- *When do you need it?* Never rush to the bank with immediate requests for money with no plan. Such a strategy shows that you are a poor planner and most lenders will not want to get involved. Remember, they want to know you can meet your repayments.
- *How long will you need it?* The shorter the period of time you need the money, the more likely you are to get the loan. The time at which the loan will be repaid should correspond to some important milestone in your business plan.
- *How will you repay the loan?* This is the most important question. What if plans go awry? Can other income be diverted to pay off the loan? Does collateral exist? Even if a quantity of fixed assets exists, the bank may be unimpressed because it knows from experience that assets sold at a liquidation auction bring only a fraction of their value. Five to 10 cents in the dollar is not unusual.[6]

Remember that banks are businesses too. They have **shareholders** to whom they must report and they are highly regulated by federal and state agencies. They may sometimes not lend to certain industries based on their corporate policy.

shareholder
One who owns shares in a corporation or mutual fund, often evidenced by a stock or share certificate. The word 'stockholder' is used in the US instead of 'shareholder'.

opportunity cost
The cost of using a resource in terms of the loss of its alternative uses, measured by the value of the next-best alternative use of that resource.

Debt financing has both advantages and disadvantages. On the plus side, you don't have to give up ownership of your company. More borrowing allows for potentially greater return on equity. And during periods of low interest rates, the **opportunity cost** is justified since the cost of borrowing is low. On the minus side, you will have regular (usually monthly) principal and/or interest payments. Continual cash-flow problems can be intensified because of payback responsibility. Heavy use of debt can inhibit growth and development.

Other debt-financing sources

Banks are not the only source of debt financing. Sometimes a new venturer can obtain long-term financing for a particular piece of equipment from the manufacturer, who will take a portion of the purchase price in the form of a long-term note. Manufacturers are most willing to do this when an active market exists for their used equipment, so that if the machines must be repossessed they can be resold. In addition, new ventures can sometimes obtain short-term debt financing by negotiating extended credit terms with suppliers. However, this kind of trade credit restricts the venture's flexibility with selecting suppliers and may reduce its ability to negotiate supplier prices.

Other debt-financing sources include trade credit, accounts receivable factoring, finance companies, leasing companies, mutual savings banks, savings and loan associations and insurance companies. Table 13.2 provides a summary of these sources, the business types they often finance and a guide to their financing terms.

TABLE 13.2 COMMON DEBT SOURCES

SOURCE	BUSINESS TYPE FINANCED		FINANCING TERM		
	START-UP BUSINESS	EXISTING BUSINESS	SHORT TERM	INTERMEDIATE TERM	LONG TERM
Trade credit	Yes	Yes	Yes	No	No
Commercial banks	Sometimes, but only if strong capital or collateral exists	Yes	Frequently	Sometimes	Seldom
Finance companies	Seldom	Yes	Most frequent	Yes	Seldom
Factors	Seldom	Yes	Most frequent	Seldom	No
Hire purchase	Sometimes	Yes	No	Yes	Occasionally
Leasing companies	Seldom	Yes	No	Most frequent	Occasionally
Mutual savings banks and savings-and-loan associations	Seldom	Real estate ventures only	No	No	Real estate ventures only
Insurance companies	Rarely	Yes	No	No	Yes

trade credit
Temporary financing extended by suppliers of goods and services pending customer settlement.

Trade credit is credit given by suppliers who sell goods on account. This credit is reflected on the entrepreneur's balance sheet as accounts payable and in most cases it must be paid in 30 to 90 days. Many small, new businesses obtain this credit when no other form of financing is available to them. Suppliers typically offer this credit as a way of attracting new customers.

Accounts receivable financing is short-term financing that involves either the pledge of receivables as collateral for a loan or the sale of receivables (factoring). Accounts receivable loans are made by commercial banks, whereas factoring is done primarily by commercial finance companies and factoring companies.

Accounts receivable bank loans are made on a discounted value of the receivables pledged. A bank may make receivable loans on a notification or non-notification plan. Under a notification plan, purchasers of goods are informed that their accounts have been assigned to the bank. They then make payments directly to the bank, which credits them to the borrower's account. Under the non-notification plan, borrowers collect their accounts as usual and then pay off the bank loan.

Factoring is the sale of a business' accounts receivable. Under this arrangement the receivables are sold at a discounted value to a factoring company. Some commercial finance companies also do factoring. Under a standard arrangement the factoring company, known as a *factor*, will buy the client's receivables outright, without recourse, as soon as the client creates them by shipment of goods to customers. Factoring fits some businesses better than others and it has become almost traditional in industries such as textiles, furniture manufacturing, clothing manufacturing, toys, shoes and plastics.

Hire purchase is an extended payment scheme entered into between the entrepreneur/hirer and the owner (equipment manufacturer or financial institution). Under hire purchase the hirer only needs to pay a small deposit up front and then make regular instalment payments. Only on final instalment does the hirer acquire ownership.

Finance companies are asset-based lenders that lend money against assets such as receivables, inventory and equipment. The advantage of dealing with a commercial finance company is that it often will make loans that banks will not. The interest rates can vary anywhere from 2 to 6 per cent over that charged by a bank. New ventures that are unable to raise money from banks and factors, often turn to finance companies.

EQUITY FINANCING

Equity financing is money invested in the venture with no legal obligation for entrepreneurs to repay the **principal** amount or pay interest on it. The use of equity funding thus requires no repayment in the form of debt. It does, however, require sharing the ownership and profits with the funding source. Since no repayment is required, **equity capital** can be much safer for new ventures than debt financing. Yet the entrepreneur must consciously decide to give up part of the ownership in return for this funding.[7] Other ways to raise cash include equity instruments, which give investors a share of the ownership. Here are some examples.

- **Loans with warrants** provide the investor with the right to buy shares at a fixed price at some future date. Terms on the warrant are negotiable. The warrant customarily provides for the purchase of additional shares, such as up to 10 per cent of the total issue at 130 per cent of the original offering price within a five-year period following the offering date.
- **Convertible debentures** are unsecured loans that can be converted into shares. The conversion price, the interest rate and the provisions of the loan agreement are all areas for negotiation.
- **Preferred shares** are equity that give investors a preferred place among the creditors in the event the venture is dissolved. These shares also pay a dividend and can increase in price, thus giving investors an even greater return. Some preferred-share issues are convertible to common shares, a feature that can make them even more attractive.

accounts receivable financing
Involves either the pledge of receivables as collateral for a loan or the sale of receivables (factoring).

factoring
Process of purchasing commercial accounts receivable (invoices) from a business at a discount.

hire purchase
The purchase of an asset according to a pre-agreed payment method, often calculated with a high-interest component compared to regular debt finance. The user may be the owner for tax purposes.

finance company
Asset-based lender that lends money against assets such as receivables, inventory and equipment.

principal
The amount of the entire mortgage loan, not counting interest.

equity capital
Funding of the business in the form of part or whole ownership of the company in order to finance start-up operations.

loan with warrants
Type of loan that provides the investor with the right to buy shares at a fixed price at some future date. Terms on the warrants are negotiable.

convertible debentures
Loans to a company made by investors, as opposed to loans raised from a bank. The investors receive a fixed rate of interest. Debentures may be 'convertible' into shares or 'redeemable' for cash at a specified future date.

preferred shares
Shares that pay dividends at a specified rate and that have preference over common shares in the payment of dividends and the liquidation of assets. The word 'stock' is used in the US instead of 'shares'.

common shares
Shares that represent part of whole ownership of a company. Holders of common shares have voting rights but no guarantee of dividend payments. Note: The word 'stock' is used in the US instead of 'shares'. (See also *ordinary shares*.)

private offerings
Raising of capital from friends, employees, customers, relatives and local professionals.

initial public offering (IPO)
The raising of capital through the sale of company securities on the public markets.

liquidity
A property of any asset that can be sold without causing a significant price change and with minimum loss of value.

prospectus
A document, published prior to the issue of shares to the public, that explains all aspects of a company's business.

disclosure
Declaration of information relevant to specific transactions that is required by law.

dividends
Cash, shares or other assets from an incorporated company's profits distributed to shareholders, an equal amount for each share owned. Paid from the total net earnings. Retained earnings are what remain after dividend distribution.

- **Common shares** are the most basic form of ownership. These shares usually carry the right to vote for the board of directors. If a new venture does well, common-share investors often make a large return on their investment. These share issues often are sold through public or **private offerings**.

Equity capital can be raised through two major sources: public share offerings and private placements. In both cases, entrepreneurs must follow the local laws pertaining to raising such funds. The entire process can be difficult, expensive and time consuming. On the other hand, successful share offerings can help a fledgling enterprise raise a great deal of money. The smart entrepreneur will keep an eye on dual or triple-tracking the business. That means simultaneously preparing for an initial public offering, a trade sale or a venture capital/private-equity round, depending on the balance of advantage.

PUBLIC OFFERINGS

During the last decade, many new ventures have sought capital through the public markets. The term **initial public offering (IPO)** is used to represent the registered public offering of a company's securities for the first time. *Going public* is a term used to refer to a corporation raising capital through the sale of securities on the public markets. This is a company's first-ever sale of shares to the public. In many cases it is the first time people outside the company have the opportunity to buy its shares. A company often is said to be 'going public' or 'floating' when it conducts an initial public offering. Here are some of the advantages to this approach.

- *Size of capital amount*: Selling securities is one of the fastest ways to raise large sums of capital in a short period.
- **Liquidity**: The public market provides liquidity for owners since they can readily sell their shares. *Liquid assets* are those that can be sold without causing a significant price change and with minimum loss of value
- *Value:* The marketplace puts a value on the company's shares, which in turn allows value to be placed on the corporation.
- *Image:* The image of a publicly traded corporation is often stronger in the eyes of suppliers, financiers and customers.

There has been tremendous *volatility* within the market over the years and entrepreneurs should be aware of the concerns that confront them when they pursue an IPO. In addition, many new ventures have begun to recognise some other disadvantages of going public. Several of these are outlined below.

- *Costs*: The expenses involved with a public offering are significantly higher than for other sources of capital. Accounting fees, legal fees and **prospectus** printing and distribution, as well as the cost of underwriting the shares, can result in high costs.
- **Disclosure**: Details of the company's affairs must be publicly disclosed. New-venture businesses often prefer to keep such information private.
- *Requirements*: The paperwork involved with government regulations, as well as continuing performance information, drains large amounts of time, energy and money from management. Many new ventures consider these elements better invested in helping the company grow.
- *Shareholder pressure*: Management sometimes make short-term rather than long-term decisions in order to maintain a good performance record for earnings and **dividends** to the shareholders. This pressure can lead to a failure to consider the company's long-term growth and improvement.

The advantages and disadvantages of going public must be weighed carefully. If the decision is to undertake a public offering, then it is important the entrepreneur understand the process involved.

PRIVATE EQUITY AND PLACEMENTS

Private placement is money invested in a company in the form of shares or sometimes bonds. This investment usually comes from private investors (as a pooled source of funds it is collectively called the **private equity market** or PE); however, large banks, mutual funds, insurance companies and superannuation funds may also participate in private placement transactions. It is sometimes possible to avoid issuing a prospectus, but rules will differ from country to country. In most cases, a placement agent (usually a share-broking firm or investment bank) will manage the process for a fee.

private placement
A method of raising capital through securities; often used by small ventures.

private equity market
The collective pool or community of high-wealth individuals who are willing to invest significantly into later-stage ventures in exchange for shares in the venture (equity) accessed through private placement agents.

The ideal small-business candidate for private placement is a company looking for growth or expansion funding. In 2016, private equity investments in Australia exceeded AUD$2.5 billion. According to Deloitte Access Economics, PE is shown to significantly benefit business growth, with the average workforce of PE-backed businesses growing from 378 to 1636 full-time equivalent (FTE) jobs over a five-year period.[8] A private placement is suitable when you need an injection of capital to jump to the next level of growth and you have a proven track record of profitability.

A *private placement memorandum* (PPM) is the document that discloses everything the investors need to know to make an informed investment decision about the direct public offering (DPO) being considered. This includes:

- the offering structure
- the share structure of the company
- disclosures about the securities being purchased
- company information
- information on company operations
- risks involved with the investment
- management information
- use of proceeds
- information on certain transactions that could affect the investor and investor suitability data.[9]

THE VENTURE CAPITAL MARKET

Venture capitalists are a valuable and powerful source of equity funding for some (a small minority of) new ventures. These experienced professionals provide a full range of financial services for new or growing ventures, including the following:

venture capitalist
Person who syndicates the money of others to invest in a company start-up assessed as having high potential to create extraordinary returns for the syndicated investors.

- capital for start-ups and expansion
- market research and strategy for businesses that do not have their own marketing departments
- management-consulting functions and management audit and evaluation
- contacts with prospective customers, suppliers and other important businesspeople
- assistance in negotiating technical agreements
- help in establishing management and accounting controls
- help in employee recruitment and development of employee agreements
- help in risk management and the establishment of an effective insurance program
- counselling and guidance in complying with a myriad of government regulations.

seed financing
Initial funds for a business concept to be developed.

start-up financing
Funding for use in prototyping and product development as well as initial marketing before sales. Most start-up funding comes from the four Fs. (See also *four Fs*.)

early-stage financing
Financing provided to companies that have completed the product development stage and test marketing, but require additional financing to expand commercial manufacturing and sales.

expansion financing
Financing for a company that is viable and is reaching break-even; usually used to increase production capacity, market or product development.

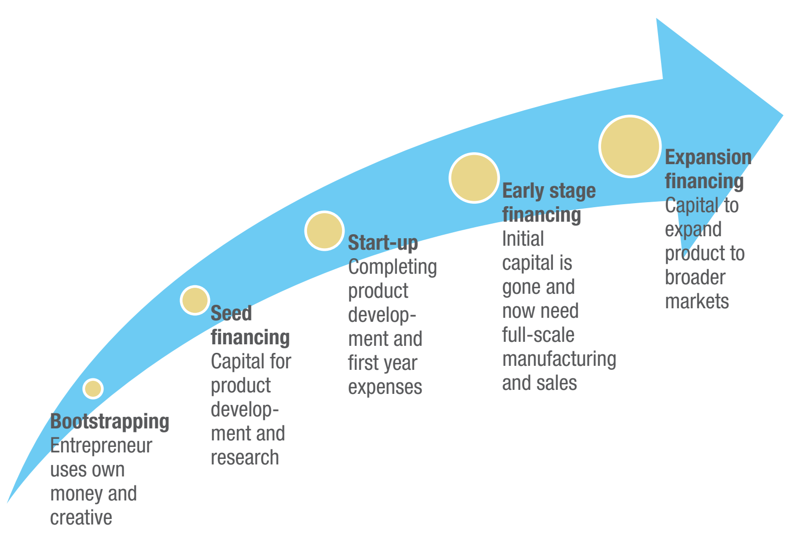
late-stage funding
Financing for new-product development or introduction, or to support major capacity expansion. Offered before public offering investments to strengthen the company.

VC investment covers a spectrum of different venture timings and purpose. Here are the different stages of financing a venture at which a VC may invest (see Figure 13.2):

- **Seed financing** provides the initial funds for a business concept to be developed. This may involve additional research, product development and initial marketing to reach out to early-adopter customers. Companies receiving funding at this stage may be in the process of being incorporated or may have been in operation for a while.
- **Start-up financing** is where product development is completed and the market is trial-tested. Sales are still low and the company needs one year or less of expense money.
- **Early-stage financing** is provided to companies that have completed the product development stage and test marketing, but require additional financing to expand commercial manufacturing and sales.
- **Expansion financing** is provided when the start-up company is poised to grow rapidly. The business is viable and is reaching break-even point. The funds may be used to increase production capacity, support market or product development and/or provide additional working capital.
- **Late-stage funding** refers to pre-IPO investments in a company for strengthening the positioning of the company and gaining endorsements from the top venture capital firms as the company prepares for its listing.

Overall, Australia ranks poorly in its rate of domestic VC investment compared to other OECD countries. VC investment is around 0.013 per cent of Australia's GDP – about a quarter of the OECD average. The Office of the Chief Economist also reports that most VC investment goes to more mature businesses aged five years or older and not to young start-ups. Australian domestic VC investments have tended to slump since the global financial crisis and be somewhat volatile according to Australian Bureau of Statistics data. On the other hand, The Australian Private Equity and Venture Capital Association Limited (AVCAL) shows more buoyant numbers, although their data includes overseas investment into Australia.[10] Today, venture capital is a global market with investors scouting internationally.

FIGURE 13.2
FUNDING STAGES



VENTURE CAPITAL IN THE NEW ERA

A number of major trends have occurred in venture capital over the last few years or more.

First, innovation has become recognised globally and is no longer thought to be the dominant domain of the Americans. Therefore, many VCs have opened offices in Eastern Europe, China, India, Israel and Vietnam, to name a few.[11]

Second, funds are becoming more specialised and less homogeneous. The industry has become more diverse, more specialised and less uniform than is generally thought. Sharp differences are apparent in terms of investing objectives and criteria, strategy and focus on particular stages, sizes and market technology niches. Some of the tech sectors that have funds focused exclusively on them are life sciences, biotech, cleantech and digital media.[12]

Third, small start-up investments have weakened over the last decade. VC funds typically lack professionals who have experience with start-ups and first-stage ventures. Consequently, the level of seed and start-up financing is much lower in comparison to the financing available for early stages, expansion and acquisition.[13]

Fourth, the industry has become more efficient and more responsive to the needs of the entrepreneur as a result of greater professionalism and greater competition. Now most VCs view themselves as service providers whose job is to provide advice and counsel, which adds more value to the enterprise than just cash. Many VCs today were successful entrepreneurs themselves and can therefore relate to the challenges faced by entrepreneurs and can help with strategies to finance and build a successful enterprise. Entrepreneurs should look for a VC that not only is a source of capital but also has deep industry knowledge and a broad network.[14]

Fifth, the heated competition for venture capital in recent years has resulted in a more sophisticated legal and contractual environment. The frequency and extent of litigation are rising. As an example, the final document governing the investor/entrepreneur relationship – called the investment agreement – can be several centimetres thick and can comprise two volumes. In this regard, legal experts recommend that the following provisions be carefully considered in the investment agreement: choice of securities (preferred stock, common stock, convertible debt and so forth), control issues (who maintains voting power), evaluation issues and financial covenants (ability to proceed with mergers and acquisitions), and remedies for breach of contract (rescission of the contract or monetary damages).[15]

DISPELLING VENTURE CAPITAL MYTHS

Because many people have mistaken ideas about the role and function of VCs, a number of myths have sprung up about them. Some of these, along with their rebuttals, follow.

- *Myth 1: Venture capital firms want to own control of your company and tell you how to run the business.* No venture capital firm intentionally sets out to own control of a small business. VCs have no desire to run the business. They do not want to tell entrepreneurs how to make day-to-day decisions and have the owner report to them daily. They want the entrepreneur and the management team to run the company profitably. They do want to be consulted on any major decision, but they want no say in daily business operations.[16] Of course, if the entrepreneur is perceived as unable to manage the venture – a circumstance they will desperately seek to avoid through their **due diligence** to weed out incompetent or incapable entrepreneurs – then they are likely to step in to protect their investment.
- *Myth 2: Venture capitalists are satisfied with a reasonable return on investments.* VCs expect exorbitant, sometimes unreasonable returns. They can obtain reasonable returns from hundreds

due diligence
A process undertaken by potential investors to analyse and assess the desirability, value and potential of an investment opportunity.

of publicly traded companies. They can obtain reasonable returns from many types of investments that do not have the degree of risk involved in financing a small business. Because every venture capital investment involves a high degree of risk, it must have a correspondingly high return on investment.[17]

- *Myth 3: Venture capitalists are quick to invest.* It takes a long time to raise venture capital. On average, it will take six to eight weeks from the initial contact to raise venture capital. If the entrepreneur has a well-prepared business plan, the investor will be able to raise money in that timeframe. A VC will see 50 to 100 proposals a month; of that number, 10 will be of some interest. Of those, two or three will receive a fair amount of analysis, negotiation and investigation. Of the two or three then, just one may be funded. This funnelling process of selecting one out of 100 takes a great deal of time. Once the venture capitalist has found that one, they will spend a significant amount of time investigating possible outcomes before funding it.
- *Myth 4: Venture capitalists are interested in backing new ideas or high-technology inventions – management is a secondary consideration.* VCs back only good management. If an entrepreneur has a bright idea but a poor managerial background and no experience in the industry, they should try to find someone in the industry to bring onto the team. The VC will have a hard time believing that an entrepreneur with no experience in that industry and no managerial ability in his or her background can follow through on a business plan. A good idea is important, but a good management team is even more important.[18]
- *Myth 5: Venture capitalists need only basic summary information before they make an investment.* A detailed and well-organised business plan is the only way to gain a venture capital investor's attention and obtain funding. Every VC, before becoming involved, wants the entrepreneur to have thought out the entire business plan and to have written it down in detail.[19]

ENTREPRENEURSHIP IN PRACTICE

VENTURE CAPITALISTS' DUE DILIGENCE 'DEAL KILLERS'

When venture capitalists examine a business plan and then conduct their own due diligence on a proposed venture, if certain areas stand out, it is immediately a negative. These are referred to as 'deal killers', because it is sometimes impossible to get a deal done if any one of these items is identified.

- *An arrogant management team*. This is a team that will not listen, that has displayed a lack of integrity or that is preoccupied with complete control.
- *No defendable market position*. This occurs when there is no identified intellectual property to defend or specific market niche to occupy.
- *Excessive founder salaries*. If the focus seems to be on the founders distributing the proceeds to themselves quickly (or bonuses), then there is a problem with commitment to the venture.
- *Vulnerability of the founder*. Whenever there is overdependence on one person (in particular a founder) for their skills or persona, there could be a major issue.
- *Yesterday's news*. If a business plan is perceived as 'overshopped' or simply presented too often over a short period of time, then it may be perceived as an 'old idea'.
- *Ignorance of the competitive landscape*. Whenever the team lacks the understanding of the real strengths and weaknesses of the competition, a major red flag goes up for the VC.
- *Unrealistic expectations*. A typical problem of entrepreneurs is their lack of understanding of the valuation of their venture and the deal terms involved in the VC investment proposal. Usually entrepreneurs think that their venture is worth far more than the VC does.

Adapted from Sherman, A. J. (2012). *Raising capital* (3rd edn). New York: AMACOM Books, 196.

VENTURE CAPITALISTS' OBJECTIVES

Venture capitalists have different objectives from other capital lenders. They are interested in security and payback. As part owners of the companies they invest in, venture capitalists are most concerned with **return on investment (ROI)**. As a result they put a great deal of time into weighing the risk of a venture against the potential return. They carefully measure both the product/service and the management.

return on investment (ROI)
Net profit divided by investment.

The best advice is to delay outside investment as long as possible and to build as much value as you can into your business before you seek it, because venture capitalists are interested in making a large ROI. Table 13.3 provides some commonly sought targets. Of course, these targets are flexible. They would be reduced, for example, in cases where a company has a strong market potential or is able to generate good cash flow, or where management has invested a sizable portion of its own funds in the venture. However, an annual goal of 20 to 30 per cent ROI would not be considered too high, regardless of the risks involved.[20]

TABLE 13.3 RETURNS ON INVESTMENT TYPICALLY SOUGHT BY VENTURE CAPITALISTS

STAGE OF BUSINESS	EXPECTED ANNUAL ROI	EXPECTED INCREASE ON INITIAL INVESTMENT
Start-up business (idea stage)	60% +	10–15 × investment
First-stage financing (new business)	40–60%	6–12 × investment
Second-stage financing (development stage)	30–50%	4–8 × investment
Third-stage financing (expansion stage)	25–40%	3–6 × investment
Turnaround situation (rescuing an apparently failing business)	50% +	8–15 × investment

Source: Originally adapted from W. Keith Schilit (1987). How to obtain venture capital. *Business Horizons*, May/June, 78. Copyright 1987 by the Foundation for the School of Business at Indiana University. Reprinted by permission; and interviews with Silicon Valley Venture Capitalists by Professor Kuratko in March 2012.

CRITERIA FOR EVALUATING NEW-VENTURE PROPOSALS

In addition to the evaluation of product ideas and management strength, numerous criteria are used to evaluate new-venture proposals. Shepherd developed a list of eight critical factors that VCs use in the evaluation of new ventures, as follows:

1 Timing of entry
2 Key success factor stability
3 Educational capability
4 Lead time
5 Competitive rivalry
6 Entry wedge imitation
7 Scope
8 Industry-related competence.[21]

All factors are defined from the high/low perspective (see Table 13.4 for definitions) and are generic in nature, as reflects the research of the earlier era that provides a foundation for understanding what

VCs look for. More recently, research has moved away from trying to define specific sets of factors due to instabilities relating to variations in gender, human attitudinal and cognitive characteristics, funder characteristics, business focus and style, market and industry characteristics, and national and cultural contexts.

In the end, the business plan is a critical element in a new-venture proposal and should be complete, clear and well presented. Venture capitalists will generally analyse five major aspects of the plan: (1) the proposal size, (2) financial projections, (3) investment recovery, (4) competitive advantage and (5) company management.

TABLE 13.4 FACTORS IN VENTURE CAPITALISTS' EVALUATION PROCESS

ATTRIBUTE	LEVEL	DEFINITION
Timing of entry	Pioneer	Enters a new industry first
	Late follower	Enters an industry late in the industry's stage of development
Key success factor stability	High	Requirements necessary for success will not change radically during industry development
	Low	Requirements necessary for success will change radically during industry development
Educational capability	High	Considerable resources and skills available to overcome market ignorance through education
	Low	Few resources or skills available to overcome market ignorance through education
Lead time	Long	An extended period of monopoly for the first entrant prior to competitors entering the industry
	Short	A minimal period of monopoly for the first entrant prior to competitors entering this industry
Competitive rivalry	High	Intense competition among industry members during industry development
	Low	Little competition among industry members during industry development
Entry wedge mimicry	High	Considerable imitation of the mechanisms used by other firms to enter this, or any other, industry – for example, a franchisee
	Low	Minimal imitation of the mechanisms used by other firms to enter this, or any other, industry – for example, introducing a new product
Scope	Broad	A firm that spreads its resources across a wide spectrum of the market – for example, many segments of the market
	Narrow	A firm that concentrates on intensively exploiting a small segment of the market – for example, targeting a niche
Industry-related competence	High	Venturer has considerable experience and knowledge with the industry being entered or a related industry
	Low	Venturer has minimal experience and knowledge with the industry being entered or a related industry

Source: Shepherd, D. A. (1999). Venture capitalists' introspection: A comparison of "in use" and "espoused" decision policies. *Journal of Small Business Management,* April, 76–87; and Shepherd, D. A. (1999). Venture capitalists' assessment of new venture survival. *Management Science,* May, 621–32. Reprinted by permission. Copyright 1999 by the Institute for Operation Research and the Management Sciences (INFORMS). Reprinted by permission.

The evaluation process typically takes place in stages. The four most common stages are:

- *Stage 1*: Initial screening – a quick review of the basic venture to see if it meets the venture capitalist's particular interests.
- *Stage 2*: Evaluation of the business plan – a detailed reading of the plan to evaluate the factors mentioned earlier.
- *Stage 3*: Oral presentation – the entrepreneur verbally presents the plan to the venture capitalist.
- *Stage 4*: Final evaluation – after analysing the plan and visiting suppliers, customers, consultants and others, the venture capitalist makes a final decision.

This four-step process screens out approximately 98 per cent of all venture plans. The rest receive some degree of financial backing.

Evaluating the venture capitalist

The venture capitalist will evaluate you and so you should not hesitate to evaluate them. Does the venture capitalist understand the proposal? Are they familiar with the business? Are they someone with whom you can work? If the answers reveal a poor fit, look for a different venture capitalist.

Venture capitalists do add value to an entrepreneurial business beyond the money they supply, especially in high-innovation ventures. You should therefore choose the appropriate venture capitalist at the outset and, most importantly, they must keep the communication channels open as the business grows.[22]

On the other hand it is important to realise that you may have a limited choice of venture capitalist firms. Funds tend to be controlled by very few groups and the quality of the venture must be promising. In addition, the trend toward concentration of venture capital under the control of a few firms is increasing.[23]

That means you shouldn't be deterred from evaluating prospective venture capitalists. Table 13.5 lists some useful venture capital resources. The 'Entrepreneurship in practice: Asking venture capitalists the right questions' box provides a list of important questions that a prospective venture capital firm should answer. Evaluating and even negotiating with the VC are critical to establishing the best equity funding. You may worry that if you rock the boat by demanding too much, the venture capital firm will lose interest. That's an understandable attitude; venture capital is hard to get and if you've gotten as far as the negotiating process, you're already among the lucky few.

But that doesn't mean you have to roll over and play dead. A venture capital investment is a business deal that you may have to live with for a long time. Although you'll have to give ground on many issues when you come to the bargaining table, there is always a point beyond which the deal no longer makes sense for you. You must draw a line and fight for the points that really count.[24]

ENTREPRENEURSHIP IN PRACTICE

ASKING VENTURE CAPITALISTS THE RIGHT QUESTIONS

There are a number of important questions that entrepreneurs should ask of venture capitalists. Following are seven of the most important.

- Does the venture capital firm in fact invest in your industry? How many deals has the firm actually done in your field? What sort of successful exits have they achieved and how many?
- What is it like to work with this venture capital firm? Can they clearly explain their processes and due diligence?

continue

continue

Get references. (An unscreened list of referrals, including from CEOs of companies that the firm has been successful with as well as those it has not, can be very helpful.)

- What experience does the partner doing your deal have and what is their clout within the firm? Check out the experiences of other entrepreneurs and whether the partner has actually ever been an entrepreneur to see whether they will be empathetic.
- How much time will the partner spend with your company if you run into trouble?

A seed-stage company should ask, 'You guys are a big fund and you say you can seed me a quarter of a million dollars. How often will you be able to see me?' The answer should be at least once a week.

- How healthy is the venture capital fund and how much has been invested?

A venture capital firm with a lot of troubled investments will not have much time to spare. If most of the fund is invested there may not be much money available for your follow-on rounds.

- Are the investment goals of the venture capitalists consistent with your own? Do you like them and do they seem sincere in their concerns for you and your venture?
- Have the venture capital firm and the partner championing your deal been through any economic downturns? A good venture capitalist won't panic when things get bad.

Source: Adapted from Juilland, M.-J. (1987, August). What do you want from a venture capitalist? *Venture*. Copyright 1987 Venture Magazine, Inc. Updated from Myers, W. (2014, June 21). How should I evaluate a venture capital firm? Crown Business. https://crownbiz.com/how-should-i-evaluate-a-venture-capital-firm/; and Brisbourne N. (2013, November 26). How investors evaluate VCs. http://www.theequitykicker.com/2013/11/26/investors-evaluate-vcs/.

TABLE 13.5 VENTURE CAPITAL INTERNET RESOURCES

Australian Venture Capital Association	http://www.avcal.com.au
Global Entrepreneurship Monitor Financial Reports	http://www.gemconsortium.org
Hong Kong Venture Capital Association Ltd	http://www.hkvca.com.hk
Indian Private Equity and Venture Capital Association	http://www.indiavca.org
Korean Venture Capital Association	http://www.kvca.or.kr
Malaysia Venture Capital and Private Equity Association	http://www.mvca.org.my
New Zealand Private Equity and Venture Capital Association	http://www.nzvca.co.nz
Philippine Venture Capital Investment Group	http://www.philvencap.com
Singapore Venture Capital and Private Equity Association	http://www.svca.org.sg
Taiwan Venture Capital Association	http://www.tvca.org.tw
Thai Venture Capital Association	http://tvca.or.th/

STARTING UP WITH 'INFORMAL INVESTORS'

CourseMateExpress

Why are angels joining angel organisations? Why the proliferation of angel networks? Learn all about it on CourseMate Express.

In reality, venture capital is simply not on most companies' radar – ever. In the home of VC, the USA, for example, less than one in 10 000 companies receives classic venture capital.[25] In general, venture capital flows only to companies with superstar potential at a later stage of investment and with some proven performance behind them (refer to the VC section above). Informal investment, though, flows to companies in all segments. The truth is that if there were no informal investment there would be virtually no new ventures. In contrast, if there were no venture capital, new ventures by the millions would still be getting off the ground!

Informal investment for new ventures does not usually come from banks or venture capitalists but rather from the **four Fs** – founders, family, friends and other 'foolhardy investors'. In fact, the founder's or founders' own money is often the first and most essential source of early venture financing. If funds come from no other source than the founder(s) themselves and the creative ways they employ to bring funds into the business without the use of debt or equity, it is known as bootstrapping (see Chapter 4). However, here our primary consideration is the other three sources of capital: family, friends and the foolhardy. The 'foolhardy' could include neighbours, work colleagues, even strangers, other than the group of more professional investors known as business angels. Business angels are a special category among **informal investors** who have expertise and experience in prior ventures.

four Fs
Types of informal investors: Friends, family, founders and other 'foolhardy investors'.

informal investor
Any of the four Fs – friends, family, founders and other 'foolhardy' investors (such as neighbours, work colleagues and even strangers).

As the sources of capital move toward the more informal end of the spectrum, the data on how much is invested, and in what, becomes increasingly more difficult to ascertain simply because it is informal, private and varies in its source and amount. However, the Australian Global Entrepreneurship Monitor (GEM) has reported that about 4.1 per cent of the population in 2016 had invested in early-stage ventures. This appears comparable to the US, where the informal investor prevalence is about 4.2 per cent of the population, but higher than the 3.4 per cent average for developed countries. This means there are around 600 000 informal investors in Australia investing on average just over \$75 000 per venture – exceeding both the US at \$21 000 per venture and overall developed countries at \$48 000 per venture.[26]

Who are these informal investors? GEM found nearly half of informal investors were close family relatives of the entrepreneurs, another quarter were friends and neighbours, while workmates, other relatives and strangers make up the last quarter in roughly similar amounts.[27] Informal investors, as a group, use their own money and carry out their own (sometimes haphazard, intuitive and/or emotional) due diligence to invest in the entrepreneurial opportunities of other entrepreneurs.

What financial return do informal investors expect? GEM found that expected returns are affected by altruism. The closer the relationship between an entrepreneur and an investor, the lower the expected return. In putting money into relatives' and friends' businesses, more than 50 per cent expected to *lose money or at best break even*. It confirms a common piece of advice given to entrepreneurs who are seeking informal investments: make sure that your investors, family and friends in particular, can afford to lose all their investment without having to change their lifestyle![28]

DEALING WITH FAMILY AND FRIENDS

You've heard of the 'elevator pitch' for raising money from venture capital investors. But have you heard of the 'kitchen table pitch'? If you are thinking of raising money from someone close to you, here are some tips:

- Know their motivations. Some relatives and friends are truly in it for the altruism, but like all people your relatives and friends are also in it for the profit. When you are making the pitch around the kitchen table, be sure you list what is in it for them.
- Debt is better than equity for relatives and friends. Equity is 'funny money' to most people unless you intend to on-sell the business quickly. Let's say your sister invests \$10 000 in your restaurant. The restaurant grows and her equity share grows too. However, if you divorce and have to split **shares** with your ex-husband, or the restaurant simply closes rather than being sold, your sister's investment is devalued or disappears.
- While you will make the pitch face-to-face, do follow up with a written memo. Your relatives do not necessarily care about a formal business plan. But give them some documentation so there is no misunderstanding.[29]

shares
An equity or ownership interest in a corporation, demonstrated by share certificates. The word 'stock' is used in the US instead of 'shares'.

promissory note
Tangible recognition of a supplier's claim or a note given in connection with an acquisition of funds.

- Try to treat them as if they were strangers. Get some distance from the transaction. Have a friend present your concept and have a lawyer prepare the **promissory note**.
- Try to avoid a repayment schedule. Tie your repayments to your cash flow. Give your relative a percentage of your operating cash flow until you have repaid the whole amount. If nothing else, this gives you a constant reminder of your obligation and is less likely to sour your personal relationships.
- Don't give voting stock. Often a family member or friend will be willing to finance your start-up, but will also insist on a voting board seat. One thing you don't want is your 'rellies' looking over your shoulder and second-guessing every decision.[30]

ENTREPRENEURSHIP IN PRACTICE

build-out allowance
In a lease contract, the amount given to the tenant by the landlord to build-out the premises.

vertical integration
An arrangement whereby the same company owns multiple or all aspects of making, selling and delivering a product or service.

white knight
Someone with better credit than you who might buy the products and resell them to you for a few percentage points. Also a company that rescues another that is in financial difficulty, especially one that saves a company from an unwelcome takeover bid.

WAYS TO FIND BOOTSTRAP CAPITAL

- **Build-out allowances** from landlords: Banks will often allow you to count build-out allowances as capital in your source and use of funds statement. While the money comes in and goes out, it does increase the overall cash flow and size of your deal.
- **Vertical integration**: Capital can often be raised from outside companies with a vested interest in either developing distribution channels, or assuring themselves of adequate product flow from cash-starved companies. Example: A distributor invests in his supplier in order to assure himself adequate inventory.
- Professionals associated with the business: Just present a way for investors to be more profitable in their own companies through the proposed investment. Law firms, advertising agencies, executive recruiters and professional consultants will often accept partial payment in stock, warrants or options in return for services. This is an excellent way to build a powerful team of professionals with a vested interest in your success, including your success in raising capital. Many of these professionals are also angel investors, who can champion your cause with other private investors.
- **White knights**: If you are a retailer with poor credit and cannot get merchandise shipped without a direct payment, have someone with better credit buy the products and resell them to you. You may pay the white knight a few percentage points each month. If you have a high turnover ratio, this will allow you to re-establish cash flow and credit. Only a few specialists handle these types of operations, but you can find them through factoring companies.
- Technical or professional expertise: Many professionals are willing to reduce their fees in exchange for equity. Although the services will not be totally free, they are usually reduced by about 50 per cent. You may even be able to arrange options or warrants to avoid initial dilution. Moreover, you can provide the professional an exit strategy prior to an initial public offering if another large investor enters your market.
- Sale of licences or marketing rights: Selling off rights to foreign or geographic markets or private-labelling products is an excellent vehicle for young companies. You can use both exclusive and non-exclusive arrangements. All methods should have some type of quota and non-competition clauses. The downside is that later investors may feel that you have sold off too much of the potential, so they will not invest as readily.

Sources: Adapted from Venture Planning Associates (n.d.). 28 ways to finance your venture. http://www.ventureplan.com/how.to.finance.your.venture.html. See also Garty, L. (2012). Portrait of a modern day bootstrapper. *SVB Accelerator*. Silicon Valley Bank; and Sherman, A. J. (2012). *Raising capital*. New York: AMACOM Books.

ANGEL FINANCING

Many wealthy people are looking for investment opportunities. They are referred to as **business angels**, or informal risk capitalists. Here we distinguish business angels from the 4F informal investors we looked at earlier, who hold closer relationships with the entrepreneur. Business angels tend not to have any previous relationship with the entrepreneur and take a more objective approach to determining whether to invest. Angel investors range from those taking a passive approach (backing others' judgements) through to hands-on investors providing advice or direct management input to help the business become established. In many cases, the latter group of angel investors will take as rigorous an approach to their investing as some venture capitalists. Business angel investors typically spend 40 hours a month on their angel investing activities, such as attending pitches from entrepreneurs, mentoring entrepreneurs prior to investing and undertaking due diligence.[31]

business angel
A private investor who contributes money and experience to early-stage investments.

A key difference between angel and venture capital investors is that angels tend to invest as individuals, although increasingly they are tending to syndicate and work as part of a group. Angels tend to operate part time, whereas venture capitalists generally come via a company or a pooled fund with full-time managers and a board of directors, using formal analysis and investment procedures (see Table 13.6 for a summary of differences between VCs and angels).

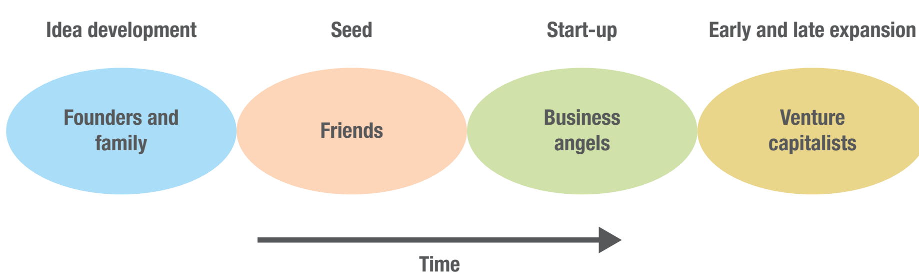


FIGURE 13.3 WHERE ANGELS FIT IN THE MIX

How do informal investors find projects? Research indicates that they use a network of friends to seek out prospective investments. Additionally, many localities are formulating angel networks, such as Melbourne Angels (http://melbourneangels.net/) and Sydney Angels (http://sydneyangels.net.au/). Angel matching services are also emerging, such as Business Angels (https://businessangels.com.au). These organisations provide services and support to business angels and entrepreneurs who are looking to fund their new ideas and early ventures. Behind these changes in the market, the Australian Federal Government is getting serious about encouraging angel investors by introducing a tax incentive scheme. Since 1 July 2016, angel investors have been able receive a 20 per cent tax offset of up to $200 000 and a capital gains tax (CGT) exemption on the disposal of their interests in early-stage innovative companies (ESICs).[32]

TYPES OF ANGEL INVESTORS

Angel investors can be classified into five basic groups:

- **Corporate angels**: Typically, so-called corporate angels are senior managers who have been laid off with generous severances or have taken early retirement. In addition to receiving the cash, an entrepreneur may persuade the corporate angel to occupy some senior management position, such as in business development.

corporate angel
A type of angel investor, typically a senior manager who has been laid off with a generous severance or has taken early retirement.

entrepreneurial angel
The most prevalent type of investor. Typically owns and operates one or more highly successful businesses.

- **Entrepreneurial angels**: The most prevalent type of angel investors, most of these individuals own and operate highly successful businesses. Because these investors have other sources of income and perhaps significant wealth from initial public offerings or partial buyouts, they will take bigger risks and invest more capital. The best way to market your deal to these angels, therefore, is as a synergistic opportunity. Reflecting this orientation, entrepreneurial angels seldom look at companies outside of their own area of expertise and will participate in no more than a handful of investments at any one time. These investors usually take a seat on the board of directors, but rarely assume management duties. They will make fair-sized investments and invest more as the company progresses.

enthusiast angel
Angel that simply loves to be involved in deals. Typically plays no role in management and rarely seeks to be placed on a board.

- **Enthusiast angels**: Whereas entrepreneurial angels tend to be somewhat calculating, enthusiasts simply like to be involved in deals. Most enthusiast angels are aged 65 or older, are independently wealthy from success in a business they started and have abbreviated work schedules. For them investing is a hobby. As a result they typically play no role in management and rarely seek to be placed on a board. Because they spread themselves across so many companies the size of their investments tends to be small.

micro-management angel
An angel investor who imposes tactics that worked for their own company. Can be a bothersome angel.

- **Micro-management angels**: Micro-managers are very serious investors. Some of them were born wealthy, but the majority attained wealth through their own efforts. Unfortunately, this heritage makes them dangerous. Because most have successfully built a company, micro-managers attempt to impose the tactics that worked for them on their portfolio companies. Although they do not seek an active management role, micro-managers usually demand a seat on the board of directors. If business is not going well they will try to bring in new managers.

professional angel
A professional, such as a doctor or lawyer, who invests in companies that offer a product or service with which they have some experience. Also may refer to angel investors who invest as an occupation and in a manner that is rigorous and systematic, developed through repeated and intentional investment strategies.

- **Professional angels**: The term 'professional' in this context refers to the investor's occupation, such as doctor, lawyer or, in rare instances, accountant. Professional angels like to invest in companies that offer a product or service with which they have some experience. They rarely seek a board seat, but they can be unpleasant to deal with when the going gets rough and may believe that a company is in trouble before it actually is. Professional angels will often invest in several companies at one time.[33]

TABLE 13.6 MAIN DIFFERENCES BETWEEN BUSINESS ANGELS AND VENTURE CAPITALISTS

CHARACTERISTIC	BUSINESS ANGELS	VENTURE CAPITALISTS
Personal	Entrepreneurs	Investors
Businesses funded	Small, early-stage	Large, mature
Due diligence done	Minimal	Extensive
Location of investment	Of concern	Not important
Contract used	Simple	Comprehensive
Monitoring after investment	Active, hands-on	Strategic
Exiting the business	Of lesser concern	Highly important
Rate of return	Of lesser concern	Highly important

Source: Osnabrugge, M., & Robinson, R. (2000). *Angel investing: Matching startup funds with startup companies*. San Francisco, CA: Jossey-Bass, 111. Copyright John Wiley & Sons. Used by permission.

angel capital
Investment in a business by an affluent individual to provide equity capital.

Another important consideration for **angel capital** is that a larger percentage of their investing is devoted to seeding a start-up business as opposed to venture capital, and funding this source of potential capital requires an entrepreneur to engage wholeheartedly with informal networks. It's worth noting that according to one survey report 92 per cent of Australian growth companies – those scaling up – are backed by either angel or VC investment capital.[34] Angel and VC equity funding, although not exclusively, tends to distinguish entrepreneurial businesses (those innovators aggressively scaling up and growing) and can be seen as a differentiator from the majority of small businesses who play it safe with debt funding and me-too products and services, seeking no or little growth.

While data on angel investment is difficult to acquire, the Sydney Angels group in Australia recently reported that from among their group the average start-up investment was $200 000 for businesses with two founders and a pre-investment valuation of $2.2 million (see Chapter 14 for valuation discussion) and the largest single investment in a start-up was $803 000, as part of a $1 million capital raising.[35] The investments made by Australian angel investors have been characterised by start-ups with demonstrated traction in the marketplace; investment of between $200 000 to $500 000; strong founders and team; and a potential 10 times return on investment.[36] By comparison, the median size of an informal investment in the US is around $700 000 – not too dissimilar to Australia.[37]

However, every entrepreneur should be careful and thorough in their approach to business angels – there are advantages and disadvantages associated with angel financing. Table 13.7 outlines some of the critical pros and cons of dealing with business angels. Only through recognition of these issues will entrepreneurs be able to establish the best relationship with a business angel.

TABLE 13.7 PROS AND CONS OF DEALING WITH ANGEL INVESTORS

Pros:
1 Angels engage in smaller financial deals.
2 Angels prefer seed stage or start-up stage.
3 Angels invest in various industry sectors.
4 Angels are located in local geographic areas.
5 Angels are genuinely interested in the entrepreneur.
Cons:
1 Angels offer no additional investment money.
2 Angels cannot offer any national image.
3 Angels may lack important contacts for future leverage.
4 Angels may want some decision making along with the entrepreneur.
5 Angels are getting more sophisticated in their investment decisions.

NEW FORMS OF ENTREPRENEURIAL CAPITAL

Most entrepreneurship textbooks stop here in their discussions about capital needs. However, it is important to realise that there are increasingly more contemporary ways of viewing capital-raising than venture capital or bank loans. Yes, there are the creative sides of bootstrapping and the 4Fs, but there are also new modalities of funding that are emerging in our fast-changing world. Here we cover such

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Islamic finance. On CourseMate Express read about the history of Islamic entrepreneurship and become familiar with its key terms.

Islamic finance
A financial system that operates according to Islamic law (sharia), which emphasises justice and partnership. Islamic entrepreneurs have very tight strictures on what they may and may not transact as business.

impact investor
A person who invests with the intention to generate a measurable, beneficial social or environmental impact, as well as financial return.

amazing topics as social lending, micro-credit, crowdfunding and the opportunities that cryptocurrencies may present. They are all part of the mix of entrepreneurial capital. Also of interest are the different perspectives on money and finance that cultural variations offer. About one in four people in the world is Muslim, and the study of Muslim entrepreneurship has deepened our knowledge about the cultural aspects of our field.[38] Muslims are taking advantage of a form of ethical investment with ancient roots, but greatly accelerated in the past 20 years in places such as Malaysia and Dubai. Learn more about **Islamic finance** on CourseMate Express.

FINDING AN 'IMPACT INVESTOR'

Particularly since the global financial crisis, there has been increasing interest in ethical and responsible investing practices. If there has been any unseen benefit within that massive financial cloud, it is the wake-up call for investors. Some now look for ways to make an impact that prevents future market meltdowns and avoids catastrophic climate change. The profits are the lure, in addition to the social benefits. The new economy needs innovation and capital to generate jobs and energy independence. There could be millions of jobs in recycling, solar, wind, water and biofuels, as well as in energy conservation (homes and buildings) and greener transportation. Investors are looking for companies that pursue a clear sustainability agenda alongside a traditional financial return.[39]

Entering now to centre stage are the **impact investors**, who seek to produce beneficial social outcomes that would not occur but for their investments in social enterprises.[40] Recent reports have estimated a global market of at least $500 billion for this type of investment over the next decade.[41] True, impact investors have been around for some time. In the past we called this socially responsible investing (SRI), sustainable investing or ethical investing. These are the investors who seek financial return just like traditional VC, but also insist that this return serves the cause of social good.

These ethical investors have various motivations. They don't fund disadvantageous labour conditions, child labour, weapons, alcohol, tobacco, pornography, environmental pollution, unethical business conduct, nuclear power or social inequality. They do fund environmental protection, energy conservation, wind power, conservation of natural resources, advantageous labour conditions, leadership, women at work, improvement of education and social equality.[42]

Globally, the SRI movement has centred on the Principles for Responsible Investment (PRI), which provide a framework for incorporating environmental, social and governance (ESG) issues into investment decision making and ownership practices.[43] Coordinated by the United Nations Environment Programme Finance Initiative and the UN Global Compact, the PRI were designed to align the goals of investors with the sustainable development objectives of the United Nations, addressing in particular human rights, labour standards in the supply chain, environment and anti-corruption. The investors that are part of PRI pledge to:

- incorporate ESG issues into investment analysis and decision-making processes
- be active owners and incorporate ESG issues into their ownership policies and practices
- seek appropriate disclosure on ESG issues by the entities in which they invest
- promote acceptance and implementation of the Principles within the investment industry
- work together to enhance their effectiveness in implementing the Principles
- report on their activities and progress toward implementing the Principles.

SRI investors are actively looking for businesses with social missions that have solid business plans and proven profits as well. How do you find socially responsible investment for your venture? Be sure that your new venture can attract SRI by assessing your environmental, social and ethical policies. You will need to be able to prove that you embrace principles such as environmental sustainability, community activism and shareholder participation and that you have a positive work environment with employee benefits. Network at VC and SRI conferences so that you can present your pitch to investors interested in socially responsible investing.

If your business plan fits the bill, what are the criteria that impact investors have in mind? These are some of the questions they might ask you:

- What evidence do you have that your customers' lives will be measurably better for having used your new product or service innovation?
- Does your business positively impact quality of life and socioeconomic wellbeing at the base of the pyramid?
- Can you give a convincing argument that the product works/delivers value and that you can measure its impact?
- Do you have evidence that existing solutions are not sufficient and that your price point is competitive?
- Have you tested the market to see if your customers will pay for the product?[44]

MICRO-FINANCE AND MICRO-CREDIT

Another funding source that has gained importance, particularly for those in developing countries, is **micro-finance**. Micro-finance providers offer savings, insurance, credit and other basic financial services to the underprivileged. To gain a sense of this market size, self-reported data from institutions across East Asia and the Pacific regions suggests that there was at least USD$18.42 billion of micro-finance loans and 19.85 million active borrowers during 2016.[45]

micro-finance
A full range of banking services for poor people.

Helms distinguishes between four types of micro-finance providers:[46]

- *Informal financial service providers*: moneylenders, pawnbrokers, savings collectors and money-guard services can be costly. Many people lose their money.
- *Member-owned organisations*: self-help groups, credit unions and a variety of hybrid organisations such as financial service associations. They are managed by the underprivileged themselves, but they may have little financial skill.
- *Non-governmental organisation (NGOs)*: Grameen Bank was the forerunner in Bangladesh. NGOs have proven very innovative, pioneering banking techniques such as solidarity lending, village banking and mobile banking that have overcome barriers to serving poor populations.
- *Formal financial institutions*: commercial banks, state banks, agricultural development banks, savings banks, rural banks and non-bank financial institutions. These are regulated and supervised, but often are reluctant to adopt social missions. The banks now see the poor as well as start-up entrepreneurs as valuable 'pre-banking customers' who can be cultivated to become more affluent customers.

For our purposes, a particular subcategory to these services is **micro-credit**, offered by micro-enterprise development programs that give very small loans (micro-loans) to aspiring micro-entrepreneurs. Micro-entrepreneurs are those in poor communities who run or work in small businesses in the informal economy, such as the farmers, fishers, transporters, artisans and street vendors who trade through village and town markets. These entrepreneurs lack minimum deposits or collateral to offer as security to a bank, they are not steadily employed and nor do they have a credit history. It is estimated that over 150 million people across the globe are serviced by around 10 000 micro-finance institutions. Disturbingly though, estimates also suggest that over 500 million micro-entrepreneurs remain excluded from financial services.[47]

micro-credit
Small loans (micro-loans) to aspiring entrepreneurs who lack collateral to offer as security to a bank, who are not steadily employed, who have no credit history or who only need a small loan.

ENTREPRENEURSHIP IN PRACTICE

HOW MICRO-CREDIT WORKS

Gangadhara Kotyan, 34, a school dropout, worked as a salesman in a bookshop in Karnataka's Madanthyar village for a meagre monthly salary of 1500 rupees ($30). 'We were nine children, including five girls,' he says. 'We had to feed them all.' Today he owns a bookshop, and earns about 25 000 rupees ($500) a month.

Kotyan's lot changed when he borrowed from Shri Kshetra Dharmasthala Rural Development Project, a micro-credit agency in Kerala State. With this money, he bought a bookshop and developed his business. 'I have been able to marry off two sisters and raise a rubber plantation and coconut on our land thanks to my business income,' he says. He owns eight acres of farmland now.

He is one of around 2.3 million people lifted out of poverty by a widespread micro-credit movement, launched in 1995 by the Shri Manjunatha Swamy Temple, a famous Hindu centre of worship. The movement, with 230 000 self-help groups, is spread across 16 districts of Karnataka, as well as in Kasargod, Kerala, and is poised to touch 335 000 groups by the end of this fiscal year.

The trust has a field staff of about 6000, all from local villages, who organise the self-help groups and handhold them on a regular basis. 'They help individuals with their business plans, take up livelihood activities, but also inculcate the habit of savings and repayment,' says the Trust's Executive Director.

The members save about 10 to 20 rupees a week, and the self-help groups keep these funds in their individual bank accounts. Where there are no bank branches, the trust manages them. A member can get a loan of anywhere between 10–30 000 rupees. The self-help group the member is attached to provides it from its own savings – if it has enough – or with the assistance of the trust. The trust borrows from a clutch of banks at 12 per cent interest and lends to the groups at 18 per cent. The interest income the trust earns is ploughed back into community welfare projects related to drinking water, sanitation, water purification and the like.

Balasubramanyam, K. R. (2013, 6 January). Self-help groups: In the name of the Lord. *Business Today* (India). http://businesstoday.intoday.in/story/self-help-groups-helping-millions-come-out-of-poverty/1/190759.html. Copyright 2013 by Living Media India Limited. Used by permission.

PEER-TO-PEER LENDING

Social lending is a very twenty-first-century phenomenon. The internet not only levels the playing field; it also can do away with those slow-moving and costly intermediaries known as banks by bringing pools of borrowers together with individual investors.[48] Borrowers who can construct a viable story can influence lenders.

peer-to-peer lending (P2P) Loans typically funded by specific individuals lending their own money on a fractional basis at interest to specific borrowers.

Peer-to-peer lending (P2P) loans are typically funded by a number of individuals coming together on a fractional basis. For example, a loan of $1000 to a specific borrower is often funded by $25 investments from 40 different lenders. Social lending sites charge fees for brokering and servicing loans (around 1 per cent from the lender and 2 to 4 per cent from the borrower) and collect penalties for late payments as well. Loan sizes are generally under $25 000. Loan terms are generally three years, and rates range from 9 to 18 per cent. The relatively small loan amounts and the ease with which people can submit their ideas has led many individuals who otherwise would have avoided pursuing their business venture due to a lack of confidence in their ability to obtain a commercial loan to view social lending as a low-risk mechanism for getting started.

While the use of social lending provides many immediate advantages for entrepreneurs in start-up mode, potential dangers include:

- *Low funding success rate*: Most loans are not completed; the funding success rate is about 10 per cent.
- *Business plan disclosure*: The entrepreneur's business plan is now released to the public domain.
- *No ongoing counselling relationship*: The entrepreneur does not receive any advice or gain experience from the lender, and there are no future rounds of lending or investment.

- *Uncertain regulatory environment*: The law is often way behind advances in technologies and new business models, which leaves the entrepreneur vulnerable to regulatory changes that may have adverse impacts in the future.
- *Lending site track record*: While a company's founding date is not a measure of future performance, you will at least see which ones have established a track record.
- *Unclear terms and conditions*: Frequently asked questions (FAQ) should explain the rules, fees and risks to minimise disappointment.

CROWDFUNDING

A recent financial phenomenon of the twenty-first century and a twist on P2P lending is **crowdfunding**, which makes it possible for entrepreneurs to collect funds through the internet by 'open invitation'. Entrepreneurs finance their projects/ventures and raise the necessary funds by collecting relatively small contributions from a relatively large number of sponsors or investors.[49] The crowdfunding model has three principal parts: the entrepreneur who proposes the idea and/or venture to be funded; individuals or groups who support the idea; and a moderating organisation (the web 'platform') that brings the parties together to launch the idea.[50] These three stakeholders in the process have both incentives and disincentives (see Table 13.8).

crowdfunding
The practice of funding a project or venture by raising monetary contributions from a large number of people, typically via the internet.

TABLE 13.8 CROWDFUNDING INCENTIVES AND DISINCENTIVES FOR THE THREE STAKEHOLDERS

STAKEHOLDER	INCENTIVES	DISINCENTIVES
Creator/entrepreneur	Lower cost of capital Better match between entrepreneurs and investors Access to global funders More and better information increases the funders' willingness Crowdfunding is a good type of market research Gives entrepreneurs valuable feedback on their project Engages potential users in the product design	Entrepreneur typically must disclose their proprietary idea to a larger public Negative repercussions for patentability Gives competitors inside information Entrepreneur must (prematurely) disclose staff names The 'crowd' often has no special industry knowledge compared to professional funders The 'crowd' is atomised individuals, not networks Because there are more investors, there are more 'investor management' issues Entrepreneur must deal with strong personalities
Funder/investor	The funder gains early access to the product and recognition for helping innovation Gives access to otherwise hidden investment opportunities Helps stimulate demand through 'pre-buying' Gives the community a feeling of participation Gives some funders the feeling of being philanthropists Helps formalise the transaction through contracts and terms and conditions Gives the crowdfunding platform a revenue model (typically 4–5%) based on successful transactions	Some creators are just plain incompetent Delays and mismanagement are common Fraudulent and false information is possible without checking Early-stage projects are inherently risky Information is not equally known and shared There is considerable reputation risk with even one failure
Platform/website	Platform can aggregate proposals into a large pool of offers Able to attract a large community of funders and creators Allows the platform to generate publicity and marketing	

Adapted from: Agrawal, A., Catalini, C., & Goldfarb, A. (2014). Some simple economics of crowdfunding. *NBER Innovation Policy & the Economy* (University of Chicago Press), 14(1), 63–97. Copyright University of Chicago Press. Used by permission.

rewards crowdfunding
A simple means of raising funds that utilises an internet platform to source relatively small donated sponsorship amounts from the public in exchange for recognition and small rewards. Particularly useful for innovative products and services to enable market testing for start-up ventures.

equity crowdfunding
A simplified capital-raising instrument that utilises an internet platform to source relatively small capital amounts from the public in exchange for shares (equity) in the venture. Particularly useful for start-up ventures.

sophisticated investor
Wealthy individual who invests more or less regularly in new, early- and late-stage ventures. They are knowledgeable about the technical and commercial opportunities and risks of the businesses in which they invest. They know the kind of information they want about their prospective investment, and they have the experience and ability to obtain and analyse the data.

There are two distinct forms of crowdfunding. In one form, known as **rewards crowdfunding**, an artist, innovator or entrepreneur will seek a target amount of funding to launch a project or business concept without incurring debt or sacrificing equity. This is the most useful channel for those using lean start-up methodology. The funders, usually friends and family or others closely networked, interested in seeing the venture come to fruition, sponsor and donate their funds in return for some type of reward or incentive for participating (e.g. T-shirt, gift card, pre-buy or quantity discounts, public recognition or access to the entrepreneur and the production team). In 2018, the total transaction value of rewards crowdfunding is expected to be USD$9369.6 million across the globe. The number of fundraising campaigns is projected to be around 8.7 million, each raising on average USD$1065.[51]

The second form of crowdfunding is **equity crowdfunding**, which is growing internationally in popularity. In this form, the entrepreneur shares equity in the venture, usually in its early stages, in exchange for the money pledged. Compared to rewards crowdfunding, the 2018 total global transaction value projection is similar at USD$8057 million but the number of equity crowdfunding transactions is far less at 58 570 campaigns and with a much larger average capital raising of USD$137 533.[52] It is equity crowdfunding that we are most concerned with here. Equity crowdfunding has tight regulatory controls and is still, at the time of writing, in Australia, not open to private businesses seeking to raise capital through the sale of equity. However, there is change on the horizon.

In Australia, in September 2017, the *Corporations Amendment (Crowd-sourced Funding) Act 2017* legislation came into effect, which amended the *Corporations Act 2001*, and made minor amendments to the *Australian Securities and Investments Commission Act 2001*, to provide a legislative framework for crowdsourced funding. Under the crowd sourced funding (CSF) regime, *unlisted public companies* (Ltd) can make offers of their shares via an intermediary CSF service by using an offer document. Unlisted public companies with less than $25 million in assets and annual turnover will be eligible to raise funds under the CSF regime. Eligible companies will be able to make offers of ordinary shares to raise up to $5 million in any 12-month period.[53] These businesses are far beyond start-up and the provisions do not currently extend to private companies (Pty Ltd – see Chapter 10) of any size. However, federal parliament is working toward making access to equity crowdfunding for private businesses through new legislation expected to pass during 2018. The new legislation is intended to broaden provisions to private companies, although under strict guidelines.[54]

New Zealand has been far more rapid to advance its legislation. In April 2014, the *Financial Markets Conduct Act 2013* came into force, permitting small businesses to access equity crowdfunding.[55] In both Australia and NZ, the key parts of the respective legislature define the rules and obligations of licensed crowdfunding service providers (CSPs) through which those seeking funding must operate to invite equity offers.

In spite of the promise and predictions, there are numerous critics of crowdfunding. Some in the media warn that equity crowdfunding may be just hype and that it will fail to significantly improve the supply of investment capital or improve the investment return of investors. Reporter Jim Saksa argues, 'Frantic companies will turn to online platforms to find that special someone who'll help pay the bills … exhausting all other options – after their friends spurn their advances, after they strike out with angel investors, after venture capitalists decline a date, and when they can't get so much as a poke on accredited investor portals…'[56] The argument follows the line that when funding fails to appear from close networks and **sophisticated investors**, efforts will turn to unprotected naive investors through equity crowdfunding channels. Therefore, it is wise for any entrepreneur to be aware of the potential concerns and risks that exist with crowdfunding, such as:

- *Reputation*: Reaching financial goals and successfully gathering substantial public support but being unable to deliver on the venture could have a negative impact.
- *IP protection*: Concerns arise about idea theft and protecting intellectual property.
- *Donor dilution*: If the same network of supporters is reached out to multiple times, they will eventually tire of the necessary support.
- *Public fear*: Without a proper regulatory framework, the likelihood of a scam or an abuse of funds is high.[57]

In any event, this new form of equity financing is here to stay and with some predictions of huge growth, crowdfunding may serve as a viable vehicle for raising those early, seed-stage dollars. As with any potential funding mechanism, entrepreneurs must be diligent in their pursuit of complete understanding of the regulations and drawbacks involved with the investments.

Given the increasing interest in equity crowdfunding, here is some solid advice from been-there, done-that crowdsourced entrepreneurs.[58]

- You still need a solid plan. Cocktail napkin plans and whiteboard exercises won't cut it. Use the planning approach presented in this text and be prepared to put in literally hundreds of hours preparing your business plan as well as your promotional material and social media marketing before you even launch an equity crowdfunding campaign.
- You really do need support during the prelaunch phase from prospective backers who are waiting 'with bated breath' for your offer. That means a heavy self-investment in social media marketing and social capital before the train leaves the station. You should have your thought leaders, celebrities and other supporters lined up and ready to back the project. Plus, they should be ready and willing to amplify your messages to their own networks.
- It's all about 'us.com'. Make it personal. People fund people, not just ideas. Use snappy videos to project your passion and enthusiasm and offer the funders rewards and perks to engage them.
- Be ready to respond to (sometimes negative) feedback. Your backers are often ready to offer more than just money. They are a critical resource of ideas and marketing strategy. Make sure you publicise adjustments you are making in response to their advice.
- Don't go 'whole hog' for an impossible amount. Consider a lower funding target. If you achieve your campaign, you can build up a psychological advantage for next steps. Reaching a funding goal means early validation.
- Don't forget your offline world! Most success stories of crowdfunding include very real-world components such as launch parties, roundtables and community events.
- Follow-through is everything. Most backers want behind-the-scenes views through updates and promised rewards.
- Consider follow-up campaigns. Experienced crowdsourced entrepreneurs advise against done-and-gone. It is actually smart to do successive campaigns. It might be wise to have a series of small campaigns that build upon one another toward a larger funding goal.

Bitcoin
A popular digital currency invented to make international monetary exchanges and purchasing easier across the internet. It uses blockchain technology and is one of a class of digital currencies called cryptocurrencies.

CRYPTOCURRENCIES AND BLOCKCHAIN TECHNOLOGY

cryptocurrencies
A class of digital currencies invented to make international monetary exchanges and purchasing easier across the internet.

It is most likely that you have heard of **Bitcoin**, a digital or cyber form of currency that is one of the best-known **cryptocurrencies**. At the time of writing there were 1469 cryptocurrencies with a market capitalisation of nearly USD$612 billion listed on coinmarketcap.com.[59] However, it is not the cryptocurrencies themselves that are of particular interest to this chapter on sources of capital, although

blockchain technology
A digital technology that consists of blocks of information linked and encrypted together to form a chain that records the continuous series of linked transactions right from the original source.

these digital currencies are a different form of financial capital that will possibly become increasingly available to finance new ventures. Rather it is the **blockchain technology** that sits behind many of these currencies that offers potentially interesting new ways of accessing finance for early-stage entrepreneurs.

According to Katherine Purvis of *The Guardian*, 'Blockchain is a digital ledger that provides a secure way of making and recording transactions, agreements and contracts – anything that needs to be recorded and verified as having taken place.'[60] Blockchain technology consists of blocks of information linked and encrypted together to form a chain that records the continuous series of linked transactions right from the original source. Any transaction recorded by blockchain technology instantaneously and securely encrypts and distributes the transaction record onto a digital ledger that resides on multiple computers, simultaneously. The encryption ensures that only the parties involved in the transaction can see the details of the transaction, while those not party to the transaction can only see that the transaction has occurred. The instantaneous distribution and deep encryption ensures that the data cannot the tampered with, as every computer holding the information would need to be hacked simultaneously to avoid detection. In 2016 it was estimated that USD$1 billion was invested into developing the technology and further applications.

The implication of this technology is that transparent and accountable information can be made secure and be encrypted on a public ledger, meaning that it can be trusted and verified.

For entrepreneurs, the use of blockchain technology will mean that capital in the form of cryptocurrencies can be raised from anywhere in the world, more cheaply and easily, with a single digital currency decoupled from geographic currency markets and eliminating international fees and exchange charges. The reliable self-verification system that blockchain provides will also make transactions quicker and more efficient, enabling fund transfer transactions to take minutes in cyberspace rather than filtering through various banks and handling agents. It will not speed up the decision-making process of any funder, but once decisions are made the transactions will be simpler and cheaper.[61]

pyramid scheme
An illegal scheme whereby sellers attract payment from people on the promise of a return on their investment based on their selling to others who also buy into the scheme. This continues in a pyramid fashion, with a percentage or proportion of the sales always flowing to those who recruit sellers. Those at the top collect fees from all those below until there are no further recruits and the sales are saturated. This forces the pyramid to collapse, with no further sellers recruited or funds collected by those at the base of the pyramid. Those at the top, initiating or getting into the scheme early, win; those at the bottom, late into the scheme, lose.

As with all new technology though, caution is needed before rushing out to fund your newest venture with the latest cryptocurrency. There is much discussion in the media around the hype of cryptocurrencies and with it there are signs of weakening value, with some forecasting that this market is a bubble about to burst. Others are signalling that legislators are uncomfortable with the digital currency market, with the likes of the US Securities Commission warning that the currency is not a currency at all but instead a security that falls under securities law. States such as China are outlawing the sale of digital currencies, arguing that they amount to nothing more than a **pyramid scheme** and are engaged in criminal activity. Meanwhile, other states such as Japan are implementing rules for recognising cryptocurrency as a payment method and Sweden and India are purportedly preparing their own cryptocurrency. In addition, the legal fraternity shares concerns about the misused and deceptive language around these currencies and technologies that overstate the benefits and capabilities.[62] As with all innovation, even in the financial markets, there is a vast array of uncertainty and a high degree of risk to be faced for the early adopters.

ENTREPRENEURSHIP IN PRACTICE

EARLY ADOPTERS OF CRYPTOCURRENCY FINANCING

While there are some who believe that cryptocurrencies are a 'bubble' of fraudulent activity, and while regulators do not have clear or compatible approaches about how to deal with this new and emerging technology, there are other brave souls who have wholeheartedly ventured in, investing millions. In 2017, USD$3.2 billion was reportedly sunk into cryptocurrency start-ups, projects and 'initial coin offerings' (ICOs).

Cryptocurrency believers are supporting a new way to fund start-ups through an ICO (rather than the traditional IPO). Some suggest that the technological shift in the currency markets could radically alter the traditional form of the USD$500 billion venture capital market. *Wired* reporter Erin Griffith describes an ICO:

> In most ICOs, entrepreneurs sell ''digital tokens'' related to a service they plan to build using blockchain technology; in some cases, they sell options to buy the tokens. If the service is successful, the value of the tokens will presumably rise, and its creators will have funded their companies without ceding any of their ownership stakes to venture capitalists.

According to PitchBook, crypto start-ups have attracted most of the US-based investor activity during 2016 and 2017. Along with a few traditional VC investors dabbling in the Bitcoin market, there are a number of firms devoted to the blossoming sector. PitchBook claims that '179 US investors have participated in at least one VC deal for a crypto start-up'.

Here is a list of eight pioneering VC crypto deal makers that you can check out:

- Pantera Capital: https://www.panteracapital.com/
- Hard Yaka: https://hardyaka.com/
- Blockchain Capital: http://blockchain.capital/
- Andreessen Horowitz: https://a16z.com/about/
- Union Square Ventures: https://www.usv.com/
- Draper Associates: http://www.draper.vc/
- Boost VC: https://www.boost.vc/about/

Sources: Griffith, E. (2017, September 11). Cryptocurrency mania fuels hype and fear at venture firms. *Wired*. https://www.wired.com/story/cryptocurrency-mania-fuels-hype-and-fear-at-venture-firms/; Clark, K. (2017, December 12). The top venture capital investors in cryptocurrency startups. https://pitchbook.com/news/articles/the-top-venture-capital-investors-in-cryptocurrency-startups.

SUMMARY

The primary focus of this chapter has been on sourcing and acquiring financial capital for an entrepreneurial venture. While all new ventures and businesses will need to acquire capital at some stage either through revenue growth, self-funding or external sources, the entrepreneurial venture is likely to need a significant cash injection at some point either to set up an ambitious new venture, accelerate growth, respond to significant customer demand or expand into new markets. This chapter opened by discussing the various sources of financial capital that may be relevant to different stages of the venture's development and setting out where these different sources sat in a spectrum from very informal to extremely formal sources of capital.

We next looked at the differences between debt and equity financing. Debt financing incurs a repayment obligation of the principal and/or interest of the amount borrowed. Under this category we discussed many formal sources of capital, including commercial bank loans, trade credit, accounts receivable financing, factoring and finance companies, and various forms of equity instruments. Equity financing by contrast acquires money by sharing ownership of the business. We discussed the advantages and disadvantages of public share offerings as a source of equity capital. Although large amounts of money can be raised in short periods, the entrepreneur must sacrifice a degree of control and ownership. Private placements are an alternative means of raising equity capital for new ventures.

A very significant formal source of funds for an entrepreneurial venture is venture capital (VC), and we dedicated a section to discussing this particular source. In recent years the venture capital market has grown dramatically, but the VC market can be volatile. Venture capitalists use a number of different criteria when evaluating new-venture proposals. In the main these criteria focus on two areas: the entrepreneur and the investment potential of the venture. The evaluation process typically involves four stages: initial screening, business plan evaluation, oral presentation and final evaluation.

The chapter then switched to focus on informal sources of capital. Here we introduced the 4Fs as sources of capital: the founder, family, friends and foolhardy. We raised critical issues and approaches that need to be considered when approaching family and friends, and presented some ideas for sourcing funds through bootstrapping (see also Chapter 4). Next we discussed the second-most significant source of capital for entrepreneurial ventures: business angels. Everyone with money to invest in new ventures can be considered a source for this type of capital. Entrepreneurs who are unable to secure financing through banks or through public or private share offerings typically will turn to the business angel market by seeking out friends, associates and other contacts who may have (or know of someone who has) experience and money to invest in a new venture.

We discussed the interesting emerging landscape of new forms of entrepreneurial capital. For many entrepreneurs in Asia, Islamic finance is a definite option. Another important source of capital for entrepreneurs is impact investing from socially responsible investors. Micro-credit and micro-finance lending programs give small loans (micro-loans) to aspiring entrepreneurs who lack collateral to offer as security to a bank, who are not steadily employed, who have no credit history, or who simply need less money and want to know who their investors are. We then examined some very twenty-first-century ways to raise funding, through peer-to-peer lending, two forms of crowdfunding and tapping into the cryptocurrency market emerging through advances in blockchain technology. While all sources of capital have advantages, each also has disadvantages and an entrepreneur should be alert to the drawbacks in their specific choices.

KEY TERMS & CONCEPTS

CourseMateExpress

Review key terms with interactive flashcards.

accounts receivable financing
angel capital
bitcoin
blockchain technology
build-out allowance
business angel
capital
common shares
convertible debentures
corporate angel
crowdfunding
cryptocurrencies
debt financing
disclosure
dividends
due diligence
early-stage financing
enthusiast angel
entrepreneurial angel
equity capital
equity crowdfunding

equity financing
expansion financing
factoring
finance company
financial capital
four Fs
hire purchase
impact investor
informal investor
initial public offering (IPO)
Islamic finance
late-stage funding
liquidity
loans with warrants
long-term debt
micro-credit
micro-finance
micro-management angel
opportunity cost
peer-to-peer lending (P2P)
preferred shares
principal
private equity market
private offerings
private placement
professional angel
promissory note
prospectus
pyramid scheme
return on investment (ROI)
rewards crowdfunding
seed financing
shareholder
shares
sophisticated investor
start-up financing
trade credit
venture capitalist
vertical integration
white knight

REVIEW & DISCUSSION QUESTIONS

1 Identify five different sources of capital and describe the stage of venture development that would most suit each different source.
2 Profile the differences in characteristics between formal and informal investors as sources of capital.
3 If a new venture has its choice between long-term debt and equity financing, which would you recommend? Why?
4 Identify and describe four types of debt financing. Which would you use and why?
5 What are some of the advantages of going public? What are some of the disadvantages?
6 What advantages does venture capital financing offer over finance from an angel investor?
7 Identify and describe four of the most common criteria venture capitalists use to evaluate a proposal.
8 In a new-venture evaluation, what are the four stages through which a proposal typically goes? Describe each in detail.
9 Some entrepreneurs do not like to seek new-venture financing because they feel that venture capitalists are greedy. In your opinion, is this true? Do these capitalists want too much ROI?
10 An entrepreneur is in the process of contacting three different venture capitalists and asking each to evaluate her new business proposal. What questions should she be able to answer about each of the three?
11 Which type of informal investors demand a lower return on investment (ROI)?
12 What are the four Fs and can you identify four-F investors that you know?
13 What are some special considerations in approaching family, friends and the foolhardy for entrepreneurial capital?
14 An entrepreneur of a new venture has had no success in getting financing from formal venture capitalists. He now has decided to turn to the informal risk capital market. Who is in this market? How would you recommend that the entrepreneur contact these individuals?
15 What has given rise to the emergence of the 'Impact Investor' and what, if any, are the differences between them and an angel investor?
16 Why do some entrepreneurs need micro-credit?
17 Define the difference between peer-to-peer lending and crowdfunding.
18 Why would an entrepreneur opt to seek crowdfunding? Describe the types of funds an entrepreneur may expect to achieve through the two main types of crowdfunding.
19 What are the opportunities and risks associated with the new forms of cryptocurrencies for entrepreneurs seeking funds?

EXPERIENCING ENTREPRENEURSHIP

Angel investor versus venture capitalist

Directions: Contact a local venture capital firm to schedule an interview with one of the partners. Then contact the local angel network to schedule an interview with an angel investor. If there is no local angel network, contact one of the respected law firms in your area and ask for a recommended source that could serve as an angel investor for the purposes of this exercise. For each interview, simply find out the answer to each component of the comparison table below.

TOTAL ANNUAL INVESTMENT IN START-UP VENTURES		
	ANGEL	VENTURE CAPITALIST
Total dollars		
Number of investments		
Number of investors		
Per round		
Entities per round		
INDIVIDUAL INVESTMENTS IN START-UP VENTURES		
Investment size per round		
Each investor		
Typical investment stage		

CASE STUDIES

CASE 13.1

LOOKING FOR EARLY-STAGE EXPANSION CAPITAL

When Ananda and Suda Kumar opened their bookstore one year ago in Perth, Western Australia, they estimated it would take six months to break even. Because they had gone into the venture with enough capital to keep them afloat for nine months they were sure they would need no outside financing. However, sales have been slower than anticipated and most of their funds now have been used to purchase inventory or meet monthly expenses. On the other hand, the store is doing better each month and the Kumars are convinced they will be able to turn a profit within six months.

At present, Ananda and Suda want to secure additional financing. Specifically, they would like to raise $100 000 to expand their market channels. The store focuses on how-to-do-it and do-it-yourself (DIY) books and is developing a loyal customer following. However, they feel the local market reach is not large enough to help them grow the business as they planned. The Kumars feel that if they expand into an online store, they can develop both market segments that, when combined, will lift their profitability. Suda is convinced that their chosen market segment has potential and she has tagged news items online and in newspapers and magazines reporting increases in online sales. Suda cites Amazon as an example of the possibilities. People who buy DIY books tend to spend more time online and are prepared to pay to get the best information. Additionally, customer loyalty among this group tends to be very high.

The Kumars own all of their inventory, which has a retail market value of $280 000. The merchandise cost them $140 000. They also have at a local bank a line of credit of $10 000, of which they have used $4000. Most of their monthly expenses are covered out of the initial capital with which they started the business ($180 000 in all). However, they will be out of money in three months if they are not able to get additional funding.

The owners have considered investigating a number of sources. The two primary options are a loan from their bank or approaching their uncle back in Malaysia who has recently sold his highly successful electronics components manufacturing business. However, one of their friends has also mentioned crowdfunding. They know nothing about how to raise money and these are only general ideas that they have been discussing with each other and that they plan to discuss further at the next meeting with their accountant. For the moment, the Kumars are focusing on writing a business plan that spells out their short business history and objectives, and explains how much money they would like to raise and where it would be invested. They hope to complete the plan by the end of the week and take it with them to the accountant. The biggest problem they are having in writing the plan is that they are unsure of how to direct their presentation. Should they aim it at a banker, their uncle or a crowdfunding campaign? After their meeting with the accountant, they plan to refine the plan and direct it toward the appropriate source.

QUESTIONS

1. Would a commercial banker be willing to lend money to the Kumars? How much? On what do you base your answer?
2. What would be the advantages of approaching their uncle and what would be the risks if he said yes? Should they consider debt or equity with a family member?
3. Would a crowdfunding campaign be the right avenue? After all, they want to grow the business online, so why shouldn't they use this same channel to raise funds? Be complete in your answer and describe why or why not this form of capital raising would be suitable.

CASE 13.2

THE 120 MILLION–BAHT VENTURE

The Friendly Market is a large supermarket in a Thai provincial city. 'Friendly's', as it is popularly known, has more sales per square metre than any of its competitors because it lives up to its name. The personnel go out of their way to be friendly and helpful. If someone asks for a particular brand-name item and the store does not carry it, the product will be ordered. If enough customers want a particular product, it is added to the regular line. Additionally, the store provides free delivery of groceries for elderly citizens and credit for those who have filled out the necessary application and have been accepted into the 'Friendly Credit' group.

The owner, Pacapol Anurit, believes that his marketing-oriented approach can be successfully used in any area of the country. He is therefore thinking about expanding and opening two new stores, one in the northern part of the same city and the other in a city located 50 kilometres east. Locations have been scouted and a detailed business plan has been drawn up. However, Pacapol has not approached anyone about providing the necessary capital. He estimates he will need about THB 120 million (AUD$4 million) to get both stores up and going. Any additional funding can come from the current operation, which has a positive cash flow of about THB 4 million monthly.

Pacapol first considers two avenues available to him: debt and equity. His local banker has told him the bank would be willing to look over any business plan he submits and would give him an answer within five working days. Pacapol is convinced he can get the bank to lend him THB 120 million. However, he does not like the idea of owing that much money. He believes he would be better off selling shares to raise the needed capital. Doing so would require him to give up some ownership, but this is more agreeable to him than the alternative.

The big question now is: How can the company raise THB 120 million through a shares offering? Pacapol intends to check into this over the next four weeks and make a decision within eight weeks. A number of customers have approached him over the past year and have asked him if he would consider making a private shares offering. Pacapol is convinced he can get many of his customers to buy into the venture, although he is not sure he can raise the full THB 120 million this way. The other approach he sees as feasible is to raise the funds through an informal investor network connected with the ICC chain of food products. This might be the best way to get such a large sum, but Pacapol wonders how difficult it would be to limit his food range to ICC products on a long-term basis. In any event, as he said to his wife yesterday, 'If we're going to expand, we have to start looking into how we can raise more capital. I think the first step is to identify the best source. Then we can focus on the specifics of the deal.'

QUESTIONS

1 What would be the benefits of raising the THB 120 million through a private placement? What would be the benefits of raising the money through ICC? Are there other creative ways to find a blend of capital raising and adapting the business model?

2 In preparing the business plan for the bank, how would this differ to the approach for a private placement, or for the ICC network? Can he present the same plan?

3 What would you recommend Pacapol do now? Briefly outline a plan of action he can use to get the financing process started.

ONLINE STUDY RESOURCES

CourseMateExpress

Visit http://login.cengagebrain.com and use the access code that comes with this book for 12 months' access to the resources and study tools for this chapter.

The CourseMate Express website contains:

- take it further activities
- revision quizzes
- video activities
- and more!

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CHAPTER 14

VALUING AND HARVESTING ENTREPRENEURIAL VENTURES

If you are too lazy to plough don't expect a harvest.

Proverbs 20:4

CHAPTER OBJECTIVES

1. To identify the underlying core issues involved in the acquisition process
2. To explain the importance and the major considerations in establishing a business' value
3. To highlight the available methods of valuing a venture and examine closely three principal methods currently used in business valuations
4. To consider additional factors that affect a venture's valuation
5. To present the concept of 'harvest' as a plan for the future
6. To examine the ways to develop a succession strategy and the key factors that make a good succession strategy
7. To examine exit strategies, such as an IPO as a potential harvest strategy, and 'selling out' as a final alternative in the harvest strategy

THE CORE ISSUES OF VENTURE ACQUISITION

Venture acquisition will at some point be a dominant concern for any entrepreneur, either because they seek to acquire a venture or because they seek to be acquired. As we demonstrated in Chapter 4, acquisition of a venture is one pathway to entering the entrepreneurial arena. Transferring ownership to the acquirer of the business or any other form of ownership divestment of a venture is the point at which entrepreneurs harvest the value created within the venture. Valuation of a business is a critical issue when a venture is being either bought (acquired) or sold (harvested), in part or in whole.

To appreciate the issues of venture acquisition we first need to consider some key points within the process of acquisition of a venture and how these points influence valuation (see Figure 14.1). At the individual level there are the perspectives and intentions of both the buyer and the seller. At the opportunity level there are the future prospects for the venture and the threats to these prospects that need to be taken into account. Then there is the business itself. Its team, assets, financial position, relationships and so forth need to be fully understood. The key question to ask is: To what extent can the business in its current form address and meet the opportunities and threats?

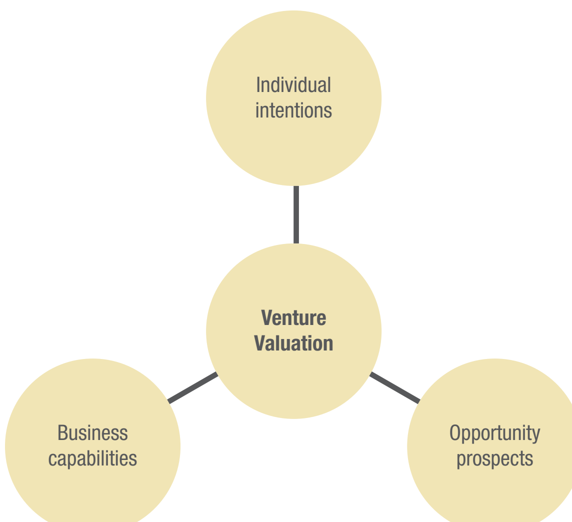

FIGURE 14.1 THE CORE CONCERNS OF VENTURE VALUATION

Later in this chapter, we will look directly at the methods of venture valuation. Regrettably there is not a single approach, and we outline three approaches that use different assumptions. An entrepreneur will need to be aware of these different viewpoints on valuation techniques and be able to assess the appropriate method, as it may be relevant to the situation the entrepreneur faces. In some cases all three methods may be applied to arrive at a decision on the valuation that best reflects the circumstances of the venture and the entrepreneur.

In the concluding sections of the chapter we will move to the point of view of the seller and look at approaches to harvesting the venture that will invariably utilise the different valuation methods. The objective in this closing section is to focus not on the valuation, but rather on the options available to an entrepreneur to exit the business venture, or, in other words, harvest the venture to reap the rewards for all the effort of growing the business.

By gaining an appreciation of the issues of acquisition, the methods of valuation and the options for harvest, you are provided with a holistic view on what it means to harvest value from an entrepreneurial

emotional bias
The tendency of an entrepreneur to believe their enterprise is worth a great deal more than outsiders believe it is worth.

venture. Let's first look at the concerns you may be confronted with in venture acquisition. Three issues influence the valuation of a venture: (1) the differing goals of a buyer and seller, (2) the **emotional bias** of the seller and (3) the reasons for the acquisition.

GOALS OF THE BUYER AND SELLER

In any venture acquisition there are two major parties to the transaction, the buyer and the seller. Both of these parties will assign different values to the enterprise because of their basic objectives. The seller will attempt to establish the highest possible value for the business and is likely to ignore any realistic considerations of the market, the environment or the economy. The buyer, on the other hand, will try to determine the lowest possible price to be paid. The enterprise is regarded as an investment for the buyer through which they will want to maximise value, and he or she must assess the profit potential. The buyer often takes a pessimistic view, and this is reflected in a lower valuation. An understanding of both positions in the valuation process is important.

EMOTIONAL BIAS

The second issue in valuing a business is the emotional bias of the seller. To the seller, the enterprise may represent a lifetime investment – or at the very least one that took a lot of effort. Someone who starts a venture, nurtures it through early growth and makes it a profitable business tends to believe that the enterprise is worth a great deal more than outsiders believe it is worth. Entrepreneurs therefore must try to be as objective as possible in determining a fair value for the enterprise (realising that this fair amount will be negotiable).

REASONS FOR THE ACQUISITION

The third issue in valuing a business is the reason an entrepreneur's business is being acquired.

The following are some of the most common reasons for acquisition:

- Developing more growth-phase products by acquiring a business that has developed new products in the buyer's industry
- Increasing the number of customers by acquiring a business whose current customers will substantially broaden the buyer's customer base
- Increasing market share by acquiring a business in the buyer's industry
- Improving or changing distribution channels by acquiring a business with recognised superiority in the buyer's current distribution channel
- Expanding the product line by acquiring a business whose products complement and complete the buyer's product line
- Developing or improving customer service operations by acquiring a business with an established service operation, as well as a customer service network that includes the buyer's products
- Reducing operating leverage and increasing absorption of fixed costs by acquiring a business that has a lower degree of operating leverage and can absorb the buyer's fixed costs
- Using idle or excess plant capacity by acquiring a business that can operate in the buyer's current plant facilities
- Integrating vertically, either backward or forward, by acquiring a business that is a supplier or distributor

- Reducing inventory levels by acquiring a business that is a customer (but not an end user) and adjusting inventory levels to match the acquired business' orders
- Reducing indirect operating costs by acquiring a business that will allow elimination of duplicate operating costs (e.g. warehousing and distribution)
- Reducing fixed costs by acquiring a business that will permit elimination of duplicate fixed costs (e.g. corporate and staff functional groups).[1]

In summary, it is important that the entrepreneur and all other parties involved objectively view the business' operations and potential. An evaluation of the following points can assist in this process:

- A business' potential to pay for itself during a reasonable period of time
- The difficulties the new owners face during the transition period
- The amount of security or risk involved in the transaction; changes in interest rates
- The effect on the company's value if a turnaround is required
- The number of potential buyers
- Current managers' intentions to remain with the business
- The taxes associated with the purchase or sale of an enterprise.[2]

BUSINESS VALUATION IN PRACTICE

Every entrepreneur should be able to calculate the value of his or her business as well as the value of a competitor's operation. Such **business valuation** is essential in the following situations:

- Buying or selling a business, division or major asset
- Establishing an **employee stock option plan (ESOP)** or profit-sharing plan for employees
- Raising growth capital through stock warrants or convertible loans
- Determining inheritance tax liability (potential estate tax liability)
- Giving a gift of stock to family members
- Structuring a buy/sell agreement with stockholders
- Attempting to buy out a partner
- Going public with the company or privately placing the stock.

Equally important is the entrepreneur's desire to know the real value of the venture. This valuation can provide a scorecard for periodically tracking increases or decreases in the business' value.[3]

business valuation
The calculated value of the business, used to track its increases or decreases.

employee stock ownership plan (ESOP)
Plan for passing control of the enterprise to the employees if the owner has no immediate successor in mind.

ESTABLISHING A BUSINESS' VALUE

An entrepreneur can begin to examine the various methods used to value a business after becoming thoroughly conversant with the strengths, weaknesses, opportunities and threats the venture acquisition offers. The establishment of an actual value is more of an art than a science – estimations, assumptions and projections are all part of the process. The quantified figures are calculated based in part on such hidden values and costs as goodwill, personal expenses, family members on the payroll, planned losses and the like.[4] Several traditional valuation methods are presented in this chapter, each using a particular approach that uncovers these hidden values and costs. Employing these methods will provide the entrepreneur with a general understanding of how the financial analysis of a business works. Remember also that many of these methods are used concurrently and that the *final* value determination will be the actual price agreed on by the buyer and seller.

ENTREPRENEURIAL EDGE

THE VALUATION OF FACEBOOK: REAL OR FANTASY?

In May 2012 the amazingly successful social networking site Facebook, on its first day of trading on the stock market, opened with shares valued at USD$38 per share and a market capitalisation of around USD$81 billion. When trading commenced some investors paid as much as USD$45 a share, which, for a few moments at least, valued the company at more than USD$133 billion. That was equivalent to the valuation of Amazon.com and exceeded the valuation of Hewlett-Packard and Dell combined. Experts argued that the valuation was too high for a company that posted USD$1 billion in profit on revenue of USD$3.7 billion in 2011.

Most valuation experts agreed that a USD$50 billion valuation would have been more in line with the company's true earnings potential. That valuation would have made the original share price closer to USD$20. But the fact that Facebook had many advertisers and built a huge following on their platform provided a solid foundation to build a growth business.

In the initial public offering, Facebook raised USD$16 billion. Facebook's share price was introduced at over 100 times historical earnings versus Apple's stock price, which was 14 times historical earnings. Even with that extremely high price, numerous investors figured that the stock price would soar even higher because Facebook was the leader in social networking, with in excess of 1 billion users (one in seven people on the planet) being projected.

When a software error on Nasdaq OMX U.S. exchange delayed the start of trading by 30 minutes, it sparked claims of 'selective disclosure' about Facebook's slowing revenue growth in the lead up to the initial public offering (IPO) immersing the company in controversy. Perceptions among some investors were that the stock had been overpriced from the beginning.

Facebook's share price began to tumble as concerns surfaced about the social network's long-term business prospects and overpriced initial offering. At one point the share price fell to a low of USD$18.05 in August 2012 but has since been on a steady rise. In July 2017, the company topped a milestone valuation of over USD$500 billion. Yet, at the time of writing (April 2018), Facebook's share price has been hit by privacy scandals arising from the misuse of data by Cambridge Analytica, causing a reduction in market capitalisation of around USD$100 billion. Uncertainty abounds around how regulation may affect this and similar companies and how this in turn will influence users and advertisers in the long term.

Moreover, some analysts predict that the challenges of earning money off smartphone and tablet users may cause difficulties for Facebook in securing large advertisers, where the majority of its revenue is found. But with acquisitions like Instagram and What's App now in the Facebook company portfolio, will Facebook have the metrics to prove and sustain profitability and growth in the future? Only time (and the market) will tell.

Sources: Adapted from: Magid, L. (2012, May 30). Facebook's real value has nothing to do with its stock price. *Forbes*. http://www.forbes.com/sites/larrymagid/2012/05/30/facebooks-real-value-has-nothing-to-do-with-itsstock-price; Barr, A., & Chan, E. (2012, May 29). Facebook shares plumb new depths, valuation questioned. *Reuters*. http://www.reuters.com/article/2012/05/30/us-facebook-shares-idUS-BRE84S0VR20120530. Updated from Pepitone, J. (2012). Facebook trading sets record IPO volume. (2012, May 18). *CNN Money*. http://money.cnn.com/2012/05/18/technology/facebook-ipo-trading/index.htm; Egan, M. (2017, July 27). Facebook and Amazon hit $500 billion milestone. *CNN Money*. http://money.cnn.com/2017/07/27/investing/facebook-amazon-500-billion-bezos-zuckerberg/index.html; Y Charts (2018, 17 February). Facebook (FB). https://ycharts.com/companies/FB/market_cap; Yahoo Finance (2018). Facebook Inc. (FB). https://finance.yahoo.com/quote/FB?ltr=1; Shen, L. (2018, March 26). Facebook stock is in the red for the year after the FTC confirms investigation. *Fortune*. http://fortune.com/2018/03/26/facebook-stock-ftc-investigation-cambridge-analytica/.

ANALYSING A VENTURE FOR ACQUISITION

When considering the acquisition of a venture, an entrepreneur should be aware of three distinct aspects; first, the opportunity and threats in terms of markets and growth prospects; second, the additional and full assessment of strengths and weakness of the venture; and third, the money needed when all things are considered above and beyond the asking price.

To resolve the opportunities and threats provided by a prospective business, an entrepreneur would undertake due diligence, which means a thorough analysis of every facet of the existing business. CourseMate Express provides a due diligence outline that is used to assess the viability of a business plan. Each major segment of the analysis is guided by specific questions relevant to that part.

When analysing small, privately held businesses, entrepreneurs should be aware of the venture's strengths and weaknesses and be careful not to make comparisons with larger corporations. Many factors distinguish small business from large corporations, and valuation factors that have no effect on large businesses may be significantly important to smaller enterprises. For example, many closely held ventures have the following shortcomings:

- Lack of management depth. The degrees of skills, versatility and competence are limited.
- **Undercapitalisation**. The amount of equity investment is usually low (often indicating a high level of debt).
- Insufficient controls. Because of the lack of available management and extra capital, measures in place for monitoring and controlling operations are usually limited.
- Divergent goals. The entrepreneur often has a vision for the venture that differs from the investors' goals or stockholders' desires, thus causing internal conflicts in the business.

undercapitalisation
When a company has insufficient capital to conduct normal business operations and pay creditors.

These weaknesses indicate the need for careful analysis of the small business and how its strengths offset any potential shortcomings. The checklist in CourseMate Express is modelled on the information required for an effective business plan (see Chapter 11) and provides a concise method for examining the various factors that differentiate one business from another, exposing the strengths and weaknesses.

CourseMateExpress

An Analysis Checklist. On CourseMate Express access a comprehensive checklist to fully assess the strengths and weaknesses of a prospective venture.

However, the entrepreneur will also need to assess the viability of the potential purchase. Once the critical areas of strengths, weaknesses, opportunities and threats (SWOT) that need to be addressed are assessed, then how much capital is needed to buy the venture must be determined. Such factors as the future trends of the business, the financial health of the business and the projections for business viability all influence the value of the business. The entrepreneur must understand that the final purchase price is not the only factor that needs to be taken into consideration in determining the amount of capital needed. Repairs, new inventory, opening expenses, working capital, strategy implementation and taxes due are just a few of the additional costs that should be considered. Table 14.1 illustrates some key areas of critical concern in calculating the total amount needed to buy a business venture.[5]

TABLE 14.1 TOTAL AMOUNT NEEDED TO BUY A BUSINESS

Family living expenses	From last paycheck to takeover day	$__________
	Moving expense	$__________
	For three months after takeover day	$__________
Purchase price	Total amount (or down payment plus three monthly instalments)	$__________
Taxes	Stamp duties	$__________
	Goods and services tax (GST) (if applicable)	$__________
Professional services	Escrow, accounting, legal	$__________
Deposits, prepayments, licenses	Last month's rent (first month's rent is in operating expense below)	$__________
	Utility deposits	$__________
	Sales tax deposit	$__________
	Business licenses	$__________
	Insurance premiums	$__________
Takeover announcements	Media advertising	$__________
	Mail announcements	$__________
	Exterior sign changes	$__________
	New stationery and forms	$__________

continue

continue

New strategy implementation	Marketing and channel development	$___________
	Relationships and capability development	$___________
New inventory		$___________
New fixtures and equipment		$___________
Remodelling and redecorating		$___________
Three months' operating expense	Including loan repayments/rent	$___________
Reserve to carry customer accounts		$___________
Cash	Petty cash, change, etc.	Total $___________

Note: Money for living and business expenses for at least three months should be set aside in a bank savings account and not used for any other purpose. This is a cushion to help get through the start-up period with a minimum of worry. If expense money for a longer period can be provided, it will add to peace of mind and help the buyer concentrate on building the business.

VALUATION METHODS

Table 14.2 lists the various methods that may be used for business valuation. Each method is described and key points about them are presented. In this section, specific attention will be concentrated on the three methods that are considered the principal measures used in current business valuations: (1) adjusted tangible assets (balance sheet values), (2) price/earnings (multiple earnings value) and (3) discounted future earnings.

TABLE 14.2 VALUATION METHODS

METHOD	DESCRIPTION/EXPLANATION	NOTES/KEY POINTS
Fixed price	Two or more owners set initial value based on what owners 'think' business is worth Uses figures from any one or a combination of methods Common for buy/sell agreements	Inaccuracies exist due to personal estimates Should allow periodic update
Book value (known as balance sheet method) 1 Tangible 2 Adjusted tangible	1 *Tangible book value*: Set by the business' balance sheet Reflects net worth of the firm Total assets less total liabilities (adjusted for intangible assets) 2 *Adjusted tangible book value*: Uses book value approach Reflects fair market value for certain assets Upward/downward adjustments in plant and equipment, inventory and bad debt reserves	Some assets also appreciate or depreciate substantially, thus not an accurate valuation Adjustments in assets eliminate some of the inaccuracies and reflect a fair market value of each asset
Multiple of earnings	Net income capitalised using a price/earnings ratio (net income multiplied by P/E number) 15% capitalisation rate often used (equivalent to a P/E multiple of 6.7, which is 1 divided by 0.15) High-growth businesses use lower capitalisation rate (e.g. 5%, which is a multiple of 20) Stable businesses use higher capitalisation rate (e.g. 10%, which is a multiple of 10) Derived value divided by number of outstanding shares to obtain per-share value	Capitalisation rates vary as to firm's growth; thus, estimates or P/E used must be taken from similar publicly traded corporation

continue

continue

METHOD	DESCRIPTION/EXPLANATION	NOTES/KEY POINTS
Price/earnings ratio (P/E)	Similar to a return-on-investment approach Determined by price of common stock divided by after-tax earnings Closely held firms must multiply net income by an appropriate multiple, usually derived from similar publicly traded corporations Sensitive to market conditions (prices of stocks)	More common with public corporations Market conditions (stock prices) affect this ratio
Discounted future earnings (discounted cash flow)	Attempts to establish future earning power in current dollars Projects future earnings (five years), calculates present value using a then discounted rate Based on projected 'timing' of future income	Based on premise that cash flow is most important factor Effective method if (1) business being valued needs to generate a return greater than investment and (2) only cash receipts can provide the money for reinvesting in growth
Return on investment (ROI)	Net profit divided by investment Provides an earnings ratio Need to calculate probabilities of future earnings Combination of return ratio, present value tables and weighted probabilities	Will *not* establish a value for the business Does not provide projected future earnings
Replacement value	Based on value of each asset if it had to be *replaced* at current cost Firm's worth calculated as if building from 'scratch' Inflation and annual depreciation of assets are considered in raising the value above reported book value Does *not* reflect earning power or intangible assets	Useful for selling a company that's seeking to break into a new line of business Fails to consider earnings potential Does not include intangible assets (goodwill, patents and so on)
Liquidation value	Assumes business ceases operation Sells assets and pays off liabilities Net amount after payment of all liabilities is distributed to shareholders Reflects 'bottom value' of a firm Indicates amount of money that could be borrowed on a secured basis Tends to favour seller since all assets are valued as if converted to cash	Assumes each division of assets sold separately at auction Effective in giving absolute bottom value below which a firm should liquidate rather than sell
Excess earnings	Developed by the US Treasury to determine a firm's intangible assets (for income tax purposes) Intent is for use only when no better method available Internal Revenue Service refers to this method as a last resort Method does not include intangibles with estimated useful lives (i.e. patents, copyrights)	Method of last resort (if no other method available) Very seldom used
Market value	Needs a 'known' price paid for a similar business Difficult to find recent comparisons Methods of sale may differ – installment versus cash Should be used only as a reference point	Valuable only as a reference point Difficult to find recent, similar firms that have been sold

ADJUSTED TANGIBLE BOOK VALUE

A common method of valuing a business is to compute its net worth as the difference between total assets and total liabilities. However, it is important to adjust for certain assets in order to assess true economic worth, because inflation and depreciation affect the value of some assets.

adjusted tangible book value
A common method of valuing a business, by computing its net worth as the difference between total assets and total liabilities.

goodwill
The residual value created by an owner of a business in terms of their time, effort and public image after the value of the physical and tangible assets is deducted from the total value of a business.

In the computation of the **adjusted tangible book value**, **goodwill**, patents, deferred financing costs and other intangible assets are considered with the other assets and deducted from or added to net worth. This upward or downward adjustment reflects the excess of the fair market value of each asset above or below the value reported on the balance sheet. Following is an example:

	BOOK VALUE	FAIR MARKET VALUE
Inventory	$100 000	$125 000
Plant and equipment	$400 000	$600 000
Other intangibles		−$50 000
Total	**$500 000**	**$675 000**
Excess = $175 000		

Remember that in industry comparisons of adjusted values, only assets used in the actual operation of the business are included.

Other significant balance sheet and income statement adjustments include (1) bad debt reserves; (2) low-interest, long-term debt securities; (3) investments in affiliates; and (4) loans and advances to officers, employees or other companies. Additionally, earnings should be adjusted. Only true earnings derived from the operations of the business should be considered. One-time items (from the sale of a company division or asset, for example) should be excluded. Also, if the company has been using a net operational loss carry forward, then its pre-tax income has not been fully taxed, and this also should be considered.

Upward (or downward) income and balance sheet adjustments should be made for any unusually large bad-debt or inventory write-off, and for certain accounting practices, such as accelerated versus straight-line depreciation.

price/earnings ratio
A method of valuing a business by dividing the price of the common shares in the market by the earnings per share and multiplying the result by the number of shares issued.

ordinary shares
Shares, also known as common shares, that make up the vast majority of financial equity assets traded on the stock exchange. Shareholders with ordinary shares have the normal (or ordinary) rights as set out in the *Corporations Act, 2001*. (See also *common shares*.)

securities
A tradeable financial asset of company equity that includes company shares, bonds and options.

PRICE/EARNINGS RATIO (MULTIPLE OF EARNINGS) METHOD

The **price/earnings ratio (P/E)** is a common method used for valuing publicly held corporations. The valuation is determined by dividing the market price of the **ordinary shares** by the earnings per share. A company with 100 000 publicly listed shares and a net income of $100 000 would have earnings per share of $1. If the share price were $5 per share, the P/E would be 5 ($5 divided by $1). Additionally, since the company has 100 000 shares, the valuation of the enterprise would be $500 000 (100 000 shares multiplied by $5 per share).

The primary advantage of a price/earnings approach is its simplicity. However, this advantage applies only to publicly traded corporations. Privately held companies do not have prices in the open market for their shares and thus must rely on the use of a multiple derived by comparing the business to similar public corporations. This approach has four major drawbacks:[6]

1 The shares of a private company are not publicly traded. They are illiquid and may actually be restricted from sale (that is, not registered with the **securities** agencies, such as the Australian Securities and Investment Commission). Thus, any P/E multiple usually must, by definition, be subjective and lower than the multiple commanded by comparable publicly traded stocks.

2 The stated net income of a private company may not truly reflect its actual earning power. To avoid or defer paying taxes, most business owners prefer to keep pre-tax income down. In addition, the privately held business may be 'overspending' on fringe benefits instituted primarily for the owner's benefit.
3 Company shares that are bought and sold in the public market normally reflect only a small portion of the business's total ownership. The sale of a large controlling block of shares (typical of privately held businesses) demands a premium.
4 It is very difficult to find a truly comparable publicly held company, even in the same industry. Growth rates, competition, dividend payments and financial profiles (liquidity and leverage) will rarely be the same.

When applied to a privately held business, the following is an example of how the multiple-of-earnings method could be used:

Number of ordinary shares issued	100 000
2018 net income	$100 000
15% capitalisation rate assumed	6.7 price/earnings multiple (derived by dividing 1 by 15 and multiplying the result by 100)
Price per share	$6.70
Value of company	100 000 × $6.70 = $670 000

DISCOUNTED EARNINGS METHOD

Most analysts agree that the real value of any venture is its potential earning power. The **discounted earnings method**, more than any other, determines the business' true value. One example of a pricing formula that uses earning power as well as adjusted tangible book value is illustrated in the 'Entrepreneurship in practice: The pricing formula' box.

discounted earnings method
A method of determining the true value of the firm using a pricing formula that includes earning power as well as adjusted tangible book value.

The idea behind discounting the business' cash flows is that dollars earned in the future (based on projections) are worth less than dollars earned today (due to the loss of purchasing power). With this in mind, the timing of projected income or cash flows is a critical factor.

Basically, the discounted earnings method for calculating the value of a venture uses a four-step process:

1 Expected cash flow is estimated. For long-established businesses, historical data are effective indicators, although adjustments should be made when available data indicate that future cash flows will change.
2 An appropriate discount rate is determined. The buyer's viewpoint has to be considered in the calculation of this rate. The buyer and seller often disagree, because each requires a particular rate of return and will view the risks differently. Another point the seller often overlooks is that the buyer will have other investment opportunities to consider. The appropriate rate, therefore, must be weighed against these factors.
3 A reasonable life expectancy of the business must be determined. All businesses have a life cycle that depends on such factors as whether the business is one product/one market or multiproduct/multimarket.
4 The business' value is then determined by discounting the estimated cash flow by the appropriate discount rate over the expected life of the business.[7]

ENTREPRENEURSHIP IN PRACTICE

THE PRICING FORMULA

The following step-by-step process outlines the traditional pricing formula used when calculating the value of a business:

Step 1. Determine the adjusted tangible net worth of the business. (The total market value of all current and long-term assets less liabilities.)

Step 2. Estimate how much the buyer could earn annually with an amount equal to the value of the tangible net worth invested elsewhere.

Step 3. Add to this a salary normal for an owner-operator of the business. This combined figure provides a reasonable estimate of the income the buyer can earn elsewhere with the investment and effort involved in working in the business.

Step 4. Determine the average annual net earnings of the business (net profit before subtracting owner's salary) over the past few years.

This is before income taxes, to make it comparable with earnings from other sources or by individuals in different tax brackets. (But the tax implications of alternative investments should be carefully considered.)

This trend of earnings is a key factor. Have they been rising steadily, falling steadily, remaining constant or fluctuating widely? The earnings figure should be adjusted to reflect these trends.

Step 5. Subtract the total of earning power (2) and reasonable salary (3) from the average net earnings figure (4). This gives the extra earning power of the business.

Step 6. Use this extra earnings figure to estimate the value of the intangibles. This is done by multiplying the extra earnings by what is termed the 'years-of-profit' figure. The years-of-profit multiplier pivots on these points. How unique are the intangibles offered by the business? How long would it take to set up a similar business and bring it to this stage of development? What expenses and risks would be involved? What is the price of goodwill in similar businesses? Will the seller be signing an agreement with a covenant not to compete?

If the business is well established, a factor of five or more might be used, especially if the business has a valuable name, patent or location. A multiplier of three might be reasonable for a moderately seasoned business. A younger but profitable business might merely have a one-year profit figure.

Step 7. Final price equals adjusted tangible net worth plus value of intangibles (extra earnings times years of profit).

EXAMPLE	ENTERPRISE X	ENTERPRISE Y
1. Adjusted value of tangible net worth (assets less liabilities)	2 000 000	2 000 000
2. Earning power at 8%* of an amount equal to the adjusted tangible net worth, if invested in a comparable risk business	160 000	160 000
3. Reasonable salary for owner-operator in the business	50 000	50 000
4. Net earnings of the business over recent years (net profit before subtracting owner's salary)	255 000	209 000
5. Extra earning power of the business (line 4 minus lines 2 and 3)	45 000	−1 000
6. Value of intangibles – using three-year profit figure for moderately well-established business (3 times line 5)	135 000	0
7. Final price (lines 1 and 6)	2 135 000	2 000 000 (or less)

With Enterprise X, the seller receives a value for goodwill because the business is moderately well established and earning more than the buyer could earn elsewhere with similar risks and effort.

continue

continue

With Enterprise Y, the seller receives no value for goodwill because the business, even though it may have existed for a considerable time, is not earning as much as the buyer could through outside investment and effort. In fact, the buyer may feel that even an investment of $2 000 000 – the current appraised value of net assets – is too much because it cannot earn sufficient return.

*This is an arbitrary figure, used for illustration. A reasonable figure depends on the stability and relative risks of the business and the investment picture generally. The rate of return should be similar to that which could be earned elsewhere with the same approximate risk.

ADDITIONAL FACTORS IN THE VALUATION PROCESS

After reviewing these valuation methods, the entrepreneur needs to remember that additional factors intervene in the valuation process and should be given consideration. Presented next are three factors that may influence the final valuation of the venture.

AVOIDING START-UP COSTS

Some buyers are willing to pay more for a business than what the valuation methods illustrate its worth to be. This is because buyers are often trying to avoid the costs associated with start-up and are willing to pay a little more for an existing business. The higher price they pay will still be less than actual start-up costs and also avoids the problems associated with working to establish a clientele. Thus, for some buyers, a known commodity may command a higher price.

ACCURACY OF PROJECTIONS

The sales and earnings of a venture are always projected on the basis of historical financial and economic data. Short histories, fluctuating markets and uncertain environments are all reasons for buyers to keep projections in perspective. It is critical that they examine the trends, fluctuations or patterns involved in projections for sales revenues (higher prices or more customers?), market potential (optimistic or realistic assumptions?) and earnings potential (accurate cost/revenue/market data?), because each area has specific factors that need to be either understood or measured for the accuracy of the projection.

The degree of control, or **control factor**, an owner legally has over the business can affect its valuation. If the owner's interest is 100 per cent or such that the complete operation of the business is under his or her influence, then that value is equal to the enterprise's value. If the owner does not possess such control, then the value is less. For example, buying out a 49 per cent shareholder will not be effective in controlling a 51 per cent shareholder. Also, two 49 per cent shareholders are equal until a 2 per cent 'swing vote' shareholder makes a move. Obviously, minority interests also must be discounted due to lack of liquidity – a minority interest in a privately held corporation is difficult to sell. Overall, it is important to look at the control factor as another facet in the purchase of any interest in a business.

control factor
The degree of control an owner legally has over the firm, which can affect its valuation.

TERM SHEETS IN VENTURE VALUATION

Whenever investors are examining a venture for potential infusion of capital, the value of the venture comes into play. This always involves what is called the **term sheet**. This document outlines the material terms and conditions of a venture agreement. After a term sheet has been executed, it guides legal counsel in the preparation of a proposed final agreement. It then guides the final terms of the agreement, but is not necessarily binding.

term sheet
Document that outlines the material terms and conditions of a venture agreement and lists deal terms in bullet-point format.

letter of intent (LOI)
A non-binding document meant to record two or more parties' intentions to enter into a future agreement based on specified (but incomplete or preliminary) terms. Many LOIs contain provisions that are binding, such as non-disclosure agreements, a covenant to negotiate in good faith or a 'stand-still' provision promising exclusive rights to negotiate.

A term sheet is very similar to a **letter of intent (LOI)** in that they are both preliminary, mostly non-binding documents meant to record two or more parties' intentions to enter into a future agreement based on specified (but incomplete or preliminary) terms. Many LOIs, however, contain provisions that are binding, such as non-disclosure agreements, a covenant to negotiate in good faith or a 'stand-still' provision that promises exclusive rights to negotiate.

The purposes of an LOI may be:

- to clarify the key points of a complex transaction for the convenience of the parties
- to declare officially that the parties are currently negotiating
- to provide safeguards in case a deal collapses during negotiation.

The difference between a term sheet and an LOI is slight and mostly a matter of style: An LOI is typically written in letter form and focuses on the intentions; a term sheet skips most of the formalities and lists deal terms in bullet-point format. To help clarify the concepts of term sheets in the valuation process, the terminology most commonly used in these documents is provided in the following 'Entrepreneurship in practice' box.

ENTREPRENEURSHIP IN PRACTICE

THE TERM SHEET: WHAT DOES IT ALL MEAN?

The following are terms commonly referred to on a 'term sheet'.

- *Price/valuation*: The value of a company is what drives the price investors will pay for a piece of the action. The information used to determine valuation comes out of the due diligence process and has to do with the strength of the management team, market potential, sustainable advantage of the product/service and potential financial returns. Another way to look at valuation is how much money it will take to make the company a success. In the end, the value of a company is the price at which a willing buyer and seller can complete a transaction.

fully diluted
Basis for calculating ownership and valuation in which all securities – including preferred stock, options and warrants – that can result in additional ordinary shares are counted in determining the total amount of shares outstanding.

liquidation preference
When the company is sold or liquidated, the amount that must be distributed to the preferred stockholders before remaining assets are distributed to common stockholders.

- **Fully diluted**: Ownership and valuation is typically calculated on a fully diluted basis. This means that all securities (including preferred stock, options and warrants) that can result in additional common shares are counted in determining the total amount of shares outstanding for the purposes of determining ownership or valuation.
- *Type of security*: Investors typically receive convertible preference shares in exchange for making the investment in a new venture. This type of share has priority over common shares if the company is acquired or liquidated and assets are distributed. The higher priority of the preference shares justifies a higher price, compared to the price paid by founders for common shares. *Convertible* means that the shares may be exchanged for a fixed number of common shares.
- **Liquidation preference**: When the company is sold or liquidated, the preferred shareholders will receive a certain fixed amount before any assets are distributed to the common stockholders; this is known as liquidation preference. A *participating preferred* shareholder not only will receive the fixed amount but will also share in any additional amounts distributed to common shareholders.
- *Dividend preference*: Dividends are paid first to preferred shareholders and then to common shareholders. This dividend may be cumulative, so that it accrues from year to year until paid in full, or non-cumulative and discretionary.
- *Redemption preference*: Redemption preference shares may be redeemed or retired, either at the option of the company or the investors, or on a mandatory basis – frequently at some premium over the initial purchase price of the share. One reason why venture firms want this right is due to the finite life of each investment partnership managed by the firm.

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- *Conversion rights*: Preference shares may be converted into ordinary shares at a certain conversion price, generally whenever the shareholder chooses. Conversion may also happen automatically in response to certain events, such as when the company goes public.
- **Antidilution protection**: The conversion price of the preferred stock is subject to adjustment for certain diluting events, such as share splits or share dividends; this is known as antidilution protection. The conversion price is typically subject to *price protection*, which is an adjustment based on future sales of shares at prices below the conversion price. Price protection can take many forms. One form is called *ratchet* protection, which lowers the conversion price to the price at which any new share is sold, no matter the number of shares. Another form is broad-based *weighted average* protection, which adjusts the conversion price according to a formula that incorporates the number of new shares being issued and their price. In many cases, a certain number of shares are exempted from this protection to cover anticipated assurances to key employees, consultants and directors.
- *Voting rights*: Preference shares have a number of votes equal to the number of ordinary shares into which it is convertible. Preference shares usually have special voting rights, such as the right to elect one or more of the company's directors, or to approve certain types of corporate actions, such as amending the articles of incorporation or creating a new series of preference shares.
- *Right of first refusal*: Holders of preference shares typically have the right to purchase additional shares when issued by the company, up to their current aggregate ownership percentage.
- *Co-sale right*: Founders will often enter into a co-sale agreement with investors. A co-sale right gives investors some protection against founders selling their interest to a third party by giving investors the right to sell some of their shares as part of such a sale.
- *Registration rights*: Registration rights are generally given to preferred investors as part of their investment. These rights provide investors liquidity by allowing them to require the company to register their shares for sale to the public, either as part of an offering already planned by the company (called piggyback rights), or in a separate offering initiated at the investors' request (called demand rights).
- *Vesting on founders' stock*: A percentage of the founders' shares, which decreases over time, can be purchased by the company at cost if a founder leaves the company. This protects investors against founders leaving the company after it gets funded.[8]

antidilution protection
Protection against adjustment of the conversion price of preferred shares as a result of certain diluting events, such as share splits or share dividends. The conversion price is typically subject to 'price protection', which is an adjustment based on future sales of shares at prices below the conversion price.

HARVESTING THE VENTURE: A FOCUS ON THE FUTURE

Well before the entrepreneur becomes entrenched in acquisition and sale of the business, it is best to establish the **harvest strategy** for the venture. This section deals with the planning side of acquisition or the strategy to realise value from the hard work and effort that has gone into building a business. At some point entrepreneurs must realise that the eventual success of their venture will lead them to a decision concerning the future operation and management of the business. A harvest strategy defines how and when owners and investors will realise an actual cash return on their investment. Note that 'harvest' does not mean that the challenges and responsibility of the entrepreneur are over. There are challenging decisions to be made. It may be a decision regarding managerial control and succession for successful continued operations as a privately held business.[9] It may be a desire to initiate a **liquidity event**, through which the venture is able to generate a significant amount of cash for investors. It may be that the venture has grown to a stage at which the possibility of an initial public offering (IPO), which we discussed in Chapter 13, is a reality. Or it may be that the most realistic opportunity is selling the business. In any of these situations, the entrepreneur is confronted with a myriad of choices and possibilities. Although it is impossible for this chapter to answer all of the questions that an entrepreneur faces at this point, because each venture presents a unique set of circumstances, it is the goal of this final section to review some of the more common challenges that confront entrepreneurs during this stage. Thus, we examine the challenge of a management succession strategy and the two most notable harvest strategies for ventures: the IPO and the sale of the venture.

harvest strategy
A strategy of how and when the owners and investors will realise an actual cash return on their investment in a venture.

liquidity event
The way in which an investor plans to close out an investment; also known as 'exit strategy'.

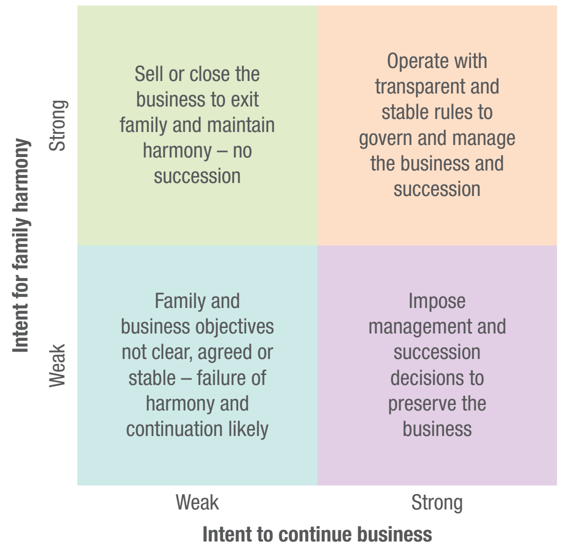
THE MANAGEMENT SUCCESSION STRATEGY

As discussed in Chapter 2, research shows that only 30 per cent of private businesses make it into a second generation, and only 16 per cent make it to a third.[10] One of the major problems most private businesses face is the lack of preparation for passing managerial control to the next generation.The cruel fact is that one generation succeeds the other with biological inevitability, yet most privately held businesses never formulate succession plans.

Management succession, which involves the transition of managerial decision making in a business, is one of the greatest challenges confronting owners and entrepreneurs in privately held businesses. At first glance, succession would not seem to be a major problem. All an owner has to do is designate which heir will inherit the operation or, better yet, train one (or more) of them to take over the business during the founder's lifetime. Unfortunately, this is easier said than done – a number of problems exist. One of the major ones is the owner. If, to a large degree, the owner is the business; the individual's personality and talents make the operation what it is. If this person were to be removed from the picture, the company might be unable to continue. Additionally, this individual may not want to be removed. So, if the owner/manager begins to have health problems or is unable to manage effectively, he or she may still hang on. The owner often views any outside attempt to get him or her to step aside as greedy efforts to plunder the operation for personal gain. What's more, the owner and family members may feel anxiety about death, because discussing the topic of death conjures up a negative image in everyone's mind.

Other barriers to succession include sibling rivalry, family members' fear of losing status or a complete aversion to death for fear of loss or abandonment.[11] Figure 14.2 shows a diversity of responses that can arise through balancing the issues of business continuity and family harmony. Where a family business sits within this matrix suggests the possible pathways forward for business management and succession.

FIGURE 14.2
FAMILY BUSINESS MANAGEMENT AND SUCCESSION



Source: Adapted from Gilding, M., Gregory, S., & Cosson, B. (2015). Motives and outcomes in family business succession planning. *Entrepreneurship: Theory & Practice*, 39(2), 299–312.

The basic rule for private businesses is this: The owner should develop a succession plan. Because many people want to keep the business in their families, decisions have to be made regarding heirs. This is often psychologically difficult. Choosing an heir can be like buying a cemetery plot – it is an admission of one's mortality. Owners who refuse to face the succession issue, however, place an unnecessary burden on those whom they leave behind. Successor problems are not insurmountable. For our consideration of these problems, the best place to begin is with an identification of the key factors in succession.

KEY FACTORS IN SUCCESSION

Be aware that a 'smooth succession' in a business is sometimes a contradiction in terms because succession is a highly charged emotional issue that requires not only structural changes, but cultural changes as well.[12] Succession includes the transfer of ethics, values and traditions along with the actual business itself. The family business and the business family are two distinct components that must be dealt with and disentangled if progress toward succession is to be made.[13]

A number of considerations affect the succession issue.[14] One way to examine them is in terms of pressures and interests inside the business and outside the business. Another way is to examine forcing events. A third way is to examine the sources of succession.

Pressures and interests inside the business

Two types of succession pressures originate within privately held businesses. One comes from the family members; the other comes from non-family employees.[15]

Family members

After giving their children life, directing their every step and investing so much in them, many founders may still be nervous about handing their children control and ownership of their personal and business assets. When members of the family are also employees, a number of succession-type problems can arise. One is that the family members may want to keep the business in existence so that they and their families will be able to manage it. Sometimes this results in the members wanting to get, or increase, control over operations. Another common development is pressure on the owner-manager to designate an heir. A third possible development is rivalry among the various branches of the family. For example, each of the owner's children may feel that the owner should put them (or one of their children) in charge of the operation. Given that only one of the family branches can win this fight, the rivalry can lead to the sale or bankruptcy of the business.[16] Other inside sources of disruption from the family can include marriage, birth, death and divorce of family members.

Non-family employees

Non-family employees sometimes bring pressure on the owner-manager in an effort to protect their personal interests. For example, long-term employees often think the owner should give them an opportunity to buy a stake in the company, or they believe they should be given a percentage of the business in the owner's will. Such hopes and expectations are often conveyed to the owner and can result in pressure for some form of succession plan. Moreover, to the extent that non-family employees are critical to the enterprise's success, these demands cannot be ignored. The owner must reach some accommodation with these people if the business is to survive.[17]

Succession pressures and interests outside the business

Outside the business, both family members and non-family elements exert pressure on and hold interest in the company's succession.

Family members

Even when family members do not play an active role in the business, they can apply pressure. Quite often these individuals are interested in ensuring that they inherit part of the operation and they will put pressure on the owner-manager toward achieving that end. In some cases they pressure in order to get involved in the business. Some family members will pressure the owner-manager to hire them. Quite often these appeals are resisted on the grounds of the company not needing additional personnel or needing someone with specific expertise (sales ability or technical skills) and thus the owner sidesteps the request.

Non-family elements

Another major source of pressure comes from external environmental factors. One of these is competitors who continually change strategy and force the owner-manager to adjust to new market considerations. Other factors include customers, technology and new product development, public policy changes, economic upheavals and technological innovation. These forces continually change and the entrepreneur must respond to them. Tax laws, regulatory agencies and trends in management practices constitute still other elements with which the owner-manager must contend.[18]

These disruptions may be either good or bad. In either case, they require a response from both the family and the business. The extent of overlap between the family and the business will vary from family business to family business. In privately held businesses, where the prevailing orientation is to keep the family and the business separate, the pressures are reduced. Conversely, in privately held businesses characterised by great overlap between the family and business, the pressures on both the business and family can be considerable.

Continuation of the business and family relationship results from the confluence of family success, business success and appropriate responses to disruptions. In other words, sustaining the business and the family relationships requires simultaneous consideration of the family and the business. It also requires consideration of the ability of the family and business to cooperate in responding to disruptions in a way that does not impede the success of either.[19]

Forcing events

forcing events
Unavoidable events that cause the replacement of the owner-manager, such as death, illness, legal problems or poor mental health.

Forcing events are those happenings that cause the replacement of the owner-manager. These events require the entrepreneur to step aside and let someone else direct the operation. The following are typical examples:

- death, resulting in the heirs immediately having to find a successor to run the operation
- illness or some other form of non-terminal physical incapacitation
- mental or psychological breakdown, resulting in the individual having to withdraw from the business
- abrupt departure, such as when an entrepreneur decides, with no advance warning, to retire immediately
- legal problems, such as incarceration for violation of the law
- severe business decline, resulting in the owner-manager deciding to leave the helm
- financial difficulties, resulting in lenders demanding the removal of the owner-manager before lending the necessary funds to the enterprise.

These types of events are often unforeseen and the family seldom has a contingency plan for dealing with them. As a result, when they occur they often create major problems for the business. A key motto should be 'Always be prepared', as factors such as these influence the environment within which the successor will operate. Unless that individual and the environment fit well, the successor will be less than maximally effective.

Sources of succession

An **entrepreneurial successor** is someone who is high in ingenuity, creativity and drive. This person often provides the critical ideas for new product development and future ventures. The **managerial successor** is someone who is interested in efficiency, internal control and the effective use of resources. This individual often provides the stability and day-to-day direction needed to keep the enterprise going.

entrepreneurial successor
A successor to a venture who is highly gifted with ingenuity, creativity and drive.

managerial successor
A successor to a venture who is interested in efficiency, internal control and the effective use of resources.

When looking for an inside successor, the entrepreneur usually focuses on a son, daughter, nephew or niece with the intent of gradually giving the person operational responsibilities followed by strategic power and ownership. An important factor in the venture's success is whether the founder and the heir can get along. The entrepreneur must be able to turn from being a leader to being a coach, from being a doer to being an adviser. The heir must respect the founder's attachment to the venture and be sensitive to this person's possessive feelings. At the same time the heir must be able to use their entrepreneurial flair to initiate necessary changes.[20]

When looking ahead toward choosing a successor from inside the organisation, the founder often trains a team of executive managers consisting of both family and non-family members. This enables the individual to build an experienced management team capable of producing a successor. The founder assumes that, in time, a natural leader will emerge from the group.[21]

Sometimes the founder will look for a non-family outsider to be the successor, perhaps only temporarily. The entrepreneur may not see an immediate successor inside the company and may decide to hire a professional manager, at least on an interim basis, while waiting for an heir to mature and take over.

Another form of non-family outsider is the specialist who is experienced in getting ventures out of financial difficulty. The founder then usually gives the specialist total control, and this person later hands the rejuvenated venture to another leader.

Still another non-family approach is for the founder to find a person with the right talents and to bring this individual into the venture as an assistant, with the understanding that they will eventually become president and owner of the venture. No heirs may exist, or perhaps no eligible family member is interested.

ENTREPRENEURIAL EDGE

THE CHALLENGE OF NAVIGATING SUCCESSION

The succession planning process is a challenge for any organisation, but especially for a family business. Retaining a core culture for the business, while also ensuring the whole process is handled in a neutral manner, is one of the biggest challenges an organisation can face.

Research from PricewaterhouseCoopers (PwC) found that 47 per cent of family businesses in Australia don't have a succession plan in place. Further, only three in every 10 family businesses have a documented succession plan, while only 18 per cent describe their succession process as robust.

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Succession is sometimes assisted by external advisors, and The Executive Connection (TEC) were instrumental in assisting one of its members, Zina Hopgood of Bev Marks Beds, to navigate the succession process. Zina says the successful transition was due to receiving the support she needed to assume the new responsibility. Having an impartial outsider can help.

Identifying a successor

Among the first, and most challenging, processes when handing over the reins of a business is to select a successor. For many organisations, this is the hardest part of the process, as many may find it difficult to balance family concerns against the need to find the right candidate for the position.

Zina came to the Managing Director role after a lengthy succession process, overseen by her father. The selection process began when her father approached her directly about taking over his role within the company. Instead of completing an internal selection process, Zina and her father worked together to win over both the other family members and business partners who were involved in the company.

'David, my father, came to me and said, "We need to start talking about succession planning and I need someone who can replace me who has vision and can be creative and who is not just day-to-day but can plan ahead"', said Zina.

'We then took the plan to [the family and business partners] and said "This is the succession plan, how do you feel about it?" and we started putting in the stepping stones from there.'

For Zina, the process of being selected as the successor for the business was just the beginning – the next step was to embark on the plan that would see her assume a leadership role. Zina received training for the position over an extended period of time.

Embarking on a structured mentoring programme

Once Zina had been selected for the role officially, the succession process began. It involved her working with her father over four years in order to learn the skills needed to eventually assume the position leading the company.

A major part of this process also involved communicating with different levels to explain why they were pursuing the succession strategy. Zina spent time working with her father in order to learn the ropes and understand the business' strengths.

'There were lots of steps that came with transitioning into this role. There's lots of tiers to the business, so we had to ask, "How can they see the changing of the guard?"' said Zina. 'We made a point of building that trust with them and making sure they feel like they can talk to me and, equally, if I'm not happy with something I can say that to them.'

What can other family businesses do?

For Zina, the process has given her valuable insights into what makes for a successful succession process.

Having gone through the experience, Zina also thinks it's important for succession plans to move at their own pace, rather than be forced into a timeline.

'In my experience, I would say "don't rush" – if you're on a timeline and it isn't working for you it makes it really difficult to get it done, especially if everyone is fighting against it.'

Clearly there are a whole range of different factors that a family business will need to consider when looking to hand over the business. From the process of selecting a candidate through to establishing a plan to hand over responsibility to the next generation, finding the right strategy for the situation is vital for every family business.

Source: Adapted from TEC (n.d.). Succession planning creates strong family businesses. http://tec.com.au/succession-planning-creates-strong-family-businesses/.

DEVELOPING A SUCCESSION STRATEGY

As we can see, succession is a viable pathway for entrepreneurial ventures. Helping your relatives to develop a succession strategy involves several important steps: (1) understanding the contextual aspects, (2) identifying successor qualities and (3) understanding influencing forces and carrying out the succession plan.[22]

Understanding the contextual aspects

Here are the five key contextual aspects that must be considered for an effective succession.

Time

The earlier the entrepreneur begins to plan for a successor, the better the chances of finding the right person. The biggest problem the owner faces is the prospect of events that force immediate action and result in inadequate time to find the best replacement.

Type of venture

Some entrepreneurs are easy to replace; some cannot be replaced. To a large degree, this is determined by the type of venture. An entrepreneur who is the 'ideas person' in a high-tech operation is going to be difficult to replace. The same is true for an entrepreneur whose personal business contacts throughout the industry are the key factors in the venture's success. On the other hand, a person running an operation that requires a minimum of knowledge or expertise usually can be replaced without much trouble.

Capabilities of managers

The skills, desires and abilities of the replacement will dictate the future potential and direction of the enterprise. As the industry matures, the demands made on the entrepreneur may also change. Industries where high tech is the name of the game often go through a change in which marketing becomes increasingly important. A technologically skilled entrepreneur with an understanding of marketing, or with the ability to develop an orientation in this direction, will be more valuable to the enterprise than will a technologically skilled entrepreneur with no marketing interest or background.

Entrepreneur's vision

Most entrepreneurs have expectations, hopes and desires for their organisation. A successor, it is hoped, will share this vision, except, of course, in cases where the entrepreneur's plans have contributed to the organisation getting into trouble and a new vision is needed. An example is Apple Computer Inc., where one of the founders, Steve Jobs, was replaced by John Sculley because the board of directors felt that a more managerial, day-to-day entrepreneur was needed to replace the highly conceptual, analytical Jobs. As history now records, Steve Jobs returned later to lead Apple through some spectacular achievements.

Contextual factors

Sometimes a successor is needed because the business context changes and a parallel change is needed at the top. The Sculley-Jobs example is one case in point. Another is that of Edwin Land of Polaroid. Although his technological creativity had made the venture successful, Land eventually had to step aside for someone with more marketing skills. In some cases owners have had to allow financial experts to assume control of the venture because internal efficiency was more critical to short-run survival than was market effectiveness.

WRITING A SUCCESSION STRATEGY

Contextual elements prepare the entrepreneur to develop a management continuity strategy and policy. A written policy can be established using one of the following strategies.

- The owner controls the *management continuity strategy* entirely. This is very common, yet legal advice is still needed and recommended.
- The owner consults with selected family members. Here, the legal adviser helps to establish a liaison between family and owner in constructing the succession mechanism.
- The owner works with professional advisers. This is an actual board of advisers from various professional disciplines and industries that works with the owner to establish the mechanism for succession (sometimes referred to as a 'quasi-board').[23]

- The owner works with family involvement. This alternative allows the core family (blood members and spouses) to actively participate in and influence the decisions regarding succession.

If the owner is still reasonably healthy and the company is in a viable condition, the following additional actions should be considered.

buy/sell agreements
An agreement designed to handle situations in which one or more of the entrepreneurs wants to sell their interest in the venture.

- The owner formulates **buy/sell agreements** at the very outset of the company, or soon thereafter, and whenever a major change occurs. This is also the time to consider an appropriate insurance policy on key individuals that would provide the cash needed to acquire the equity of the deceased.
- The owner considers employee stock ownership plans (ESOPs). If the owner has no immediate successor in mind and respects the loyalty and competence of his or her employees, then an appropriate ESOP might be the best solution for passing on control of the enterprise. After the owner's death, the employees could decide on the management hierarchy.
- The owner sells or liquidates the business when losing enthusiasm for it, but is still physically able to continue. This could provide the capital to launch another business. Whatever the owner's plans, the business would be sold before it fails due to lack of interest.
- The owner sells or liquidates after discovering a terminal illness, but still has time for the orderly transfer of management or ownership.[24]

Legal advice is beneficial for all of these strategies, but of greater benefit is having advisers (legal or otherwise) who understand the succession issues and are able to recommend a course of action.

Entrepreneurial founders of privately held businesses often reject thoughts of succession. However, neither ignorance nor denial will change the inevitable. It is therefore crucial for entrepreneurs to design a plan for succession very carefully. Such plans prevent flourishing privately held businesses from becoming a statistic of diminishing family dynasties.

ENTREPRENEURIAL EDGE

USING BUY/SELL AGREEMENTS

Many entrepreneurs owe their continued success to the combined skills of two or more owners. But did any owner, at the inception of the venture, contemplate involuntarily continuing the business with a co-owner's children? With a co-owner 's ex-spouse? With a co-owner's creditors? Probably not. But smart entrepreneurs plan ahead, in order to deal with issues of control that may unpredictably arise by virtue of one of the 'four Ds': disability, death, dissolution and debtorship. Should a co-owner become disabled, die, be involved in a marital dissolution or have assets seized by his or her creditors, ownership of his or her interest in the business may be in jeopardy of transfer to one or more third parties. Fortunately, it is possible (and imperative) that the parties take the steps necessary to assure that the transfer of any ownership interest in the business is carried out in a way that protects the future of the business, the ownership interests of remaining shareholders and the financial security of the departing owner's family. A buy/sell agreement can provide just such protection. It ensures that, in the event of one of these 'triggering events', interest in a privately held business is transferred in a manner that is advantageous to all involved parties. The buy/sell agreement is normally funded by an insurance policy that ensures the buying party has the funds to purchase if a triggering event occurs. This type of agreement can be designed to address the following:

1 The remaining shareholder(s) has (have) the first right to retain the ownership interest.
2 The departing owner (or beneficiaries) receives a fair market price for the ownership interest.
3 Lawsuits and disputes that could threaten the company's existence are avoided.
4 Funds are available to purchase the ownership interest.

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Legal counsel is necessary to ensure that a buy/sell agreement addresses all of the unique circumstances of a particular company.

The two basic types of agreements are the cross-purchase agreement, in which the shareholders are obligated to purchase the departing owner's shares, and the corporate entity redemption agreement, in which the company is obligated to purchase the departing owner's shares. Each case has certain advantages, disadvantages and tax implications that need to be considered, and some agreements include 'blended' options and obligations for such purchases. Thus, both a lawyer and a tax accountant should be consulted.

Source: Owens, T. (1991). Buy–sell agreements. *Small Business Reports,* January, 57–61; and Need, M. E. (2015). Elmore Entrepreneurship Law Clinic Director, Indiana University–Bloomington, 2015; RetireLaw (2018). Buy/sell agreements. http://www.findlaw.com.au/articles/1490/buysell-agreements.aspx.

Consider outside help

Promotion from within is a morale-building philosophy. Sometimes, however, it is a mistake. When the top person does a poor job, does promoting the next individual in line solve the problem? The latter may be the owner-manager's clone. Alternatively, consider family-owned businesses that start to outgrow the managerial ability of the top person. Does anyone in the business really have the requisite skills for managing the operation? The questions that must be answered are: 'How can the business be effectively run?' and 'Who has the ability to do it?' Sometimes answering these questions calls for an outside person. Family businesses also face the ever-present ego factor.[25] Does the owner-manager have the wisdom to step aside and the courage to let someone else make strategic decisions? Or is the desire for control so great that the owner prefers to run the risks associated with personally managing the operation? The lesson is clear to the dispassionate observer; unfortunately, it is one many owners have had to learn the hard way.[26]

THE EXIT STRATEGY: LIQUIDITY EVENTS

It is true that most entrepreneurs are focused on launching and growing their ventures rather than the plan for exiting the venture in the years to come. However, an **exit strategy** is always of prime importance to outside investors. Investors' commitment to capital will always reside on the confidence that they will recover their initial investment with a healthy profit. Entrepreneurs need to be aware that an exit strategy *for* the venture may mean the entrepreneur's exit *from* the venture as well.

exit strategy
Method by which the initial investors in a company can liquidate their investment. The two most common exit strategies are either to take the company public by an initial public offering (IPO) or to sell the company to another firm.

An exit strategy is defined as that component of the business plan where an entrepreneur describes a method by which investors can realise a tangible return on their investment. The questions of how much, when and how need to be addressed. Investors always want to convert their share of the investment into a more 'liquid' form, known as a liquidity event, which refers to the positioning of the venture for the realisation of a cash return for the owners and the investors. This 'event' is most often achieved through an IPO or complete sale of the venture. In either scenario, the entrepreneur must seek professional advice and legal counsel due to the significant regulations and legal parameters involved. For our purposes, we delve into the basic concepts involved with each of these liquidity events.

THE INITIAL PUBLIC OFFERING (IPO)

As we covered in Chapter 13, many entrepreneurs have sought capital through the public markets. Just to reiterate, the term initial public offering (IPO) is used to represent the registered public offering of a company's securities for the first time. There is tremendous volatility within a stock market and entrepreneurs should be aware of the matters that confront them when they pursue an IPO strategy to raise funds. Entrepreneurs need to be aware of the more rigorous requirements involved with managing the business and disclosure of information when going public.

For instance, in Australia, The Australian Securities and Investment Commission (ASIC) oversees the process of IPO and provides a set of listing rules in accordance with the *Corporations Act 2001*. Companies going public will nearly always be required to complete and lodge a prospectus with ASIC, which is used by ASIC to enforce certain regulatory standards that build trust and maintain confidence among the investor markets. There are a number of matters a company must consider when thinking about going public, including whether the existing company is an adequate vehicle or whether a new holding company might be required. Do the financial reporting systems and governance structures need review and alignment to the requirements of a listed company to meet the obligations of transparency and market expectations? Does the board membership and senior management composition hold the right combination of skills and experience for a public company? There may be a need for independent directors to be appointed, for instance, or training needed for those holding certain positions. Those companies that establish the appropriate financial reporting systems and corporate governance policies, and are led by directors and managers who are trained to adhere to the requirements and regulations, are most likely to avoid trouble when their shares are traded in a public market.[27]

ASIC provides a guide (Regulatory Guide 228: Prospectuses: Effective disclosure for retail investors) that outlines the key areas and requirements that a prospectus must cover and adhere to, including:[28]

retail investor
Formally, an individual or small business that is not a wholesale investor; generally a high-wealth individual who is not acting as an institutionalised, professional investor. A wholesale investor must meet the test of individual wealth of at least $2.5 million in net assets, or a gross income for each of the last two financial years of at least $250 000 per annum.

- Be clear, concise and effective: A prospectus must be designed to help **retail investors** make informed investment decisions and be set out in a way that is easy to read and comprehend.
- Provide an investment overview: It must highlight specific and necessary key information for retail investors to enable them to make a fully informed decision.
- A clear business model: It will need to clearly show how the business will make money and consequently generate income or capital growth for investors
- Explain the risks: It will need to detail the risks associated with your business model, the security and the offer.
- Disclose financial information: Detail the financial position, performance and prospects for the company.
- Declare the directors and key managers, interests, benefits and related party transactions. Retail investors are entitled to know whether those in control have the appropriate expertise, and who will benefit and how among the management team and Board of Directors.
- Clarity around the offer: Describe clearly the effect and terms and conditions of the offer.

Entrepreneurs who pursue the public securities route should be prepared for these reporting requirements, disclosure statements, and shared control and ownership with outside shareholders.

COMPLETE SALE OF THE VENTURE

After considering the various succession ideas presented in this chapter, as well as the potential for an IPO, many privately held business entrepreneurs choose a harvest strategy that involves complete sale of the venture. If this becomes the proper choice for an entrepreneur (keep in mind that it may be the best decision for an entrepreneur who has no interested family members or key employees), then the owner needs to review some important considerations. The idea of 'selling out' actually should be viewed in the positive sense of 'harvesting the investment'.

Entrepreneurs consider selling their venture for numerous reasons. Based on 1000 business owners surveyed, some of the motivations are (1) boredom and burnout, (2) lack of operating and growth capital, (3) no heirs to leave the business to, (4) desire for liquidity, (5) aging and health problems and (6) desire to pursue other interests.[29]

Whether it is due to a career shift, poor health, a desire to start another venture, or retirement, many entrepreneurs face the sellout option during their entrepreneurial lifetime. This harvesting strategy needs to be carefully prepared in order to obtain the adequate financial rewards.[30]

Steps for selling a business

There are generally eight recommended steps for the proper preparation, development and realisation of the sale of a venture.[31]

Step 1: Prepare a financial analysis

The purpose of such an analysis is to define priorities and forecast the next few years of the business. These fundamental questions must be answered:

- What will executive and other workforce requirements be, and how will we pay for them?
- If the market potential is so limited that goals cannot be attained, should we plan an acquisition or develop new products to meet targets for sales and profits?
- Must we raise outside capital for continued growth? How much and when?

Step 2: Segregate assets

Tax accountants and lawyers may suggest the following steps to reduce taxes:

- Place real estate in a separate corporation, owned individually or by members of the family.
- Establish a leasing subsidiary with title to machinery and rolling stock. You can then lease this property to the operating company.
- Give some or all of the owner's shares to heirs when values are low, but have the owner retain voting rights. Thus, when a sale is made, part or all of the proceeds can go directly to another generation without double taxation.
- Hold management's salaries and fringe benefits at reasonable levels to maximise profits.

Step 3: Value the business

The various methods used to value a venture were discussed earlier in this chapter. Obviously, establishing the valuation of a company constitutes a most important step in its sale.

Step 4: Identify the appropriate timing

Knowing when to offer a business for sale is a critical factor. Timing can be everything. A few suggestions follow:

- Sell when business profits show a strong upward trend.
- Sell when the management team is complete and experienced.
- Sell when the business cycle is on the upswing, with potential buyers in the right mood and holding excess capital or credit for acquisitions.
- Sell when you are convinced that your company's future will be bright.

Step 5: Publicise the offer to sell

A short prospectus on the company that provides enough information to interest potential investors should be prepared. This prospectus should be circulated through the proper professional channels: bankers, accountants, lawyers, consultants and business brokers.

Step 6: Finalise the prospective buyers

Enquiries need to be made in the trade concerning the prospective buyers. Character and managerial reputation should be assessed to find the best buyer.

Step 7: Remain involved through the closing

Meeting with the final potential buyers helps to eliminate areas of misunderstanding and to negotiate the major requirements more effectively. Also, the involvement of professionals such as attorneys and accountants usually precludes any major problems arising at the closing.

Step 8: Communicate after the sale

Problems between the new owner and the remaining management team need to be resolved to build a solid transition. Communication between the seller and the buyer and between the buyer and the current management personnel is a key step.

In addition to these eight steps, an entrepreneur must be aware of the tax implications that arise from the sale of a business. For professional advice, a tax accountant specialising in business valuations and sales should be consulted.

The eight steps outlined here, combined with the information on valuation included in this chapter, will help entrepreneurs harvest their ventures. The steps provide a clear framework within which entrepreneurs can structure a fair negotiation leading to a sale. If the purpose of a valuation is to sell the business, then the entrepreneur must plan ahead and follow through with each step.

SUMMARY

Entrepreneurs need to understand how to value a business for either purchase or sale. Many would like to know the value of their businesses. Sometimes this is strictly for informational purposes, and other times it is for buying or selling a business operation. In any case, a number of ways of valuing an enterprise exist.

We outlined three major considerations with respect to understanding the venture acquisition process and venture valuation. The first was to appreciate the differing perspectives between buyers and sellers. The second was to gain a fully developed understanding of the prospects for growth, expansion or development of the venture. The third involved becoming completely familiar with the strengths and weaknesses of the venture in question.

We next examined how to establish a value of a business. Table 14.2 set forth 10 methods for the valuation of a venture. Three of the most commonly used are (1) adjusted tangible assets, (2) P/E (multiple of earnings) and (3) discounted future earnings.

The adjusted tangible book value method computes the value of the business by revaluing the assets and then subtracting the liabilities. This is a fairly simple, straightforward process.

The P/E method divides the market price of the ordinary shares by the earnings per share and then multiplies by the number of shares issued. For example, a company with a price/earnings multiple of 10 and 100 000 shares of stock would be valued at $1 million.

The discounted earnings method takes the estimated cash flows for a predetermined number of years and discounts these sums back to the present using an appropriate discount rate. This is one of the most popular methods of valuing a business. Other factors to consider for valuing a business include start-up costs, accuracy of projections and the control factor.

This chapter also focused on the harvesting of the venture. Beginning with the issue of management succession as one of the greatest challenges for entrepreneurs, a number of considerations that affect succession were discussed. Using privately held businesses as the focal point in this chapter, key issues such as family and non-family members – both within and outside the business – were identified to show the unique pressures on the entrepreneur. Some family members will want to be put in charge of the operation; others simply want a stake in the enterprise.

Two types of successors exist: An entrepreneurial successor provides innovative ideas for new product development, whereas a managerial successor provides stability for day-to-day operations. An entrepreneur may search inside or outside the family as well as inside or outside the business. The actual transfer of power is a critical issue, and the timing of entry for a successor can be strategic.

Developing a succession plan involves understanding these important contextual aspects: time, type of venture, capabilities of managers, the entrepreneur's vision and environmental factors. Also, forcing events may require the implementation of a succession plan, regardless of whether or not the business is ready to implement one. This is why it is so important to identify successor qualities and develop a succession plan in advance.

The concluding sections to this chapter moved to discuss the exit and harvest options for an entrepreneur and considered two specific approaches: the initial public offering (IPO) and the complete sale of the business. The IPO is a common way to provide investors in the company a way out, an exit, to sell their shares on the public market and raise further funding for venture growth and expansion. However, an IPO process should not be underestimated, as it takes time and requires careful planning and adherence to rigorous regulatory requirements of disclosure and transparency. A publicly floated company needs particular and exemplary management performance and behaviour.

The chapter closed with a discussion of the entrepreneur's decision to sell out. The process was viewed as a method to 'harvest' the investment, and eight specific steps were presented for entrepreneurs to follow.

KEY TERMS & CONCEPTS

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adjusted tangible book value
antidilution protection
business valuation
buy/sell agreements
control factor
discounted earnings method
emotional bias
employee stock ownership plan (ESOP)
entrepreneurial successor
exit strategy
forcing events
fully diluted
goodwill
harvest strategy
letter of intent (LOI)
liquidation preference
liquidity event
managerial successor
ordinary shares
price/earnings ratio (P/E)
retail investor
securities
term sheet
undercapitalisation

REVIEW & DISCUSSION QUESTIONS

1 Identify and discuss the three underlying issues in the acquisition of a business.
2 Define the term 'due diligence'. How is it applied to the acquisition of an existing venture?
3 To analyse a business, what types of questions or concerns should the entrepreneur address in the following areas: history of the business, market and competition, sales and distribution, management, and finances?
4 One of the most popular methods of business valuation is the adjusted tangible book value. Describe how this method works.
5 Explain how the P/E method of valuation works. Give an example.
6 What are the steps involved in using the discounted earnings method? Give an example.
7 Explain why the following are important factors to consider when valuing a business: start-up costs, accuracy of projections and degree of control.
8 What are three of the contextual aspects that must be considered in an effective succession plan?
9 In what way can forcing events cause the replacement of an owner/manager? Cite three examples.
10 What are five qualities or characteristics successors should possess?
11 Why do entrepreneurs look forward to the day when they can take their company public?
12 What eight steps should be followed to harvest a business? Discuss each of these steps.

EXPERIENCING ENTREPRENEURSHIP

What would you recommend?

Jane Winfield would like to buy Ted Garner's company. She has conducted a detailed financial analysis of Ted's business and has determined the following:

1 Book value of the inventory: $250 000
2 Discount rate on future earnings: 24%
3 Book value of the plant and equipment: $150 000
4 Fair market value of the inventory: $400 000
5 Fair market value of other intangibles: $60 000
6 Number of shares of common stock: 100 000
7 Fair market value of the plant and equipment: $400 000
8 Price/earnings multiple: 9

9 Book market value of other intangibles: $30 000

10 Estimated earnings over the next five years:

Year 1 $200 000

Year 2 $300 000

Year 3 $400 000

Year 4 $500 000

Year 5 $600 000

Based on this information, how much should Jane value the business at according to each of the following methods: adjusted tangible assets, P/E and discounted future earnings? Based on your findings, recommend the valuation method she should use. Finally, given all of your calculations, estimate what the final price will be. Give reasons for this estimate. Enter your answers here.

a Adjusted tangible assets valuation: ____________________________

b Price/earnings valuation: ____________________________________

c Discounted future earnings valuation: __________________________

d Final sales price: ____

EXPERIENCING ENTREPRENEURSHIP

Barriers to succession planning

Identify a first-generation business owner and arrange a confidential interview to discuss the four key questions below. Write up your key learnings using the table below to identify barriers and how these barriers shape the succession choices of an entrepreneur.

FOUNDER/OWNER	FAMILY
Death anxiety	Death as taboo
Company as symbol	Discussion is a hostile act
Loss of identity	Fear of loss/abandonment
Concern about legacy	Fear of sibling rivalry
Dilemma of choice	Change of spouse's position
Fiction of equality	
Generational envy	
Loss of power	

Source: Kets de Vries, M. F. R. (1993). The dynamics of family-controlled firms: The good news and the bad news. *Organizational Dynamics*, 21(3), 68.

Interview questions

1. What barriers exist to succession in a business for an entrepreneur?
2. As you see it, what pressures do entrepreneurs sometimes face from within the family?
3. As you see it, what pressures do entrepreneurs sometimes face from outside the family?
4. An entrepreneur can make a number of choices regarding a successor. What choices do you identify with that fit well for your business?

CASE STUDIES

CASE 14.1

JUST AS GOOD AS EVER

When Vince Cavuoto was found in the storage area, no one knew for sure how long he had been unconscious. Within 30 minutes, he was in the emergency room of Royal Melbourne Hospital, and by early evening, the doctors had determined that Vince had suffered a mild heart attack.

During the first few days he was in the hospital, Vince's family was more concerned with his health than anything else. However, as it became clear that Vince would be released within a week and allowed back at work within two weeks, family members talked about his stepping aside as President of the operation and allowing someone else to take over the reins.

Vince is the entrepreneur and CEO of a successful air-conditioning parts, service and repair business. Gross sales last year were $3.7 million. Working with him in the business are his son, daughter and two nephews. Vince started the business 22 years ago, when he was 33. After working for a large mechanical services contracting business for 10 years in business development, Vince broke away and started his own company. At first, he hired outside help. During the past five years, however, he has been slowly bringing his family on board. It was Vince's hope that his son would one day take over the business, but he did not see this happening for at least another 10 to 15 years.

Vince's wife, Rebecca, believes that although he should continue to work, he should begin to train his son to run the business. On the day before he left the hospital, she broached this idea with Vince and asked him to think about it. He replied, 'What is there to think about? I'm too young to retire, and Josh does not know the business well enough to take over. It will take at least five more years before he is ready to run the operation. Besides, all I have to do is slow down a bit. I don't have to retire. What's the hurry to run me out of the company? I'm as good as ever.'

Rebecca and Josh believe that, during the next couple of months, they must continue working on Vince to slow down and to start training Josh to take over the reins.

QUESTIONS

1. Why is Vince reluctant to turn over the reins to Josh? Include a discussion of Figure 14.2 in your answer.
2. Cite and discuss two reasons Vince should begin thinking about succession planning.
3. What would you recommend Rebecca and Josh do to convince Vince that they are right? Offer at least three operative recommendations.

CASE 14.2

WHICH WILL IT BE?

Georgia Isaacson and her son Rubin have been thinking about buying a business. After talking to seven entrepreneurs, all of whom have expressed an interest in selling their operations, the Isaacsons have decided to make an offer for a retail clothing store. The store is very well located, and its earnings over the past five years have been excellent. The current owner has told the Isaacsons he will sell for $750 000. The owner arrived at this value by projecting the earnings of the operation for the next seven years and then using a discount factor of 15 per cent.

The Isaacsons are not sure the retail store is worth $750 000, but they do understand the method the owner used for arriving at this figure. Georgia feels that since the owner has been in business for only seven years, it is unrealistic to discount seven years of future earnings. A five-year estimate would be more realistic, in her opinion. Rubin feels that the discount factor is too low. He believes that 20 to 22 per cent would be more realistic.

In addition to these concerns, the Isaacsons feel they would like to make an evaluation of the business using other methods. In particular, they would like to see what the value of the company would be when the adjusted tangible book value method is employed. They also would like to look at the replacement value and liquidation value methods.

'We know what the owner feels his business is worth', Georgia noted to her son. 'However, we have to decide for ourselves what we think the operation is worth. From there, we can negotiate a final price. For the moment, I think we have to look at this valuation process from a number of different angles.'

QUESTIONS

1. If the owner reduces the earnings estimates from seven to five years, what effect will this have on the final valuation? If he increases the discount factor from 15 per cent to 20–22 per cent, what effect will this have on the final valuation?
2. How do the replacement value and liquidation value methods work? Why would the Isaacsons want to examine these methods?
3. If the Isaacsons conclude that the business is worth $660 000, what will be the final selling price, assuming a sale is made? Defend your answer.

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PART FOUR

ENTREPRENEURIAL CASE ANALYSIS

THE POWER OF THE CROWD-EQUITY CROWDFUNDING AT PLEDGEME

Jodyanne Kirkwood, Otago Polytechnic; Anna Guenther, PledgeMe

Anna Guenther, a Master of Entrepreneurship student at the University of Otago, had been researching crowdfunding and the concept of creating a local platform to support the creative and arts communities in New Zealand. By a stroke of good fortune, she found a developer in her own backyard – in Wellington, New Zealand's capital city – who had been working on just such a tool, so arranged to meet him. The developer, more focused on code than marketing, was a classic 'techie' and Anna persuaded him that the project could not fly without her expertise and marketing savvy. She joined the company as director and shareholder, but in 2013 she bought him out and became the sole owner. From there, the company went into capital-raising and expansion mode. By 2018, PledgeMe (pledgeme.co.nz) employed eight staff (part-time) and was owned by Anna (35 per cent) and 193 other shareholders. There was a Board of Directors overseeing the company, made up of early investors.

Crowdfunding is a tool that helps galvanise a crowd of people to fund a project (normally through the project creator's social networks). It is a young and growing industry that has been proven internationally, with over 800 platforms worldwide. The growth and scope of crowdfunding is impressive considering the industry was unheard of until 2006, when the first crowdfunding website, Sellaband, appeared. Since then, there has been a steady progression of funding ideologies around crowdsourcing, with a move from micro-financing to micro-lending, to peer-to-peer lending, and then to crowdfunding. Many other key players have entered the industry, with the main global market share covered by huge organisations such as Kickstarter, Indiegogo and Rockethub.

PledgeMe started crowdfunding for the creative industry, comprising everything from design, fashion and film to music, performing arts and gaming. For a nation of 4.5 million people, New Zealand punches above its weight (think Peter Jackson and the *Lord of the Rings* movies); the creative community is quite large and well supported.

PledgeMe's mission is 'to help Kiwis fund things they care about', and Kiwis do care about art. Two-thirds of New Zealanders believe that art is a part of everyday life. Over NZD$100 million (USD$76 million) of funding from all sources goes into creative projects every year. Creative New Zealand alone funds over 500 projects per year, with an average project amount of NZD$15 000. However, even this amount is not enough to satisfy the creative demand. Previously, many creative projects had to be privately funded in the hopes they could recoup their investment once they had a saleable product. Crowdfunding changed this and allowed people to raise the funds they needed up front in order to develop their creative product.

PledgeMe's business model is one that charges 6.5 per cent of the project total as a success fee, and on-charges credit card fees if pledgers choose to not direct deposit their pledge. To date the company has raised over NZD$23.5 million for over 1200 campaigns. The organisation has two kinds of customers: the campaign creator and the campaign funder. The creators come from various backgrounds, and the funders are mostly from their social networks (family, friends and networked acquaintances). Everyone is a stakeholder, as every campaign creator and funder is integral to the success of the projects. Campaign creators publish their plans online and raise money from funders in exchange for rewards, normally stemming from the proposed finished project. These rewards range from tickets, to a show and dinner with the cast, to smaller items such as postcards.

PledgeMe only takes its cut when campaigns are successful and reach their target. In the industry this is called a 'threshold model', where the campaign must reach the minimum amount set by the creator for it to be successful. This amount has to be chosen with care, as the Campaign Creator will be obliged to fulfil all rewards that are claimed once this goal has been met. It means that PledgeMe offers help and advice to encourage projects to meet their targets, by providing support to the consumers, by educating the public on crowdfunding and by marketing the project.

PledgeMe has the following core values that underlie its operation:

- Community: Crowdfunding helps connect individuals with supporters to realise their goals, and will potentially revolutionise existent community and economic models.
- Passion: The main driver for PledgeMe staff and project creators.
- Creativity: The main focus of the business, which is reflected in every aspect of the company.

By 2015, PledgeMe had established itself as a leading presence in the crowdfunding market, and saw it was a good time to diversify. An opportunity arose that was too good to turn down. New Zealand changed its laws in April 2014 to allow 'equity crowdfunding' (see Chapter 13, p. 480). Companies could crowdfund in exchange for a portion of equity (shares) in their company. This was a huge opportunity for PledgeMe, but also a very daunting one in that Anna realised she would have to grow the company in order to offer equity crowdfunding. Previously, the business had consisted of Anna, her business partner, one part-time administrator and various interns managing the whole company, but they needed to hire more staff. To do this, Anna had to get more investors and, therefore, give up some of her own equity in the business.

Funding the growth of the company has taken several forms. Initially, a round of private investment was undertaken, and NZD$100 000 was raised. Then in 2014 the previous Advisory Board was turned into a formal Board of Directors and a further NZD$100 000 was raised in 23 hours by equity crowdfunding itself. In 2015, the company raised a further NZD$365 000 in a second round of equity crowdfunding, equating to about 15 per cent equity of the company across 137 shareholders. Currently there are approximately 193 shareholders, who hold 65 per cent of the company.

There are now seven companies who hold New Zealand government-issued equity crowdfunding licenses. The market is quite competitive. In fact, some believe that in the longer term New Zealand really only has room for about two equity crowdfunding providers. In 2014, when starting to offer equity crowdfunding, PledgeMe had over 500 companies approach them about possibly using their company for equity crowdfunding, indicating strong interest in the concept. In New Zealand, there is a limit of NZD$2 million per year per company that can be crowdfunded.

For a relatively young industry, equity crowdfunding is going well; however, there are still those who are yet to be convinced and say that investors should be cautious. PledgeMe currently has two campaigns that are 'live' at present, and 25 have been funded. Companies seeking investment do not receive any funds if they do not meet their target. As with creative crowdfunding, PledgeMe charges a 6.5 per cent success fee for their service (only for successful campaigns). PledgeMe also started providing crowdlending services in 2016.

In 2017 Anna (now aged 32) relocated to Brisbane, as Australia was about to implement a new law to allow equity crowdfunding (officially called crowd-sourced equity funding in Australia). In January 2018, the Australian government granted seven licences to companies who provide equity crowdfunding services. A company looking for equity crowdfunding can apply for up to $5 million per year. Presently, PledgeMe is working on applying for a licence and is hopeful this will be awarded in 2018.

QUESTIONS

1. Moving into Australia is a typical pattern for entrepreneurs from New Zealand. What advantages does PledgeMe have in moving into the Australian market?
2. What challenges do you think PledgeMe might encounter in gaining a licence to operate in Australia and subsequently gaining market share in Australia?

3 PledgeMe's roots lie in gaining funding for social enterprises and this is still a core focus for Anna and her team. Do you think it's a good idea to continue this focus, or diversify into other types of businesses/projects?

4 PledgeMe has used a number of different types of capital raising options. How do you think further growth of PledgeMe could be funded?

5 What types of performance measures do you think PledgeMe uses in terms of defining how successful it is?

6 What types of harvest strategies do you see for Anna and PledgeMe, should she wish to exit the business in the future?

7 How would you go about valuing a service business like PledgeMe, which has few physical assets such as buildings, equipment or inventory?

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An earlier version of this case was presented at the USASBE (United States Association of Small Business and Entrepreneurship) annual conference, 9–12 January 2014, Fort Worth, Texas, USA. Winner of Best Teaching case award.

REVIVING SAMOA'S COCOA INDUSTRY

COCOA SAMOA LTD BUSINESS PLAN

Every business plan has a context. This business plan was submitted to the European Union's Increasing Agricultural Commodity Trade (IACT) program. It was turned down due to 'funding priorities' (most of the money went to Fiji). While it lacks a few elements, such as a 'harvest strategy', we include it because almost everyone can relate to chocolate, and it is an example of an entrepreneurial plan emphasising sustainable development. IACT invited Pacific-based enterprises, farmer/grower/processor/exporter associations and NGOs to apply for technical assistance to support the strengthening of export capacity in primary industries (for example, agriculture, livestock and aquaculture). IACT sought projects that could develop environmentally-friendly production systems (for example, organic agriculture, low carbon footprint and eco-certification) that could assist global exporters to adapt to the impacts of climate change in export operations.

This plan closely follows many of the elements of the template in Chapter 11 and presents an easy-to-follow, sustainable business planning process. Previous editions of this book have included business plans which are available online. The first edition included 'Wai-Fi Ltd: A Māori-owned Wireless Internet Service Provider for water-adjacent [*wai* means water in Māori/*te reo*] communities in Auckland, New Zealand'. The second and third editions included 'Red River Optical: Affordable reading glasses for Vietnam', an Australian company creating 'optipreneurs' in Vietnam. The business plan in this edition made extensive use of Business Plan Pro and Sales and Marketing Pro software from Palo Alto Software (http://www.paloalto.com). As a bonus, we also are providing online the latest business plan from the American edition of the book, entitled 'Hydraulic Wind Power, LLC: A renewable energy company with a patent-pending technology to produce wind energy'.

EXECUTIVE SUMMARY

Cocoa Samoa Ltd ('CSL') is a Samoan registered company that utilises climate-smart and sustainable practices to rescue the Samoan cocoa industry, exploit the looming shortage of cocoa globally, and produce cocoa and chocolate products for Pacific Rim markets.

CSL has formed a consortium of cocoa industry stakeholders, including: cocoa growers; cocoa bean roasters; end-users (customers); chocolate makers; branding, marketing and sales forces; bio-energy and civil engineering; project management staff; sustainable landscape managers; and strategic planners.

CSL uses 'sustainable entrepreneurship'[1] to recapture Samoan national food security in a renowned industry trying to come back from natural and economic disasters. Our initiative will significantly increase export earnings for Samoa and create downstream socioeconomic returns, including an increase in Samoan GST revenues.

Our aim is to create a new brand of Samoan cocoa and chocolate brand for markets in Australia/New Zealand and the Pacific Coast of the United States of America (USA), and eventually in Northern Germany.

OBJECTIVES

The objectives of this Business Plan are to:

- attract start-up funding of $1 297 000
- exploit the looming shortage of cocoa and chocolate by reviving and rescuing Samoa's high-quality cocoa industry

- establish alliances and signed agreements with strategic partners and stakeholders as members of the value chain, and shorten the link between growers and consumers
- carry out cocoa extension training programs to rehabilitate existing Samoan plantations, and work to plant new stock
- achieve a visible market penetration in Australia and New Zealand and a foothold in the USA market, and
- achieve Samoan cocoa and chocolate brand awareness in our target markets.

VALUES AND MISSION

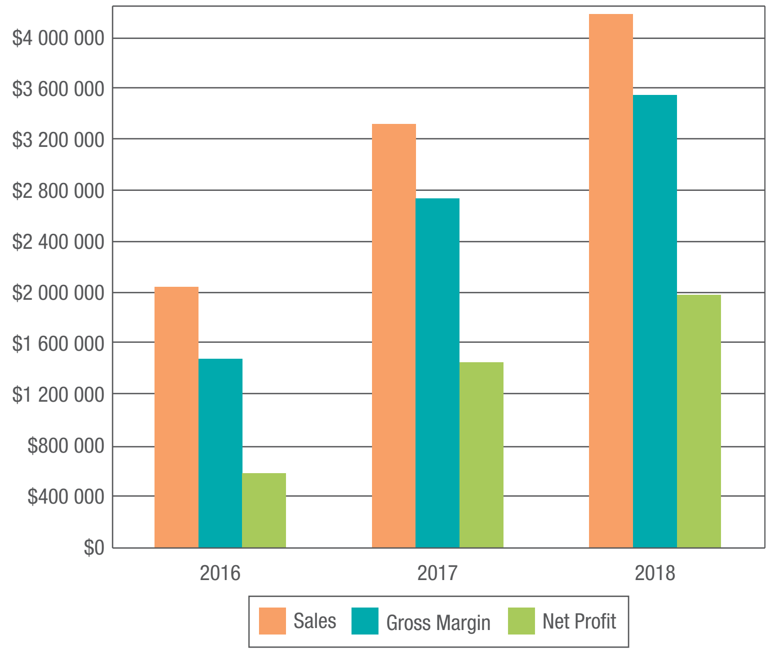
- CSL's values are rooted in protecting and empowering the Samoan cocoa grower community, who are susceptible to impacts of natural disasters, price fluctuations, global economic crises and climate change.
- Our vision is to pay Samoan communities a fair price to produce and export high-value products while adhering to sustainable, organic and fair-trade principles.
- CSL revives Samoa's century-old cocoa industry to take advantage of the shortage of cocoa products globally.

HOW WE MEASURE OUR SUCCESS

We know we will have succeeded if the following keys to success are achieved:

- Construct a pilot cocoa processing and chocolate factory
- Set up a Cloud-based cocoa lab connecting growers with buyers in Australia, New Zealand and the USA
- Pay fair farm-gate prices to the grower
- Increase the production and quality of Samoan cocoa
- Establish a recognised brand.

FIGURE A1.1 ESTIMATED SALES, GROSS MARGIN AND NET PROFIT



START-UP SUMMARY

Start-up expenses

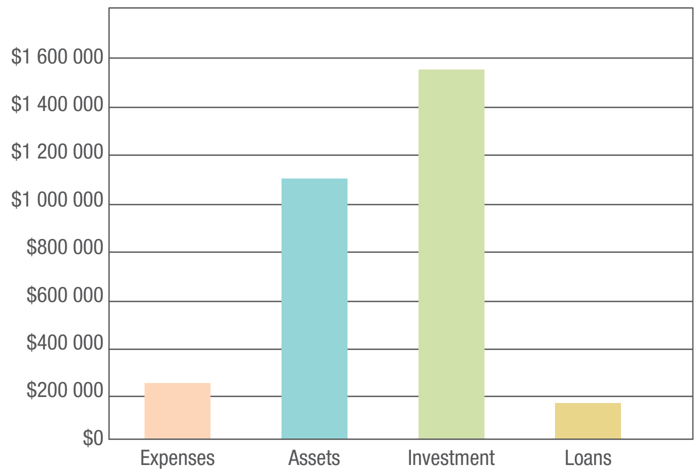
These are all the start-up expenses required before January 2016. 1 USD = 2.27 SAT // 1 SAT = 0.42 USD.

- Start-up salary expenses are $45 000 for Manager, $45 000 for Chocolatier, $25 000 for Marketer.
- Based upon previous experience and World Bank estimates, we are estimating about $15 000 in legal and administrative fees to register the company and arrange the proper compliances to build the factory in Samoa.
- Stationery, insurance, office space, secretarial assistance and other unforeseen are standard figures.
- 'Special commissions' refers to administrative fees to achieve compliance.
- 'Travel and accommodation' is because a key employee is living in Melbourne.
- 'Trade shows' refers to our intention to exhibit at the Fine Food New Zealand and Fine Food Australia shows.

TABLE A1.1 START-UP

Start-up expenses	
Salaries	$115 000
Legal	$15 000
Stationery	$1 000
Insurance	$1 000
Office space	$3 000
Other unforeseen	$5 000
Secretarial assistance	$5 000
Special commissions	$20 000
Travel and accommodation	$12 000
Trade shows and promotion	$30 000
Other	$20 000
Total start-up expenses	$227 000
Start-up assets	
Cash required	$150 000
Start-up inventory	$50 000
Other current assets	$20 000
Long-term assets	$850 000
Total assets	$1 070 000
Total requirements	$1 297 000

FIGURE A1.2
START-UP



INVESTMENT OFFERING

Business description

Samoa is a small, lower-middle-income country with relatively good human development indicators. Total GDP was USD$995 million in the 2014 financial year, while GDP per capita stood at USD$5200. With a population of about 196 000, Samoa ranks 106 out of 187 countries in human development. One of the better-performing economies in the Pacific before the 2009 tsunami, Samoa's GDP growth was averaging 2.0 per cent in 2014, up considerably from −1.1 per cent in 2013.[2] The service economy has grown strongly of late, to 59 per cent of the economy, while agriculture has dropped from 65 per cent to 11 per cent of the labour force.

Criollo and Trinitario cocoa varieties were originally planted in Samoa by German colonists before World War I. These highly praised varieties make Samoa a 'Chocolate Treasure Island', or some call it the 'Ecuador of the Pacific'. Samoan cocoa beans are of high quality, and are organic with a low carbon footprint. But today, the industry needs to be 'rescued' from natural disaster, economic calamities and the effects of climate change.

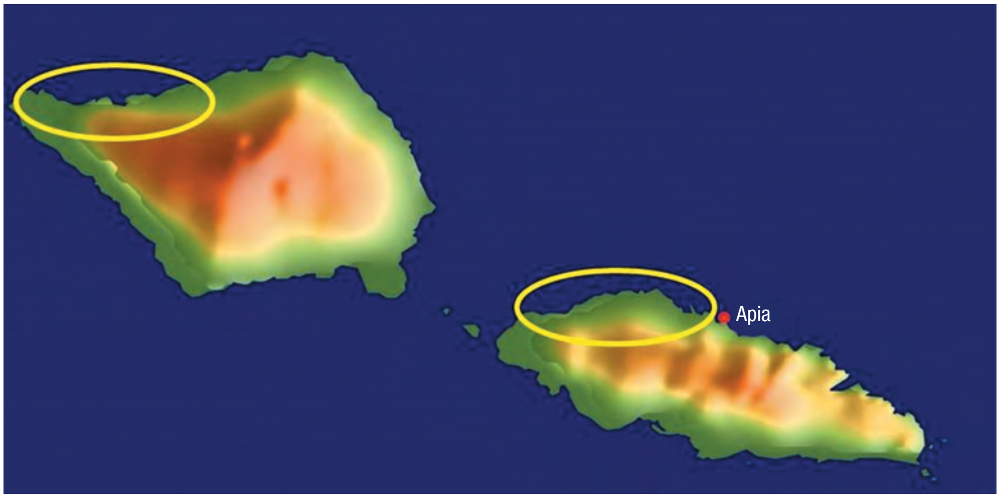
Revitalised cocoa production can make a substantial contribution to economic growth in Samoa. Both the cocoa stock and the required knowledge still exist in Samoa, but Samoan growers have lost touch with the global cocoa consumer, who desires artisan chocolate products that embody the values of health, environmental protection, climate change mitigation and community entrepreneurship.

CSL aims to revive Samoa's cocoa and chocolate industry and to recapture markets in Australia, New Zealand and the USA. This could not come at a more fortuitous moment, as cocoa stocks are declining worldwide. There is increasing political instability in large cocoa growing areas in Africa. Global chocolate consumption is rising by 2–3 per cent per annum. Cocoa producers elsewhere are tearing out cocoa and planting get-rich schemes such as oil palms. Markets for 'craft chocolate' are strong and growing in our target markets.

BUSINESS RATIONALE

Samoa's cocoa plantations are concentrated in the two 'rain shadows' (see the circled area of Figure A1.3) along the northwest coasts of both islands. Ninety per cent of Samoan cocoa is Trinitario and is classified by the International Cocoa Organisation (ICCO) as 'fine and flavour' (high standard).[3] Today, more than two-thirds of all Samoan land holdings have cocoa trees, with an estimated 2000 hectares of cocoa (including mixed cropping).[4]

FIGURE A1.3
MAP OF SAMOA



Source: GinkgoMaps-project. http://www.ginkgomaps.com. This map is licensed under Creative Commons CC-BY-3.0. http://creativecommons.org/licenses/by/3.0/deed.en.

What happened to Samoan cocoa? Despite decades of exports, the roller coaster began in the late 1970s. Exports declined due to poor planting material, falling commodity prices and declining quality and yields, coupled with unmanaged pests and disease. A recovery of sorts began in 1983 after a Cocoa Rehabilitation Program with re-plantings of a high-yielding, more disease-resistant but less flavourful variety (Amelonado). For the remainder of the decade, however, falling world prices led to a rapid decline in cocoa export values.

Then came the devastating effects of back-to-back ‘century’ Cyclones Ofa and Val, and the drought that followed Cyclone Ofa, compounded by low world cocoa prices, all of which virtually destroyed the Samoan cocoa industry from 1990 to 2000. On top of that, a devastating tsunami in 2009 killed over 140 people and caused considerable economic losses. The final blow was Cyclone Evan in 2012, which caused extensive environmental damage that will take years to regenerate. Besides, Samoa was also hard hit by the food and fuel price shocks of 2008 and the global economic crisis.

On the upside, Samoa’s competitors are also small and vulnerable, particularly Ecuador and Peru. Together with Venezuela and Mexico, these four countries produce 95 per cent of fine and flavourful cocoa. Fine or flavour beans are normally sold at a significant premium on the market due to increased market demand for gourmet chocolate. The fine cocoa market is increasing year after year, thanks to news reports of the health-related benefits of cocoa.

Cocoa products have become almost ubiquitous in the Western diet. Consumption of chocolate products in northern climates is significant and estimated at 5–10 kg per person per year, with some geographical variation linked to cultural norms and local climate. At about 10 kg per year (60 per cent of the population drink 5 cups of Koko Samoa – about 200 g – per week, or 10 kg/year), Samoa is one of the highest consuming countries per capita in the world.[5]

TABLE A1.2 TOP COCOA PRODUCING COUNTRIES (THOUSANDS OF METRIC TONNES), 2014/15

Ivory Coast	1 550
Indonesia	410
Ghana	870
Nigeria	220
Cameroon	210
Brazil	200
Peru	75
Dominican Republic	70
Papua New Guinea	40

Source: Adapted from ICCO quarterly bulletin of cocoa statistics, XLI(2), Cocoa year 2014/15, International Cocoa Organization.

TABLE A1.3 TOP CHOCOLATE CONSUMING COUNTRIES (PER CAPITA KG PER ANNUM), 2014

Switzerland	9
Germany	7.9
Austria	7.8
United Kingdom	7.5
Ireland	7.5
Norway	6.6
Sweden	5.4
Finland	5.3
Russia	5.3
Belgium	5.2
Australia	4.9
Netherlands	4.7
New Zealand	4.5
United States	4.3
France	4.2
Denmark	4.2

Source: Adapted from Hassan, B. (n.d.). Cocoa crisis: Chocolate to run out in 2015. https://www.finder.com.au/press-release-cocoa-crisis-chocolate-to-run-out-in-2015.

INDUSTRY ANALYSIS

On the face of it, the outlook for the world's chocolate industry is bright. Global chocolate consumption has also grown steadily since the 1990s and is predicted to hit 8.5 million tonnes in 2020. But numerous authorities are predicting a 'looming chocolate crisis' because demand will exceed supply. BloombergBusiness[6] has predicted that by 2020 there could be a 1-million-tonne gap in cocoa production. Chocolate deficits, whereby farmers produce less cocoa than the world eats, are becoming the norm. Already, we are in the midst of what could be the longest streak of consecutive chocolate deficits in more than 50 years.[7]

The International Cocoa Organization takes a positive beat; it believes that farmers can be incentivised to produce more of it, causing supply to rise.[8] But the major problem is that climate change is affecting the growth of cocoa trees. An estimated 30 per cent is already lost to pests and disease,[9] and the impacts of global warming are affecting the global cocoa stock. In Samoa, periods of drought and of excessive rain or wind have negatively impacted yield, and will continue to fluctuate as climate change intensifies.

Many commentators see a 'looming chocolate crisis', where manufacturers will be unable to meet the demand of increasing consumption in the developing economies where per capita consumption is skyrocketing, for example, in India, Eastern Europe, Brazil and China (where per capita consumption is only one-tenth that of Switzerland).[10]

If proper training and remediation can be introduced, Samoan growers are well positioned to take advantage of the global situation. Cocoa prices have climbed by more than 60 per cent since 2012, when people started eating more chocolate than the world could produce. The current world price of USD$2750 per tonne is expected to increase to over USD$3500 by 2020.[11] The ICCO Daily Price first closed above USD$3000 per metric tonne in 2014. Cocoa futures prices have also increased dramatically.

Samoa will always be a smaller player. The largest cocoa bean-producing countries in the world in 2013/14 are as shown in Table A1.2.[12]

GOALS AND POTENTIAL

Our business model is based upon the following three fundamentals.

- **Spanning the value chain**: Samoan growers can reclaim a portion of the end-market value by implementing a strategy based on geographical indication, trademark protection, profit sharing and tapping new niche markets.
- **Rescuing the industry**: CSL offers Samoan growers the training and knowledge they need to re-attain an economically viable cocoa industry. We can achieve market penetration to developed countries with sustainable, organic, fair-trade, and 'low-carbon' cocoa and chocolate products.
- **Creating economic incentives**: We give numerous incentives for cocoa growers to participate in this 'chocolate entrepreneurship', including: Unit Trust of Samoa (UTOS) shares to reward productive growers; cooperative trust funds; engaging with micro-financing institutions; providing school fees vouchers; introducing sustainable land management practices; offering chocolate-making training and facilities; and introducing climate change adaptation strategies.

UNIQUENESS OF PRODUCT

- Cocoa paste is produced from beans pounded with a wooden mortar and pestle in the traditional way.
- Cocoa liquor contains both cocoa solids and cocoa butter and is packed in 25-kilogram cardboard cartons with high-density polyethylene square bottom bag.
- Cocoa butter is a pale-yellow, pure edible vegetable fat used to make chocolate, but its real value is for cosmetics, pharmaceuticals, ointments and toiletries.
- Cocoa powder is the low-fat component that comes out of cocoa during cocoa butter manufacture.
- Cocoa nibs are roasted and crushed cocoa beans.
- Samoan Gold Single-Origin Bars refer to a cocoa variety from a single geographical origin (single farm).
- Samoan truffles are made with a chocolate ganache centre coated in chocolate or cocoa powder, usually in a spherical shape.
- Like a winery, the CSL Factory will have a cellar door where tourists can approach to taste and purchase.

STATEMENT ON SUSTAINABILITY

For the cocoa and chocolate industries, the sustainability challenge is becoming broader, more complex and increasingly pressing due to the advent of increased climate change effects and its market distortions. Here are our sustainability principles:

- Origins are important and traceability of supply is a growing concern to customers. Ours is 100 per cent pure, single-origin, fine-flavoured cocoa. Each bar is identified with its GPS coordinates.
- We are concerned about the sustainability of our growers. The average grower's age is 45–50 years old. Our training efforts recruit young Samoans.
- The looming chocolate deficit has been linked to extreme weather events (heavier rains, longer droughts and higher insect infestations), so our production strategy needs to take climate change into account, especially its future occurrence in the Pacific.[13]

Our sustainability performance measures include: All products list GPS origins and farmers' names. We are able to attract a corps of younger cocoa growers. Our growers are educated about climate change effects and adapt in measure (for example, by using drip irrigation).

FIGURE A1.4
CSL PRODUCTS: SAMOAN GOLD BEANS, FAIR TRADE, ORGANIC AND CARBON-NEUTRAL

Cocoa pods after harvest mature their colour toward yellow or orange.

Samoan cocoa beans after fermentation, drying and roasting, ready for manufacture.

Beans are cracked and de-shelled, resulting in pieces of beans called cocoa nibs.

Cocoa butter used to make chocolate, personal care products and pharmaceuticals.

Bags of cocoa beans ready for export to chocolatiers.

Chocolate liquor is pure cocoa mass in liquid form, which turns solid at room temperature.

Samoan kava chocolate bars. Kava relaxes without disrupting mental clarity.

Bags of organic, fair-trade, carbon neutral chocolate for sale in health food store.

Source: Author's own images

MARKETING

Samoa's chocolate history is more than 100 years old. The market evaporated due to cyclones, drought, tsunami and drops in cocoa bean prices. Still, it maintains a beautiful crop of Trinitario cocoa with market potential. Our effort will revive Samoa's cocoa legacy, build upon the existing knowledge of the grower, and take Samoan cocoa into the new age of gourmet- and health-oriented markets in New Zealand, Australia, USA and elsewhere. Samoa's main problem is establishing a prestigious brand of cocoa in the same view as Ecuador and Peru. The main strategies emphasise fair trade, organic and sustainability.

MARKETING VISION

Cocoa Samoa is built around the belief that we can assist Samoa's cocoa industry to recover from the devastating effects of natural disasters and economic calamities through sustainable entrepreneurship benefiting growers and the Samoan community. CSL believes that the modern 'choco-sumer' desires not just the finest and most flavourful cocoa and chocolate but also to make a contribution to sustainability (fair trade and natural organic ingredients) of an authentic culture in the South Pacific.

MARKET RESEARCH AND ANALYSIS

Our ideal customer is concerned about sustainability and Indigenous culture, seeks the health benefits of cocoa and chocolate, and is willing to pay a higher price in exchange for the story of Samoa's cocoa resurrection.

Target market identified

Our two target markets comprise: (1) end consumers (buyers of finished and semi-finished products) and (2) trade customers (professional chocolatiers and buyers of ingredients).

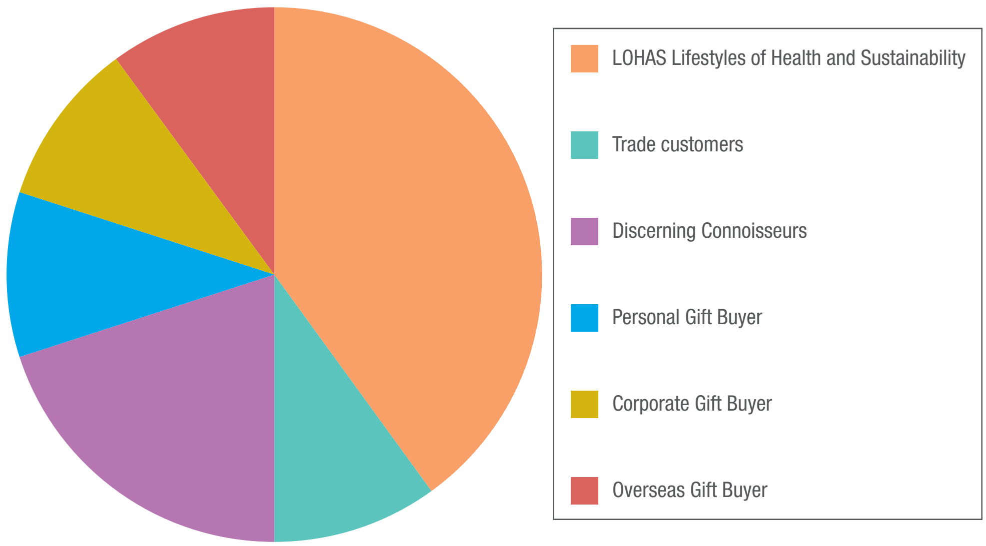
TABLE A1.4
MARKET ANALYSIS

MARKET ANALYSIS		2016	2017	2018	2019	2020	
Potential customers	Growth						CAGR
LOHAS (Lifestyles of Health and Sustainability)	4%	400 000	416 000	432 640	449 946	467 944	4.00%
Trade customers	3%	100 000	103 000	106 090	109 273	112 551	3.00%
Discerning connoisseurs	3%	200 000	206 000	212 180	218 545	225 101	3.00%
Personal gift buyers	2%	100 000	102 000	104 040	106 121	108 243	2.00%
Corporate gift buyers	2%	100 000	102 000	104 040	106 121	108 243	2.00%
Overseas gift buyers	2%	100 000	102 000	104 040	106 121	108 243	2.00%
Total	3.11%	1 000 000	1 031 000	1 063 030	1 096 127	1 130 325	3.11%

End consumers (70 per cent of total customers)

High-end, 'gourmet' and 'health' customers are trading up in quality and taste. We see this as a market opportunity since the lifestyle and gourmet categories are expected to grow as consumers incorporate cocoa products as functional foods in their diets. We can categorise our buyers in terms of their behavioural or buying patterns (psychographics) into the following categories:

FIGURE A1.5 MARKET ANALYSIS (PIE)



Discerning connoisseurs (30 per cent of total end consumers)

DCs are upper-income and married with children. Interests include wine appreciation, travelling and dining out. DCs are looking for the best tasting chocolates to enjoy personally or to serve to friends. They expect quality ingredients, exclusivity (small batch production), rare ingredients and a feeling of 'craftsmanship' (hand-made, artisanal).

LOHAS consumers (30 per cent of total end consumers)

LOHAS (Lifestyles of Health and Sustainability) customers in general like to consume goods and services focused on personal health, natural lifestyles, eco-tourism, alternative energy, green building and alternative transportation.[14] They comprise 4 million Australians (25 per cent of the adult population)[15] and spend $15+ billion per annum on products that are friendlier to the environment, Indigenous peoples and personal health. Purchasing of organic products is a permanent change in buyer decision.

Personal gift buyers (15 per cent of total end consumers)

These customers usually have a low to medium level of sophistication. For them, product appearance and packaging is as important as quality of chocolate since they want to make a good (first) impression.

Corporate gift buyers (10 per cent of total end consumers)

With a medium level of sophistication, corporate gift buyers often have a preference for pre-packaged selections and find customised designs with their own logos very attractive. They have a strong bias toward internet sales, but also are attracted by the personal approach through trade and business associations. They are prepared to pay mid-range prices.

Overseas gift buyers (10 per cent of total end consumers)

These customers have a medium to low level of sophistication and are looking for premium South Pacific products as gifts or souvenirs. Their preference is for pre-packaged selections that travel well.

Key selling factors to target segments

We have identified the relative importance of key selling factors to each target market in Table A1.5.

Trade industry

The second major market for Samoan cocoa and chocolate is 'the trade'. These are professional chocolatiers and trade buyers who supply the industry. Our focus is on Australia/New Zealand and the Pacific coast of the USA.

In Melbourne, for example, artisan chocolate consumption is increasing about 14 per cent per year.[16] Koko Black and Mámor Chocolates are typical of the 35 boutique chocolate companies. Chocolatiers are serviced through large warehouses but also make independent purchases. Callebaut's West African 53 per cent bittersweet chocolate sells for AUD$18/kg, while 70 per cent dark blocks sell for AUD$18/kg. Per-kilogram prices of the single-origin products range from AUD$23/kg for 70 per cent Ecuadorian to AUD$40/kg for 66 per cent Madagascan, 70 per cent São Tomé and 60 per cent Grenadian.

Here is a summary look at key potential 'trade' customers for Samoan cocoa blocks, beans and unrefined products:

- Cadbury (Mondelez) operates three Australian factories as well as one in New Zealand: two in Melbourne, one in Tasmania and one in Dunedin, New Zealand.
- Mars has its major production plant in Ballarat, Victoria.
- Nestlé Oceania has 15 factories in Australia, New Zealand and Papua New Guinea.
- Ernest Hillier Chocolates' production plant is in Melbourne and its product range includes over 600 chocolate products.
- Australia's Haigh's Chocolates has its plant in South Australia.
- J. H. Whittaker & Sons is a confectionery manufacturer specialising in chocolate and based in Porirua, New Zealand.
- Dozens of independent, artisan chocolatiers are scattered throughout the countries.

MARKET SIZE AND TRENDS

KPMG's 'A taste of the future: The trends that could transform the chocolate industry' reported the following in 2014:

- Global chocolate industry revenues to reach record USD$117 billion in 2014.
- Most dramatic change in consumer taste is surge in popularity of dark chocolate. Perceived health benefits have fuelled a 93 per cent growth in launches, and dark chocolate now accounts for 20 per cent of the US market.
- Confectionery companies, governments and NGOs invest heavily in cocoa farmer development programs. Over USD$800 million is set to be invested in the coming years to improve farmer

TABLE A1.5 KEY SELLING FACTORS TO TARGET MARKET SEGMENTS

SELLING FACTOR/ TARGET GROUP	SENSITIVITY TO PRICE	SOPHISTICATION OF TASTE	SENSITIVITY TO PACKAGING	DESIRE FOR KNOWLEDGEABLE RETAILER	INTEREST IN CULTURE AND DEVELOPMENT
Discerning connoisseurs	Low	High	Medium to high	High	High
LOHAS buyers	Low	Medium	Low	High	High
Personal gift buyers	Medium	Low to medium	High	Low	Medium
Corporate gift buyers	High	Low	High	Low	High
Overseas gift buyers	Medium	Medium	High	Low	High

productivity. This could have a significant impact on the farming community and on company sourcing costs.

- Sustainability remains a key challenge. Companies are recognising the need to go beyond single initiatives with a strategic approach to improve yields and consumer trust.[17]
- Digital technology could revolutionise the supply chain as 3D printing is a disruptive innovation that could change the behaviour of companies and consumers.
- Compound annual growth of 4.7 per cent in premium chocolate is driving the Australian market. Annual revenues have topped USD$5.6 billion.
- Australia has its first single-origin chocolate producer, Daintree Estates, which grows expensive beans, rich in polyphenols and antioxidants, for its high-end brand. All the farmers in this venture are shareholders.[18]

COMPETITOR ANALYSIS

Rather than calling them competitors, we would like to emulate these companies, as they are doing something that we should do. These include:

- **Divine Chocolate**. Divine Chocolate Limited is a partnership between cocoa growers' collectives in Africa and the alternative trading organisation Twin Trading. Farmers own the majority stake in the company and share its profits. Divine Chocolate is available in many natural foods stores, food co-ops and gift shops in Australia and New Zealand.
- **Grenada Chocolate Company** and the **Diamond Chocolate Factory** in Grenada. Grenada grows almost entirely Trinitario cocoa.
- **Madecasse**. Born of the American Peace Corps, Madecasse uses cocoa, vanilla and peppercorns found exclusively in Madagascar.

REMARKABLE DIFFERENCE

Robert Louis Stevenson wrote *Treasure Island* while he was in Samoa. That's why we call Samoa the 'Chocolate Treasure Island of the Pacific'. We could also say that Samoa is the 'Ecuador of the Pacific', as both are small countries with significant stands of Trinitario (best variety) cocoa.

MARKETING PLAN

Marketing strategy

CSL must create a brand – Samoa Gold – corresponding to its mission, philosophy and values, and clearly demonstrate the distinguishing characteristics of the company and the products.

Themes

- **Pride**: We are proud to produce a carbon-neutral, fair-trade, organic, 100 per cent Trinitario chocolate for high-end consumers in the developed Pacific-Rim economies from low-cost, renewable bio-energy sources, and from authentic cocoa plantations more than 120 years old.
- **Taste of paradise**: Samoan chocolate will fulfil the desires and lifestyle needs of people around the world – all eager for their 'taste of paradise'.
- **Sustainable packaging**: We use packaging made with starch, cellulose and polylactic acid (PLA), as opposed to the traditional petroleum polymer, because of consumer concern over packaging waste causing environmental damage.
- **Health benefits**: Why would a person put something into their mouth that does not give health benefits? Our message: 'You are holding in your hand the purest, most sustainable chocolates we can make. No additives, no preservatives. Only Free-Trade, Organic Chocolate from Samoa.'

- **The chocolate experience**: We want to satisfy the experiential needs of our customers. We want to deliver a great chocolate experience that meets consumer desires. Words like 'finish', 'snap' and 'sheen' are used to describe the differences between chocolates, and tasters may discern berry, vanilla or coconut 'notes' in Samoa's cocoa.

Marketing objectives

- Increase Samoa's export sales volume.
- Establish visible market share in the Australian organic and fair-trading category.

Communication objectives

- Increase brand awareness.
- Increase brand recognition and brand recall.

Targeting

Segments selected:

- aged 20–54, males and females
- chocolate lovers
- health conscious
- organic food consumers
- higher disposable income.

CSL's primary target audience are organic food lovers who are concerned with their health. Our targeted market sustain a higher disposable income and are aged between 20–54. We are focusing on both males and females. Our selected market desire a delicious treat and snack that is tasty and healthy. This mature target market know what they want from their favourite chocolate and are not predominantly focused on the price of the product.

These chocolate lovers differ from the occasional chocolate consumer, who consumes products such as Cadbury and Mars. Our audience have a sophisticated palate and prefer the healthier option.

Branding elements

FIGURE A1.6 SAMPLE SAMOAN COCOA BRANDS

Source: Author's own images

Price rationale

We are considering a dual price strategy:

- **Undercut the competition**. For the trade market of professional chocolatiers, our intention is to place products 10–15 per cent below existing equivalents (e.g. couverture $14/kg versus $16+/kg) in order to get brand awareness and traction in the market. If our couverture is as good as Callebaut, we can raise the price later.

- **Use scarcity**. For the direct-to-consumer market, one of the advantages we have is our product's scarcity, or lack of availability. Couple that with an 'object of desire' approach and you can always keep the price high online. The message is that we don't have enough product to satisfy the demand we have created. We want to emphasise the rarity of the product.

Marketing materials

Our marketing kit is tailored to individual prospects. Customer testimonials have been collected. We include case studies of chocolatiers and customers who have embraced our products.

Advertising and promotions

Our advertising is targeted and measurable. Ad types and placement address customers' concerns. Our advertising plan (available upon request) lists media outlets, a budget estimate, a timeline and a list of offers.

Web plan

CSL's websites and other social media are marketing and sales tools that serve business development, sales and shipment. Our web plan is available upon request.

Sales strategy

CSL bears in mind the relatively small total volume of cocoa production in Samoa, extent of competitors and brand concentration, price competitive nature of the market, due diligence of contracts and high levels of concentration of retail trade outlets.

Under the preferential tariff for Forum Islands, Australia and New Zealand charge 0.00 per cent tariff for cocoa and chocolate imports. However, the United States can charge over 10 per cent tariff for cocoa powder and blocks/bars.

- **Local appointed agents:** Our intention is to operate through an appointed local agent or agents to assist with market data, legislative requirements, sales contacts and market development.
- **Stock maintenance:** We must maintain six to eight weeks of stock. Retailers have been known to delete lines that are not reliably supplied.
- **Establishing partnerships:** We need to establish partnerships and alliances with buyers. We can meet them at Fine Food New Zealand, Fine Food Australia, ISM (Cologne) and All Candy (Chicago). We are keen to find those buyers interested in sourcing new, innovative lines, preferably on an exclusive basis. Samoa has its own Trade Commissioners in New Zealand, China and other countries.
- **PR campaigns:** It will be important to encourage and stimulate consumer participation and interest. For example, we wish to use one of the ocean-cruising *vakas* (Polynesian canoes) to deliver product to Melbourne, Sydney, Brisbane, Auckland, Honolulu, Seattle, San Francisco and Los Angeles.

Sales forecast

CSL is utilising its contacts in the target markets to leverage contracts through direct sales methods, trade shows and onsite demonstrations. Online and social media campaigns will also be used to create product awareness. Sales agents are controlled by the Sales Director. Our sales forecast growth rate is 10 per cent per annum due to expected high demand and because we are growing from a very small base.

TABLE A1.6 SALES FORECAST

SALES FORECAST	2016	2017	2018
Sales			
Samoa Gold Pacific BioKoko beans	$395 807	$500 000	$600 000
Koko likor	$395 807	$450 000	$550 000
Cocoa butter	$395 807	$500 000	$600 000
Cocoa powder	$213 850	$600 000	$700 000
Cocoa nibs	$115 066	$250 000	$300 000
Single-origin bars	$371 620	$500 000	$750 000
Samoan truffles	$39 738	$200 000	$250 000
Medicinal chocolates	$28 993	$200 000	$300 000
Koko Samoa	$74 329	$120 000	$130 000
Total sales	$2 031 017	$3 320 000	$4 180 000
Direct cost of sales			
Labour	$293 400	$302 960	$313 196
Energy costs	$36 000	$45 000	$55 000
Inventory	$70 000	$77 000	$84 000
Transport	$16 000	$17 600	$19 360
Marketing web	$20 000	$22 000	$24 200
Research	$24 000	$26 400	$29 040
Training	$36 000	$39 600	$43 560
Travel	$16 000	$17 600	$19 360
Direct cost of sales	$511 400	$548 160	$587 716

RESEARCH, DESIGN AND DEVELOPMENT

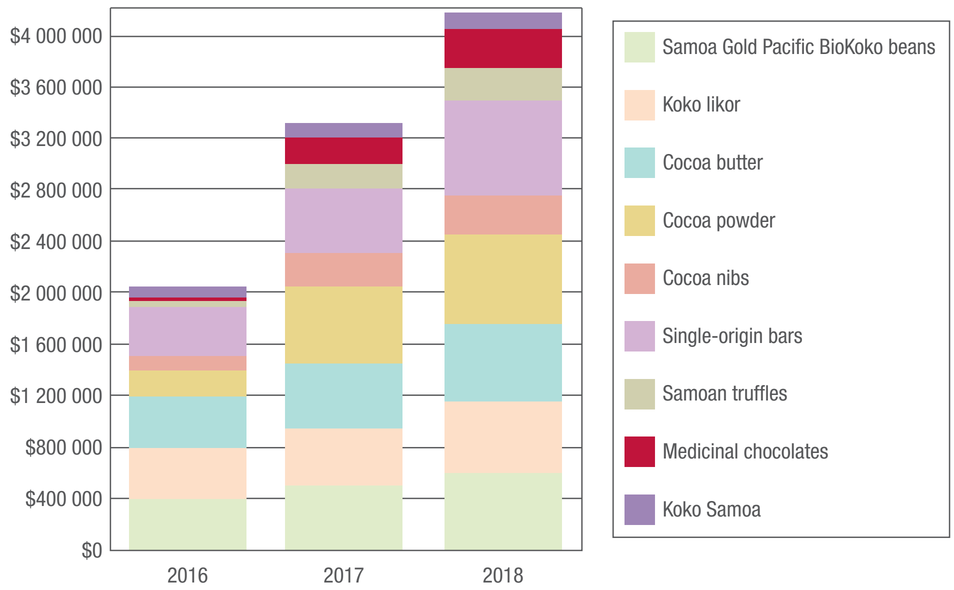
One of the biggest problems in Samoa is the unevenness of cocoa fermentation (which kills the embryo and starts the chocolate chemistry). Putting together a container of cocoa beans for export means working with dozens of growers who have different styles and practices of fermenting beans.

We intend to use the Cloud-based software Cropster (see Figure A1.8), a bean-to-bar tracking system, to help farmers taste chocolate made from their beans and adjust their processes to ensure their harvest meets buyers' needs.

Our business puts the growers in direct communication with trade customers through the Cloud-based Cropster Cocoa Lab, which brings together all the key processes on one web-based platform. This system allows:

- real-time communication between chocolatier and grower
- tracing of a sample back to its origin

FIGURE A1.7
SALES YEARLY



- cut test and tasting your samples
- monitoring of fermentation, moisture, defects, flavours, aromas
- evaluation results of cocoa samples shared with external partners such as buyers
- monitoring of volumes available and their qualities
- evaluating growers and tracing any outcome to the processes at the origin to improve quality over time.

FIGURE A1.8
CROPSTER
TECHNOLOGY

Cropster Cloud-based software uses Bluetooth, WiFi and internet to connect growers with manufacturers in real-time monitoring of quality.
Source: Author's own images

OPERATIONS

PRODUCTION PROCESS

The hillside is a five-hectare-plus site near a good road. Beans arrive and are unloaded at the top for fermenting and solar drying. From the drying rack, they spill into the roasting operation using solar or low-quality fossil materials. This spills into the processing process. Finally, the end-finishing container has few machines and needs air conditioning and dehumidification.

We would need to properly outfit at least four ocean containers in the initial stages (see Figure A1.9), and then move to eight containers (placed immediately to the right of the ones depicted). These custom-built insulated containers have already been developed into a food-quality 'chocolate laboratory' for product development and manufacture (depicted). The factory requires 230V, 3-phase, 35A wiring. We use an engineer, draftsman and production team to create solutions specifically designed to our needs.

FIGURE A1.9 FACTORY DESIGN

Source: Author's own image

Equipment

Required equipment is as follows: winnower, roaster, melangeur, mixer, bean sorter, grinder, moulding station, tempering machine, fire-proofing mechanism, and gas extraction system (see Figure A1.10 for some examples of equipment). These are manufactured in Florida, USA by Cacao Cucina of St Petersburg.

FIGURE A1.10 CHOCOLATE MANUFACTURING EQUIPMENT FROM CACAO CUCINA

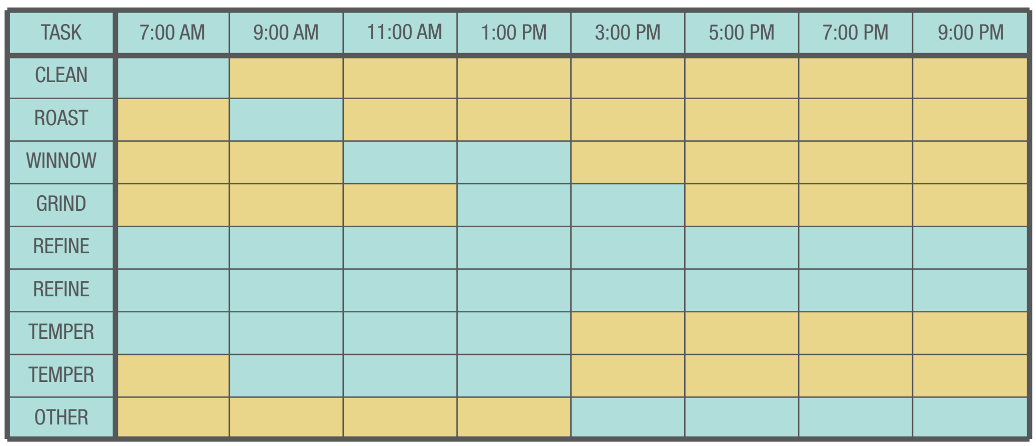
Source: Author's own images

The refrigerated kitchen itself requires refrigerators, air conditioning and dehumidifier. Beyond this we require food service equipment (stainless steel and granite tables, microwave, dishwasher, blender, etc.), storage hardware (bins, utensil rack, shelves, food case), counter area equipment (counter tops, sinks etc.) and retail store equipment (cooled display cases, security, EFTPOS, ventilation, signage). Other miscellaneous equipment includes scales, shelves and lighting fixtures, flat trays for chocolate, storage containers, chocolate pots for ganache, utensils (specialised chocolate knives, spatulas, etc.), storage racks for utensils, and miscellaneous and cleaning setup (bins, broom, buckets, aprons, towels, etc.).

TRAINING CENTRE AND FACTORIES

We commence with a Pilot Cocoa Processing and Chocolate Manufacturing and Training Centre ('Training Centre') producing 0.5–1.0 tonnes of chocolate per week (see Figure A1.11). We then build a Liquor and Couverture Processing Plant on Upolu and Savai'i. It is envisaged that this should commence with 0.5–1.0 tonne production of cocoa liquor and chocolate per week (i.e. up to 50–250 tonnes per year), which is only reliant on 10–25 per cent of hectares of Samoan cocoa production.

FIGURE A1.11 MULTI-MAN OPERATION – 450 KG/WEEK



COCOA REMEDIATION PROGRAM

CSL conducts cocoa-horticultural training and remediation programs to ensure an increase in the commercial quantities of cocoa beans produced for cocoa liquor and couverture production for export.

CERTIFICATES AND ACCREDITATION

There are numerous Standards, Accreditations and Certification programs that we could participate in. They are listed in order of our perceived importance:

- **International Cocoa Organization (ICCO):** CSL will seek the support of the Government of Samoa to rejoin the 2010 International Cocoa Agreement, particularly Annex C – countries exporting 'Fine or Flavour' (FF) cocoa.
- **Organic certification:** Working with Women in Business Development Incorporated (WIBDI), a non-governmental organisation that helps families in Samoa to establish sustainable enterprises, we will help women and families obtain organic certification.
- **Appellation:** We shall establish an appellation for the 'Samoa Gold Standard', an objective system of classifying the top beans and growers. An appellation is a legally defined and protected geographical indication used to identify where the grapes for a wine were grown. The 'Standard' concept can also be employed in other Samoan industries.
- **Fairtrade Certification:** Working with Fairtrade Australia–New Zealand we will help Samoan growers obtain better prices, decent working conditions, local sustainability and fair terms of trade for farmers and workers in the developing world.
- **ISO 14 000:** ISO 14 000 refers to a family of voluntary standards and guidance documents to help organisations address environmental issues.

MANAGEMENT

Our management team and all the employees are qualified in their fields, with experience in cocoa processing and chocolate production and marketing operations. Part-time Australian and New Zealand national sales agents will be appointed. About 13 employees, from CEO to factory workers, will be on board by the beginning of Year One (Y1).

PERSONNEL PLAN

Calculations note: Salaries using real SAT salaries: Secretary SAT 12 000; Agronomists SAT 30–35 000; Finance and Office Director SAT 20 000; Casual/labourer/field worker SAT 30/day or AUD$12/day. Some positions begin only later in Y1 (e.g. April).

Key personnel

- CEO is a motivated entrepreneur with interests in international business development, enterprise promotion and management. Experience in Australia, New Zealand and US Pacific Coast markets. Certifications in Small Business Management and Company Directorship.
- Development Director (DD) focuses on fundraising, liaison with funders and donors, company promotion and building the website. Project management and enterprise promotion background, with experience in private sector development, government ministries and aid agencies, and civil society organisations.
- Training and Community Director (TCD) organises farming communities, ensures on-time deliveries of production and carries out training. Also in charge of the Certification process.
- Operations Director (OD) focuses on day-to-day production issues, maintains inventories and systems. Arranges work timetable for factory employees.
- Technical support personnel operate equipment and vehicles, report to the OD.
- Sales Director (SD) is a passionate individual with strengths as a business developer and experience as National Account Manager within Australia. The key account manager and a significant influence upon strategic promotion and marketing.
- Admin Director (AD) is in charge of administrative functions.
- Finance Director (FD) keeps everything on financial course and within cash constraints. Responsible for complying with Samoa labour laws.
- Webmaster (part-time) has social media and e-commerce experience.

Board members/advisers

We have on- and off-island Board members with experience in manufacturing, IT, communications, marketing, and food and beverage sectors.

Legal structure

Cocoa Samoa Ltd is a Samoan registered limited liability company formed by six individuals.

FINANCIAL PLAN

We want to finance growth through a combination of grants/ODA, debt, cash flow and sweat equity of the founders. Purchase of the facility and equipment will require debt financing. Additional technology will be primarily financed with cash flow. In addition, we seek to achieve gross margins of 50 per cent and hold operating costs at no more than 25 per cent of sales.

TABLE A1.7 PERSONNEL PLAN

PERSONNEL PLAN	2016	2017	2018
CEO	$72 000	$72 000	$72 000
Development	$72 000	$72 000	$72 000
Training and community	$36 000	$17 160	$18 876
Operations	$36 000	$17 160	$18 876
Technical	$24 000	$13 200	$14 520
Sales Director (on island)	$60 000	$56 000	$56 000
Administration/secretarial	$6 000	$6 600	$7 260
Finance	$8 400	$9 240	$10 164
2 FT Factory and field hands	$24 000	$36 000	$48 000
4 FTE Casual workers	$42 000	$63 000	$75 000
Total people	13	16	18
Total payroll	**$380 400**	**$362 360**	**$392 696**

START-UP FUNDING

CSL has major start-up expenses during Y1 and Y2 in building our capacity. We expect to be positive by the end of Y3.

- Phase 1 commences with a Cocoa Processing and Chocolate Manufacturing and Training Centre ('Training Centre').
- Phases 2–3 involve building Liquor and Couverture Processing Plants ('the Plants').

Table A1.8 lists all loans and investment (including grants/ODA) that we are seeking or have already obtained to fund the start-up costs of the business before the CSL starting date of January 2016.

TABLE A1.8 START-UP FUNDING

START-UP FUNDING	
Funding required	
Start-up expenses to fund	$227 000
Start-up assets to fund	$1 070 000
Total funding required	$1 297 000
Assets	
Non-cash assets from start-up	$920 000
Cash requirements from start-up	$150 000
Additional cash raised	$375 000
Cash balance on starting date	$525 000
Total assets	$1 445 000

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LIABILITIES AND CAPITAL	
Liabilities	
Current borrowing	$25 000
Long-term liabilities	$50 000
Accounts payable (outstanding bills)	$20 000
Other current liabilities (interest-free)	$50 000
Total liabilities	$145 000
Capital	
Planned investment	
Owners	$50 000
Grant/ODA	$1 477 000
Additional investment requirement	$0
Total planned investment	$1 527 000
Loss at start-up (start-up expenses)	–$227 000
Total capital	$1 300 000
Total capital and liabilities	$1 445 000
Total funding	**$1 672 000**

We also include here:

- Long-term loans (e.g. possible bank loan of $50 000).
- Accounts payable – debts to be paid that we incur during start-up (e.g. 30 days to pay for a shipment of cocoa).
- Other current liabilities are non-interest loans from the founders.

IMPORTANT ASSUMPTIONS

The Financial Plan is based on important assumptions and is detailed in the following statements:

- CSL forecasts that there would be no unforeseen changes in technology to make our products obsolete.
- Cash flow is expected to be a problem, with most products needing to be paid for on delivery.
- Grants are listed as investments, since, unlike a loan, they do not have to be repaid.
- CSL assumes that even a slow-growth economy will not affect our Plan for the next five years due to the rising demand for cocoa products.
- The source of raw material is more than enough to satisfy our needs, pending remediation efforts.
- CSL assumes a medium-term holding (6–8 weeks) of inventory as stockpiling of product.
- CSL assumes a 10 per cent annual increase in our selling price (20 per cent for single-origin bars), that is, a price above inflation as our product becomes more known and sought after.

- CSL assumes a decrease in our material costs due to economies of scale as growers ramp up production.
- Short-term interest rate based upon current ANZ and Westpac lending rates of 11–18 per cent. These costs could be slashed with foreign direct investment or private equity at 4 per cent.

PROFIT AND LOSS

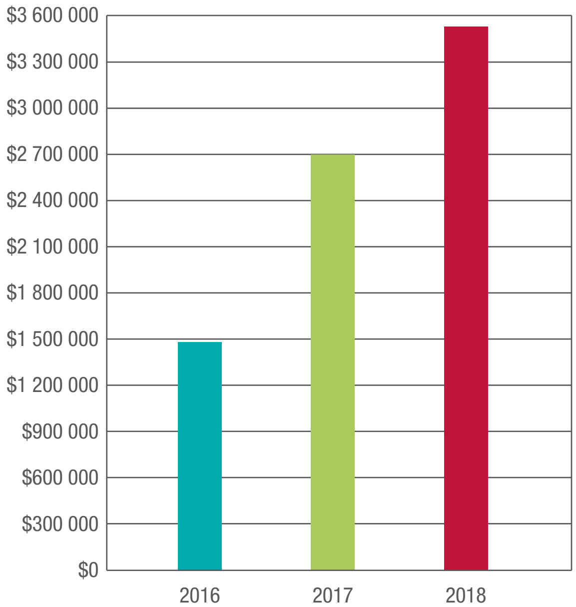
As the profit and loss table shows, CSL expects to continue its steady growth in profitability over the first three years of operations.

TABLE A1.9 PROFIT AND LOSS

PRO FORMA PROFIT AND LOSS	2016	2017	2018
Sales	$2 031 017	$3 320 000	$4 180 000
Direct cost of sales	$511 400	$548 160	$587 716
Other costs of sales	$42 769	$47 000	$52 000
Total cost of sales	$554 169	$595 160	$639 716
Gross margin	$1 476 848	$2 724 840	$3 540 284
Gross margin %	72.71%	82.07%	84.70%
Expenses			
Payroll	$380 400	$362 360	$392 696
Marketing/promotion	$42 000	$42 000	$42 000
Depreciation	$120 000	$150 000	$175 000
Rent	$6 000	$6 000	$6 000
Utilities	$6 000	$6 000	$6 000
Insurance	$6 000	$6 000	$6 000
Payroll taxes	$57 060	$54 354	$58 904
Other	$60 000	$70 000	$80 000
Total operating expenses	**$677 460**	**$696 714**	**$766 600**
Profit before interest and taxes	$799 388	$2 028 126	$2 773 684
EBITDA	$919 388	$2 178 126	$2 948 684
Interest expense	$15 059	$38 063	$57 263
Taxes incurred	$211 769	$537 317	$733 433
Net profit	**$572 560**	**$1 452 746**	**$1 982 987**
Net profit/sales	**28.19%**	**43.76%**	**47.44%**

FIGURE A1.12 PROFIT YEARLY

FIGURE A1.13 GROSS MARGIN YEARLY



CASH FLOW

Table A1.10 presents our projected cash flow balances. The critical first year reflects negative cash flow. CSL intends to distribute dividends to its shareholders in a way that will enable the continuation of the expansion of the company according to this Business Plan. CSL estimates that no distributions will occur in Y1–Y2, and $50 000 will be distributed in Y3, and that from Y4 forward 50 per cent of the profit (after tax) will be distributed to the shareholders as dividends. The Board of Directors will determine any other distributions (for example, to top leadership) to be made on an annual basis.

TABLE A1.10 PRO FORMA CASH FLOW

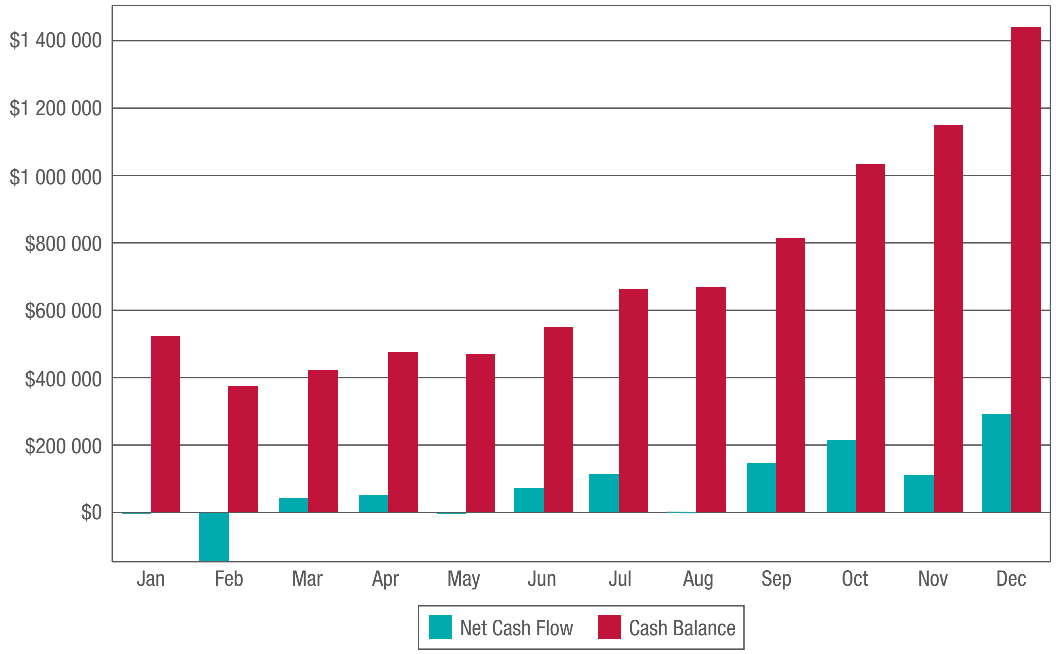
PRO FORMA CASH FLOW	2016	2017	2018
Cash received			
Cash received from operations			
Cash sales	$1 523 263	$2 490 000	$3 135 000
Cash from receivables	$332 634	$718 860	$970 848
Subtotal cash from operations	$1 855 896	$3 208 860	$4 105 848
Additional cash received			
Sales tax, VAT, HST/GST received	$304 653	$498 000	$627 000
New current borrowing	$213 850	$213 850	$213 850
New other liabilities (interest-free)	$21 379	$10 000	$10 000
New long-term liabilities	$100 000	$0	$0

continue

continue

PRO FORMA CASH FLOW	2016	2017	2018
Sales of other current assets	$1 000	$10 000	$10 000
Sales of long-term assets	$10 000	$12 000	$14 000
New investment received	$54 547	$300 000	$400 000
Subtotal cash received	$2 561 325	$4 252 710	$5 380 698
Expenditures			
Expenditures from operations			
Cash spending	$380 400	$362 360	$392 696
Bill payments	$930 771	$1 395 846	$1 620 930
Subtotal spent on operations	$1 311 171	$1 758 206	$2 013 626
Additional cash spent			
Sales tax, VAT, HST/GST paid out	$304 653	$498 000	$627 000
Principal repayment of current borrowing	$6 000	$12 000	$12 000
Other liabilities principal repayment	$6 000	$12 000	$12 000
Long-term liabilities principal repayment	$6 000	$12 000	$12 000
Purchase other current assets	$6 000	$12 000	$12 000
Purchase long-term assets	$6 000	$12 000	$12 000
Dividends	$0	$0	$50 000
Subtotal cash spent	$1 645 824	$2 316 206	$2 750 626
Net cash flow	$915 501	$1 936 504	$2 630 072
Cash balance	**$1 440 501**	**$3 377 005**	**$6 007 077**

FIGURE A1.14
CASH FLOW Y1



BREAK-EVEN ANALYSIS

Our break-even analysis is based on running costs, namely the 'burn-rate' costs we incur to keep the business running short of revenue for more than a year. Our upfront costs for building the factories and recruiting competent staff mean that we'll likely have 'pain' during our early period. Our assumptions on average unit sales and average per-unit costs are based upon a low-ball assumption.

In this analysis, we changed the definition of 'fixed costs' slightly. According to financial textbooks, fixed costs would be those that you would pay even after you closed the business down (such as lease costs, interest and other costs you could not cancel). Our definition, however, is *average running costs* (including rent, payroll, telephones, utilities, etc.) instead of fixed costs. This produces a more practical break-even point.

TABLE A1.11 BREAK-EVEN ANALYSIS

Monthly revenue break-even	$75 454
Assumptions	
Average percentage variable cost	25%
Estimated monthly fixed cost	$56 455

BALANCE SHEET

CSL's projected company balance sheet follows. Our projected balance sheet shows a growth in net worth from $1 495 143 to more than $6 million in 2016.

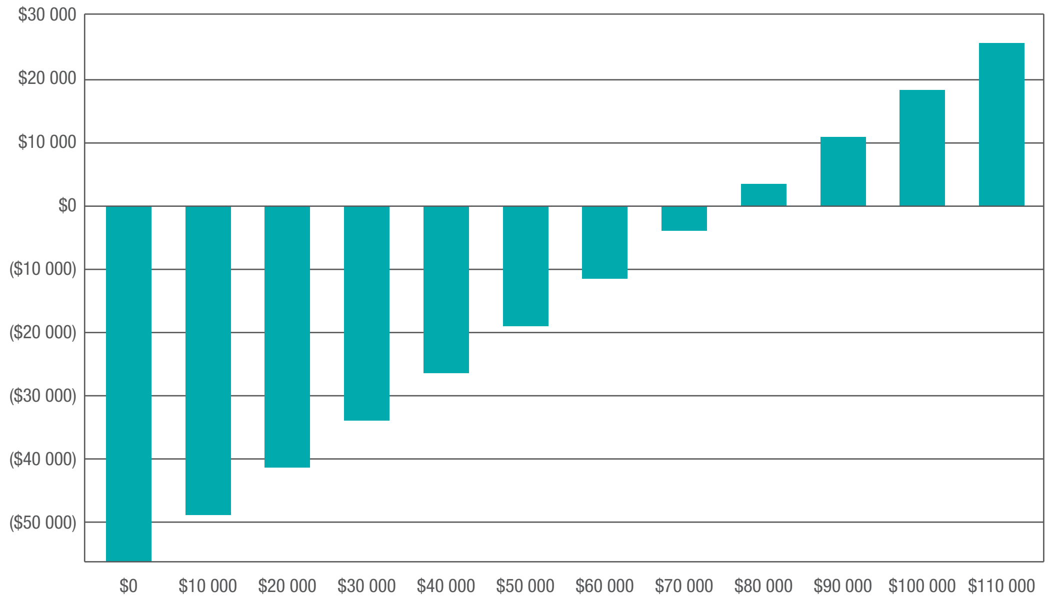


FIGURE A1.15 BREAK-EVEN ANALYSIS

TABLE A1.12 PRO FORMA BALANCE SHEET

ASSETS	2016	2017	2018
Current assets			
Cash	$1 440 &501	$3 377 005	$6 007 077
Accounts receivable	$175 120	$286 260	$360 412
Inventory	$114 600	$158 648	$170 141
Other current assets	$25 000	$27 000	$29 000
Total current assets	$1 755 221	$3 848 913	$6 566 630
Long-term assets			
Long-term assets	$846 000	$846 000	$844 000
Accumulated depreciation	$120 000	$270 000	$445 000
Total long-term assets	$726 000	$576 000	$399 000
Total assets	$2 481 221	$4 424 913	$6 965 630
LIABILITIES AND CAPITAL			
Current liabilities			
Accounts payable	$111 886	$114 982	$134 861
Current borrowing	$232 850	$434 700	$636 550
Other current liabilities	$65 379	$63 379	$61 379
Subtotal current liabilities	$410 115	$613 061	$832 790
Long-term liabilities	$144 000	$132 000	$120 000
Total liabilities	$554 115	$745 061	$952 790
Paid-in capital	$1 581 547	$1 881 547	$2 281 547
Retained earnings	–$227 000	$345 560	$1 748 306
Earnings	$572 560	$1 452 746	$1 982 987
Total capital	$1 927 107	$3 679 853	$6 012 840
Total liabilities and capital	$2 481 221	$4 424 913	$6 965 630
Net worth	**$1 927 107**	**$3 679 853**	**$6 012 840**

BUSINESS RATIOS

The ratios show a plan for growth in order to reach maximum production and profitability within three years. Return on investment increases each year as we bring the factory to maximum capacity and production. Returns on sales and assets remain strong and cost of goods decreases based upon efficiency projections.

TABLE A1.13 RATIO ANALYSIS

RATIO ANALYSIS	2016	2017	2018	INDUSTRY PROFILE
Sales growth	N/A	63.46%	25.90%	−1.41%
Percentage of total assets				
Accounts receivable	7.06%	6.47%	5.17%	60.97%
Inventory	4.62%	3.59%	2.44%	25.17%
Other current assets	1.01%	0.61%	0.42%	6.04%
Total current assets	70.74%	86.98%	94.27%	92.18%
Long-term assets	29.26%	13.02%	5.73%	7.82%
Total assets	100.00%	100.00%	100.00%	100.00%
Current liabilities	16.53%	13.85%	11.96%	47.79%
Long-term liabilities	5.80%	2.98%	1.72%	34.89%
Total liabilities	22.33%	16.84%	13.68%	82.68%
Net worth	77.67%	83.16%	86.32%	17.32%
Percentage of sales				
Sales	100.00%	100.00%	100.00%	100.00%
Gross margin	72.71%	82.07%	84.70%	33.68%
Selling, general and administrative expenses	44.52%	38.32%	37.26%	12.99%
Advertising expenses	2.07%	1.27%	1.00%	0.05%
Profit before interest and taxes	39.36%	61.09%	66.36%	2.60%
Main ratios				
Current	4.28	6.28	7.89	1.85
Quick	4.00	6.02	7.68	1.32
Total debt to total assets	22.33%	16.84%	13.68%	82.68%
Pre-tax return on net worth	40.70%	54.08%	45.18%	38.95%
Pre-tax return on assets	31.61%	44.97%	39.00%	6.75%
Additional ratios				
Net profit margin	28.19%	43.76%	47.44%	N/A
Return on equity	29.71%	39.48%	32.98%	N/A
Activity ratios				
Accounts receivable turnover	2.90	2.90	2.90	N/A
Collection days	54	101	113	N/A
Inventory turnover	3.70	4.01	3.58	N/A
Accounts payable turnover	9.14	12.17	12.17	N/A

continue

continue

RATIO ANALYSIS	2016	2017	2018	INDUSTRY PROFILE
Payment days	28	30	28	N/A
Total asset turnover	0.82	0.75	0.60	N/A
Debt ratios				
Debt to net worth	0.29	0.20	0.16	N/A
Current liab. to liab.	0.74	0.82	0.87	N/A
Liquidity ratios				
Net working capital	$1 345 107	$3 235 853	$5 733 840	N/A
Interest coverage	53.08	53.28	48.44	N/A
Additional ratios				
Assets to sales	1.22	1.33	1.67	N/A
Current debt/total assets	17%	14%	12%	N/A
Acid test	3.57	5.55	7.25	N/A
Sales/net worth	1.05	0.90	0.70	N/A
Dividend payout	**0.00**	**0.00**	**0.03**	**N/A**

CRITICAL RISKS

TABLE A1.14 SWOT ANALYSIS

	POSITIVE	NEGATIVE
EXTERNAL	*Opportunities* Great stories to tell! We become a showcase for Samoa's low-carbon strategy. World is swinging around to the lifestyles of health and sustainability. Target markets are looking for products such as ours. We have opportunity with an innovative product. Health-conscious consumers with active lifestyles. Demonstration of bio-energy technologies.	*Threats* See attached special section on 'Threats'.
INTERNAL	*Strengths* Groups anxious to engage. Certifications exist. New and innovative products that tick all the boxes for advanced markets. Products for the huge LOHAS market. Experienced principals and board members. Reduced barriers to entry through familiarity with AU, NZ, US markets. Experience in online media. Control of value chain. Samoa medium to good in many indicators of doing business.	*Weaknesses* New to the market. Restricted advertising budget. Possible impediment or delays of order deliveries. Farmers losing their knowledge. Already have pests and diseases. Cyclones are frequent. Samoa performs poorly in getting credit, trading across borders, enforcing contracts and tax compliance.

THREATS

We are especially concerned about the threats to Samoan biosecurity. We seek to reduce the risk of importation of infectious diseases, quarantined pests and invasive species.

- Fungal diseases are a principal constraint to cocoa production, and on a global scale the greatest losses result from black pod rots caused by Phytophthora.
- Cocoa pod borer is a moth whose larvae tunnel into cocoa pods to feed on the seeds for about two to three weeks. They chew their way out of the fruit to pupate.
- Samoa is also subject to natural disasters, particularly cyclones.
- Rodents are serious pests to Samoan cocoa. Rats like ripe pods, and this means that growers need to search for rats when pods are ripening.

HARVEST STRATEGY

This business plan does not contain a harvest strategy.

MILESTONE SCHEDULE

Table A1.15 lists important project milestones during the pre-production start-up period through the end of Y1.

TABLE A1.15 MILESTONES

MILESTONE	START DATE	END DATE	BUDGET	MANAGER	DEPARTMENT
Domain secured	15/03/2016	15/03/2016	$100	CEO, MD	IT
Business licence and FIC	15/03/2016	1/06/2016	$1 000	AD	Finance/accounts
Factory design	15/03/2016	1/06/2016	$10 000	CEO, Engineer	Legal
Web marketing	15/03/2016	1/06/2016	$0	MD	Marketing
Building permit/EIA	15/03/2016	1/09/2016	$1 000	TD	Team
Purchase contracts in place	15/03/2016	31/12/2017	$10 000	DD, TD	Team
Trade secrets established –NDAs	15/03/2016	1/10/2016	$1 000	CEO, DD	Team
Trademarks registered	15/03/2016	31/12/2017	$5 000	ABC	Team
Community and training	15/03/2016	31/12/2014	$150 000	TD	Team
Land lease for factory	1/06/2016	1/09/2016	$50 000	Legal office	Legal
Factory construction	1/06/2016	31/12/2017	$300 000	CEO, engineer	Team
Office IT network	1/06/2016	1/09/2016	$2 000	IT specialist	IT
Temporary HQ set up	1/06/2016	1/09/2016	$5 000	DD, TD	3 H/Q
Landscaping remediation	1/06/2016	14/10/2016	$5 000	Landscapers	Team/private
Customs/biosecurity	1/06/2016	31/12/2017	$3 000	TD	Team
Koko Shop running	1/09/2017	1/09/2017	$10 000	Coop	Team
Community and training	15/03/2016	31/12/2017	$150 000	TD	Team
Totals			$703 100		

APPENDIX

SALES FORECAST	JAN	FEB	MAR	APR	MAY	JUN	JUL	AUG	SEP	OCT	NOV	DEC
Sales												
Samoa Gold Pacific BioKoko beans	$10 000	$12 000	$14 400	$17 280	$20 736	$24 883	$29 860	$35 832	$42 998	$51 598	$61 918	$74 302
Koko liquor	$10 000	$12 000	$14 400	$17 280	$20 736	$24 883	$29 860	$35 832	$42 998	$51 598	$61 918	$74 302
Cocoa butter	$10 000	$12 000	$14 400	$17 280	$20 736	$24 883	$29 860	$35 832	$42 998	$51 598	$61 918	$74 302
Cocoa powder	$10 000	$11 000	$12 100	$13 310	$14 641	$16 105	$17 716	$19 488	$21 437	$23 581	$25 939	$28 533
Cocoa nibs	$5 000	$5 500	$6 050	$6 655	$7 321	$8 053	$8 858	$9 744	$10 718	$11 790	$12 969	$22 408
Single-origin bars	$5 000	$6 500	$8 450	$10 985	$14 280	$18 564	$24 133	$31 373	$40 785	$53 020	$68 926	$89 604
Samoan truffles	$1 000	$1 200	$1 440	$1 728	$2 074	$2 489	$2 987	$3 584	$4 301	$5 310	$6 193	$7 432
Medicinal chocolates	$1 000	$1 150	$1 322	$1 520	$1 748	$2 010	$2 312	$2 659	$3 058	$3 517	$4 045	$4 652
Koko Samoa	$1 000	$1 300	$1 690	$2 197	$2 856	$3 713	$4 827	$6 275	$8 158	$10 605	$13 786	$17 922
Total sales	$53 000	$62 650	$74 252	$88 235	$105 128	$125 583	$150 413	$180 619	$217 451	$262 617	$317 612	$393 457
DIRECT COST OF SALES												
Labour	$19 200	$19 200	$19 200	$26 200	$26 200	$26 200	$26 200	$26 200	$26 200	$26 200	$26 200	$26 200
Energy costs	$3 000	$3 000	$3 000	$3 000	$3 000	$3 000	$3 000	$3 000	$3 000	$3 000	$3 000	$3 000
Inventory	$20 000	$0	$0	$10 000	$0	$0	$20 000	$0	$0	$20 000	$0	$0
Transport	$5 000	$1 000	$1 000	$1 000	$1 000	$1 000	$1 000	$1 000	$1 000	$1 000	$1 000	$1 000
Marketing web	$5 000	$5 000	$1 000	$1 000	$1 000	$1 000	$1 000	$1 000	$1 000	$1 000	$1 000	$1 000
Research	$1 000	$1 000	$1 000	$1 000	$1 000	$1 000	$3 000	$3 000	$3 000	$3 000	$3 000	$3 000
Training	$3 000	$3 000	$3 000	$3 000	$3 000	$3 000	$3 000	$3 000	$3 000	$3 000	$3 000	$3 000
Travel	$2 000	$1 000	$1 000	$2 000	$1 000	$1 000	$2 000	$1 000	$1 000	$2 000	$1 000	$1 000
Subtotal Direct cost of sales	$58 200	$33 200	$29 200	$47 200	$36 200	$36 200	$59 200	$38 200	$38 200	$59 200	$38 200	$38 200

PERSONNEL PLAN	JAN	FEB	MAR	APR	MAY	JUN	JUL	AUG	SEP	OCT	NOV	DEC
CEO	$6 000	$6 000	$6 000	$6 000	$6 000	$6 000	$6 000	$6 000	$6 000	$6 000	$6 000	$6 000
Development	$6 000	$6 000	$6 000	$6 000	$6 000	$6 000	$6 000	$6 000	$6 000	$6 000	$6 000	$6 000
Training and community	$3 000	$3 000	$3 000	$3 000	$3 000	$3 000	$3 000	$3 000	$3 000	$3 000	$3 000	$3 000
Operations	$3 000	$3 000	$3 000	$3 000	$3 000	$3 000	$3 000	$3 000	$3 000	$3 000	$3 000	$3 000
Technical	$2 000	$2 000	$2 000	$2 000	$2 000	$2 000	$2 000	$ 2000	$2 000	$2 000	$2 000	$2 000
Sales Director (on island)	$5 000	$5 000	$5 000	$5 000	$5 000	$5 000	$5 000	$5 000	$5 000	$5 000	$5 000	$5 000
Administration/secretarial	$500	$500	$500	$500	$500	$500	$500	$500	$500	$500	$500	$500
Finance	$700	$700	$700	$700	$700	$700	$700	$700	$700	$700	$700	$700
2 FT Factory and field hands	$2 000	$2 000	$2 000	$2 000	$2 000	$2 000	$2 000	$2 000	$2 000	$2 000	$2 000	$2 000
4 FTE Casual workers	$2 000	$2 000	$2 000	$4 000	$4 000	$4 000	$4 000	$4 000	$4 000	$4 000	$4 000	$4 000
Total people	6	6	6	13	13	13	13	13	13	13	13	13
Total payroll	$30 200	$30 200	$30 200	$32 200	$32 200	$32 200	$32 200	$32 200	$32 200	$32 200	$32 200	$32 200

PRO FORMA PROFIT AND LOSS	JAN	FEB	MAR	APR	MAY	JUN	JUL	AUG	SEP	OCT	NOV	DEC
Sales	$53 000	$62 650	$74 252	$88 235	$105 128	$125 583	$150 413	$180 619	$217 451	$262 617	$317 612	$393 457
Direct cost of sales	$58 200	$33 200	$29 200	$47 200	$36 200	$36 200	$59 200	$38 200	$38 200	$59 200	$38 200	$38 200
Other costs of sales	$2 000	$2 200	$2 420	$2 662	$2 928	$3 221	$3 543	$3 897	$4 287	$4 716	$5 188	$5 707
Total cost of sales	$60 200	$35 400	$31 620	$49 862	$39 128	$39 421	$62 743	$42 097	$42 487	$63 916	$43 388	$43 907
Gross margin	($7 200)	$27 250	$42 632	$38 373	$66 000	$86 162	$87 670	$138 522	$174 964	$198 701	$274 224	$349 550
Gross margin %	−13.58%	43.50%	57.42%	43.49%	62.78%	68.61%	58.29%	76.69%	80.46%	75.66%	86.34%	88.84%
Expenses												
Payroll	$30 200	$30 200	$30 200	$32 200	$32 200	$32 200	$32 200	$32 200	$32 200	$32 200	$32 200	$32 200
Marketing/ promotion	$2 000	$2 000	$2 000	$2 000	$2 000	$2 000	$5 000	$5 000	$5 000	$5 000	$5 000	$5 000
Depreciation	$10 000	$10 000	$10 000	$10 000	$10 000	$10 000	$10 000	$10 000	$10 000	$10 000	$10 000	$10 000
Rent	$500	$500	$500	$500	$500	$500	$500	$500	$500	$500	$500	$500
Utilities	$500	$500	$500	$500	$500	$500	$500	$500	$500	$500	$500	$500
Insurance	$500	$500	$500	$500	$500	$500	$500	$500	$500	$500	$500	$500
Payroll taxes 15%	$4 530	$4 530	$4 530	$4 830	$4 830	$4 830	$4 830	$4 830	$4 830	$4 830	$4 830	$4 830
Other	$5 000	$5 000	$5 000	$5 000	$5 000	$5 000	$5 000	$5 000	$5 000	$5 000	$5 000	$5 000
Total operating expenses	$53 230	$53 230	$53 230	$55 530	$55 530	$55 530	$58 530	$58 530	$58 530	$58 530	$58 530	$58 530
Profit before interest and taxes	−$60 430	−$25 980	−$10 598	−$17 157	$10 470	$30 632	$29 140	$79 992	$116 434	$140 171	$215 694	$291 020
EBITDA	−$50 430	−$15 980	−$598	−$7 157	$20 470	$40 632	$39 140	$89 992	$126 434	$150 171	$225 694	$301 020
Interest expense	$451	$540	$639	$747	$866	$997	$1 296	$1 443	$1 605	$1 952	$2 152	$2 372
Taxes Incurred	−$16 438	−$7 161	−$3 034	−$4 834	$2 593	$8 002	$7 518	$21 208	$31 004	$37 319	$57 656	$77 935
Net profit	−$44 443	−$19 360	−$8 203	−$13 070	$7 011	$21 634	$20 326	$57 341	$83 825	$100 900	$155 886	$210 713
Net profit/sales	−83.86%	−30.90%	−11.05%	−14.81%	6.67%	17.23%	13.51%	31.75%	38.55%	38.42%	49.08%	53.55%

PRO FORMA CASH FLOW	JAN	FEB	MAR	APR	MAY	JUN	JUL	AUG	SEP	OCT	NOV	DEC
Cash received												
Cash from operations												
Cash sales	$39 750	$46 988	$55 689	$66 176	$78 846	$94 187	$112 810	$135 464	$163 088	$196 963	$238 209	$295 092
Cash from receivables	$0	$442	$13 330	$15 759	$18 680	$22 200	$26 452	$31 603	$37 855	$45 462	$54 739	$66 113
Subtotal Cash from operations	$39 750	$47 429	$69 019	$81 935	$97 526	$116 387	$139 262	$167 067	$200 943	$242 425	$292 948	$361 205
Additional cash received												
Sales tax, VAT, HST/ GST received 15.00%	$7 950	$9 398	$11 138	$13 235	$15 769	$18 837	$22 562	$27 093	$32 618	$39 393	$47 642	$59 018
New current borrowing	$10 000	$11 000	$12 100	$13 310	$14 641	$16 105	$17 716	$19 488	$21 437	$23 581	$25 939	$28 533
New other liabilities (interest free)	$1 000	$1 100	$1 210	$1 331	$1 464	$1 610	$1 771	$1 948	$2 143	$2 357	$2 593	$2 852
New long-term liabilities	$0	$0	$0	$0	$0	$0	$50 000	$0	$0	$50 000	$0	$0
Sales of other current assets	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$1 000
Sales of long- term assets	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$10 000
New investment received	$2 000	$2 280	$2 599	$2 963	$3 378	$3 851	$4 390	$5 005	$5 706	$6 505	$7 416	$8 454
Subtotal Cash received	$60 700	$71 207	$96 066	$112 775	$132 778	$156 790	$235 701	$220 601	$262 847	$364 260	$376 538	$471 063

continue

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PRO FORMA CASH FLOW	JAN	FEB	MAR	APR	MAY	JUN	JUL	AUG	SEP	OCT	NOV	DEC
Expenditures												
Expenditures from operations												
Cash spending	$30 200	$30 200	$30 200	$32 200	$32 200	$32 200	$32 200	$32 200	$32 200	$32 200	$32 200	$32 200
Bill payments	$26 061	$176 069	$8 758	$15 570	$86 545	$30 558	$58 347	$153 086	$43 670	$70 489	$179 144	$82 473
Subtotal spent on operations	$56 261	$206 269	$38 958	$47 770	$118 745	$62 758	$90 547	$185 286	$75 870	$102 689	$211 344	$114 673
Additional cash spent												
Sales tax, VAT, HST/GST paid out	$7 950	$9 398	$11 138	$13 235	$15 769	$18 837	$22 562	$27 093	$32 618	$39 393	$47 642	$59 018
Principal repayment of current borrowing	$0	$0	$0	$0	$0	$0	$1 000	$1 000	$1 000	$1 000	$1 000	$1 000
Other current liabilities principal repayment	$0	$0	$0	$0	$0	$0	$1 000	$1 000	$1 000	$1 000	$1 000	$1 000
Long-term liabilities principal repayment	$0	$0	$0	$0	$0	$0	$1 000	$1 000	$1 000	$1 000	$1 000	$1 000
Purchase other current assets	$0	$0	$0	$0	$0	$0	$1 000	$1 000	$1 000	$1 000	$1 000	$1 000
Purchase long- term assets	$0	$0	$0	$0	$0	$0	$1 000	$1 000	$1 000	$1 000	$1 000	$1 000
Dividends	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
Subtotal Cash spent	$64 211	$215 666	$50 096	$61 005	$134 514	$81 595	$118 109	$217 379	$113 487	$147 082	$263 986	$178 692
Net cash flow	−$3 511	−$144 460	$45 970	$51 770	−$1 737	$75 195	$117 592	$3 221	$149 360	$217 178	$112 552	$292 371
Cash balance	$521 489	$377 029	$422 999	$474 769	$473 032	$548 227	$665 819	$669 041	$818 400	$1 035 579	$1 148 130	$1 440 501

PRO FORMA BALANCE SHEET	STARTING BALANCES	JAN	FEB	MAR	APR	MAY	JUN	JUL	AUG	SEP	OCT	NOV	DEC
Assets													
Current assets													
Cash	$525 000	$521 489	$377 029	$422 999	$474 769	$473 032	$548 227	$665 819	$669 041	$818 400	$1 035 579	$1 148 130	$1 440 501
Accounts receivable	$0	$13 250	$28 471	$33 703	$40 003	$47 605	$56 802	$67 952	$81 505	$98 012	$118 205	$142 869	$175 120
Inventory	$50 000	$174 600	$141 400	$112 200	$141 600	$115 400	$108 600	$177 600	$139 400	$114 600	$177 600	$139 400	$114 600
Other current assets	$20 000	$20 000	$20 000	$20 000	$20 000	$20 000	$20 000	$21 000	$22 000	$23 000	$240 00	$250 00	$25 000
Total current assets	$595 000	$729 339	$566 900	$588 903	$676 372	$656 038	$733 629	$932 372	$911 945	$1 054 012	$1 355 383	$1 455 399	$1 755 221
Long-term assets													
Long-term assets	$850 000	$850 000	$850 000	$850 000	$850 000	$850 000	$850 000	$851 000	$852 000	$853 000	$854 000	$855 000	$846 000
Accumulated depreciation	$0	$10 000	$20 000	$30 000	$40 000	$50 000	$60 000	$70 000	$80 000	$90 000	$100 000	$110 000	$120 000
Total long-term assets	$850 000	$840 000	$830 000	$820 000	$810 000	$800 000	$790 000	$781 000	$772 000	$763 000	$754 000	$745 000	$726 000
Total assets	$1 445 000	$1 569 339	$1 39 900	$1 408 903	$1 486 372	$1 456 038	$1 523 629	$1 713 372	$1 683 945	$1 817 012	$2 109 383	$2 200 399	$2 481 221

continue

continue

PRO FORMA BALANCE SHEET	JAN	FEB	MAR	APR	MAY	JUN	JUL	AUG	SEP	OCT	NOV	DEC
Liabilities and capital												
Current liabilities												
Accounts payable	$175 782	$8 323	$12 620	$85 555	$28 726	$53 118	$151 657	$41 449	$64 405	$176 433	$78 615	$111 886
Current borrowing	$35 000	$46 000	$58 100	$71 410	$86 051	$102 156	$118 872	$137 360	$157 797	$180 378	$205 317	$232 850
Other current liabilities	$51 000	$52 100	$53 310	$54 641	$56 105	$57 715	$58 486	$59 434	$60 577	$61 934	$63 527	$65 379
Subtotal Current liabilities	$261 782	$106 423	$124 030	$211 606	$170 882	$212 989	$329 015	$238 243	$282 779	$418 745	$347 459	$410 115
Long-term liabilities	$50 000	$50 000	$50 000	$50 000	$50 000	$50 000	$99 000	$98 000	$97 000	$146 000	$145 000	$144 000
Total liabilities	$311 782	$156 423	$174 030	$261 606	$220 882	$262 989	$428 015	$336 243	$379 779	$564 745	$492 459	$554 115
Paid-in capital	$1 529 000	$1 531 280	$1 533 879	$1 536 842	$1 540 220	$1 544 071	$1 548 461	$1 553 466	$1 559 172	$1 565 677	$1 573 093	$1 581 547
Retained earnings	−$227 000	−$227 000	−$227 000	−$227 000	−$227 000	−$227 000	−$227 000	−$227 000	−$227 000	−$227 000	−$227 000	−$227 000
Earnings	−$44 443	−$63 803	−$72 006	−$85 076	−$78 065	−$56 431	−$36 105	$21 236	$105 061	$205 961	$361 847	$572 560
Total capital	$1 257 557	$1 240 477	$1 234 873	$1 224 766	$1 235 155	$1 260 640	$1 285 356	$1 347 702	$1 437 233	$1 544 638	$1 707 940	$1 927 107
Total liabilities and capital	$1 569 339	$1 396 900	$1 408 903	$1 486 372	$1 456 038	$1 523 629	$1 713 372	$1 683 945	$1 817 012	$2 109 383	$2 200 399	$2 481 221
Net worth	$1 257 557	$1 240 477	$1 234 873	$1 224 766	$1 235 155	$1 260 640	$1 285 356	$1 347 702	$1 437 233	$1 544 638	$1 707 940	$1 927 107

ENDNOTES

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GLOSSARY

A

A/B testing A method of hypothesis-driven entrepreneurship in which two (or more) versions of an artefact (e.g. product, service, web page or app) are compared against each other to determine which performs better and which delights the customer more. Also called split testing.

abductive logic A form of logical inference in which you start with an observation and jump to a theoretical explanation which is subsequently tested to see if the explanation fits the observation. Abductive logic leads to a series of hunches or educated guesses about what caused or causes the observations, but these might actually prove false. (See also *inductive logic*, *deductive logic*.)

absolutist ethics The belief that there are absolute standards against which moral questions can be judged, and that certain actions are right or wrong, irrespective of context.

access over ownership A disruptive business model that allows customers to use a product or service without buying it.

accounts payable Liabilities incurred when goods or supplies are purchased on credit. Treated as a current liability on a balance sheet.

accounts receivable Money that is owed to a company by a customer for products and services provided on credit. Treated as a current asset on a balance sheet.

accounts receivable financing Involves either the pledge of receivables as collateral for a loan or the sale of receivables (factoring).

accrual system of accounting A method of recording and allocating income and costs for the period in which each is involved, regardless of the date of payment or collection. For example, if you were paid $100 in April for goods you sold in March, the $100 would be income for March under an accrual system. (Accrual is the alternative to the cash system of accounting.)

achievement Accomplishing a business goal successfully through skill, risk-taking or perseverance.

adaptive business A venture that remains adaptive and innovative both through and beyond the growth stage.

adjusted tangible book value A common method of valuing a business, by computing its net worth as the difference between total assets and total liabilities.

administrative expenses An overhead cost associated with managing business affairs not directly attributable to sales, marketing, production or service delivery.

affordable loss The level of loss that can be endured by an entrepreneur or a business that can be reasoned to be affordable in order to explore the potential of an opportunity.

affordable loss principle A risk minimisation principle whereby an investment in a project, like a new venture, is limited to what the investor or entrepreneur is willing to lose.

agile development A method of product development in which the product is developed iteratively and incrementally while continuously seeking customer feedback using successive minimum viable products.

algorithm Technically refers to a 'list of steps' written in code and performed by a computer, but we can generalise a 'business algorithm' as a formula that when repeated leads to commercial success.

allowance for uncollectable accounts Accounts receivable judged to be uncollectable.

analytical thinking The ability to research, analyse, visualise and articulate a complex decision or problem. Care is needed in relying on analytical thought dependent on historical data to decide on a future course. Analytical thinking can be skewed toward past-dependence and not necessarily indicative of the future or useful in envisioning a different future.

angel capital Investment in a business by an affluent individual to provide equity capital.

annihilative entrepreneur An entrepreneur who unethically destroys rents, resulting in catastrophic and irrecoverable damage. See also *productive entrepreneur*, *unproductive entrepreneur*, *destructive entrepreneur*.

anticipatory design science Human practice that would align men and women to the conscious design of our total environment, making Earth's finite resources meet the needs of humanity without disrupting the ecological processes of the planet.

antidilution protection Protection against adjustment of the conversion price of preferred shares as a result of certain diluting events, such as share splits or share dividends. The conversion price is typically subject to 'price protection', which is an adjustment based on future sales of shares at prices below the conversion price.

appositional relationship A relationship among things and people existing in the world in relation to other things and other people.

Asia-Pacific Political and economic term used to designate the economies on the edges of the Pacific Ocean as well as the various island nations within the region.

asset protection A way to organise assets and transactions in such a way that personal assets (such as the family home) are shielded from future liabilities or business failure.

assets Anything of value that is owned by you or your business.

average revenue per user (ARPU) Total revenue divided by number of subscribers. Used widely by consumer and digital companies.

B

balance sheet An itemised statement listing the total assets, liabilities and net worth of your business at a given moment.

bank loan Long-term liability due to a loan from a lending institution.

bankruptcy Legal status of an organisation or person who cannot pay their debts to creditors to whom they owe money.

barriers to entry Elements restricting new business entry into an industry, such as proprietary technology; limited access to distribution channels, raw materials and other inputs; cost disadvantages due to lack of experience; and risk.

B-corporation accreditation An accreditation standard available for businesses that accounts for the lack of laws that make transparent a combination of employee, community and environmental interests in addition to economic motives.

benefit corporation (B-Corp) A type of for-profit corporation in the USA that builds into its constitution the commitment to create value for its shareholders while being accountable and transparent to meet a purpose that benefits society and the environment.

benefit variables Benefit variables are when you divide up your customer base according to their perceptions of benefits or advantages that they receive from a product or service. Some customers highly value quality, others performance, customer service or special features.

better widget strategies Strategies that leverage unique products that open up existing markets or stake out new markets.

biosphere All ecosystems on Earth, as well as the Earth's crust, waters and atmosphere, on and in which organisms exist; also, the sum of all living matter on Earth.

biosphere entrepreneur An entrepreneur who adds value to natural ecosystems, akin to a business entrepreneur adding value to his private pocket or to shareholders, or a social entrepreneur adding value to the community.

bird-in-hand principle From effectuation theory, this principle comes from the proverb 'a bird in the hand is worth two in the bush'. It means entrepreneurs look first at what they have and whom they know, especially from their four Fs: family, friends, other founders and other foolhardy investors.

Bitcoin A popular digital currency invented to make international monetary exchanges and purchasing easier across the internet. It uses blockchain technology and is one of a class of digital currencies called cryptocurrencies.

blockchain technology A digital technology that consists of blocks of information linked and encrypted together to form a chain that records the continuous series of linked transactions right from the original source recorded on a distributed ledger.

Blue Ocean Strategy The strategy of seeking a market space that is not yet contested or that remains unidentified by competitors. Also the strategy of creating new market spaces to avoid the tightly held known markets that competitors hotly contest for customers.

bodystorming A design thinking research method that helps the entrepreneur experience the customer's 'pain' in order to derive new ideas and generate solutions. You design an experiment or an experience where you can enact how people would respond if they had your product or service.

bootstrapping A means of starting a new venture through highly creative acquisition and use of (sometimes other people's) resources. (See also *incrementalist approach*.)

born global A company that goes global from its very 'birth'. It rapidly expands on the world market without conquering the domestic market first.

bottom line The major priority of the organisation in terms of its measure of value created. Typically it is economic but increasingly social and environmental value is being included. (See also *triple bottom line*.)

brainstorming A technique for creative idea and solution generation through unstructured group discussion. Every member of the group thinks aloud and suggests as many solutions as possible, no matter how eccentric or unusual they might be.

break-even analysis The method of determining the point at which a company makes neither a profit nor a loss. The break-even point for a product is the point where total revenue received equals total costs.

bribery A corrupt activity in which a person offers goods, money, services, etc. to sway another person's opinion, action or decision.

bricks, clicks and flips Describes an entrepreneurial venture that combines presences offline (bricks) and online (clicks), sometimes with the third extra, flips (physical catalogues).

bricolage theory Theory of entrepreneurship that emphasises making do with whatever is at hand by combining existing (scarce) resources in ways that add value. Bricolage means to 'tinker' or 'do-it-yourself' in French.

budget A statement of estimated income and expenses over a specific period of time.

build-measure-learn A core component of hypothesis-driven entrepreneurship methodology. First build a minimum viable product, then measure and learn using actionable metrics that feed back into the next iteration.

build-out allowance In a lease contract, the amount given to the tenant by the landlord to build- out the premises.

business angel A private investor who contributes money and experience to early-stage investments.

business entrepreneur An entrepreneur driven by the profit motive (as opposed to social entrepreneurs), who seeks growth and profits within the business world.

business failure When a fall in revenues and/or rise in expenses are of such magnitude that the firm becomes insolvent.

business formation The act and procedures of starting a business.

business model How a venture is designed to make money, demonstrating a clear method of getting to the market for sales.

business model canvas (BMC) A one-page visualisation or depiction of how you create customer value in terms of content, structure and operation. First devised by Alex Osterwalder in 2004, it gives entrepreneurs a common language and a visual framework. (See also *lean canvas*.)

business model design The architecture of how we exploit a new opportunity, product or service. It describes the logic of value creation by depicting how an enterprise works.

business model ontology A way to visually depict the logic of a venture's value creation through such instruments as value proposition, target customer, revenue and cost structures, unfair advantage, etc. (See also *ontology*.)

business plan The written document that details a proposed venture. It must illustrate current status, expected needs and projected results of the new business.

business valuation The calculated value of the business, used to track its increases or decreases.

buy/sell agreements An agreement designed to handle situations in which one or more of the entrepreneurs wants to sell their interest in the venture.

buzz marketing A technique of viral marketing that aims to generate 'buzz' or word-of-mouth communication leading to conversations about products and services among family, friends and larger social forums. (See also *word of mouth*.)

C

calculated risk taking An entrepreneurial behaviour whereby information and/or expertise is sought to evaluate whether the risk involved in pursuing an opportunity is calculable and worthy of the potential loss.

capex Short for 'capital expenditure'; refers to costs associated with buying machinery, equipment, property and other fixed assets that provide long-term benefit.

capital (1) The amount invested in a business by the proprietor(s) or shareholders. (2) The money available for investment or money invested.

capital budget A type of budget used to plan expenditures on assets whose returns are expected to last beyond one year. (See also *budget*.)

capital budgeting A budgeting process used to determine investment decisions, i.e. how to invest new capital to increase value in the company (for example, through machine replacement or R&D). It relies heavily on evaluation of cash inflows.

capitalism An economic system based on private ownership of the means of production. Individuals, companies or corporations invest in, own and share in profits (or losses) of the entities that produce goods, distribute products or provide services.

career risk The entrepreneurial risk associated with the potential for career damage or loss. Managers with a secure job and benefits often experience this when they consider whether they can go back to their old job if their venture should fail.

cash Coins, currency and cheques on hand, as well as money in cheque and savings accounts.

cash engine A business' stable income that generates enough surplus cash to cover dividends and fund the company's future growth.

cash flow A measure of the movement of money within a business venture, including all outflows and inflows. Usually measured for a specified period of time either in the past or in the future. The flow of money in must provide timely coverage for any necessary flows of money out of the business venture. Never, even temporarily, run out of cash flow.

cash-flow budget A budget that provides an overview of inflows and outflows of cash during a specified period of time. (See also *budget*.)

cash-flow statement A financial statement that sets forth the amount and timing of actual and/or expected cash inflows and outflows.

click-through rate (CTR) the proportion of people who view an ad who then click on a link. Useful metric for measuring effectiveness of a call-to-action or pay-per-click ad.

co-creation Collaboration between two or more parties to produce a product, service or other outcome that has shared benefit. Usually involves the customer as one party in a marketing sense but other co-creators may be suppliers or investors.

cognition Refers to mental processes, including attention, memory, language production and comprehension, problem solving and decision making.

cold call An unsolicited visit or telephone call made by someone trying to sell goods or services.

co-marketing Also known as co-promotion, cooperation of two or more companies to market or promote each other's products.

commercialisation The process of introducing a new product into the market; sequence of actions necessary to achieve market entry and general market competitiveness of new innovative technologies, processes and products.

common shares Shares that represent part of whole ownership of a company. Holders of common shares have voting rights but no guarantee of dividend payments. Note: The word 'stock' is used in the US instead of 'shares'. (See also *ordinary shares*.)

concierge method Manual delivery of a product to a customer with as little technology as possible before the automated or software-driven process is available, performed to quickly see if the product solves the customer's problems.

confirmation bias The human tendency to interpret new evidence as confirming existing beliefs, especially true for exciting entrepreneurial ideas.

consumer pain See *pain*.

contribution margin approach The percentage of each sale that remains after the variable costs are subtracted.

control factor The degree of control an owner legally has over the firm, which can affect its valuation.

convergent thinking Narrowing the scope of possibilities to devise the single best answer to a problem.

conversion funnel A visual representation of the journey that buyers take, from visitors to customers to brand ambassadors for your company.

conversion rate In an online advertising campaign, the average number of sales, enquiries or subscriptions per ad click, shown as a percentage.

convertible debentures Loans to a company made by investors, as opposed to loans raised from a bank. The investors receive a fixed rate of interest. Debentures may be 'convertible' into shares or 'redeemable' for cash at a specified future date.

cooperative business model A social business model, a non-profit association of people coming together voluntarily to meet some common need through a jointly owned and democratically controlled venture.

cooperative society An association operating on a service motive, which provides services to its members and receives limited return of capital. Unlike a company, all members of a cooperative have only one vote, irrespective of their shareholding.

copreneurs Couple with a personal relationship in addition to a business relationship.

copyright A legal protection that provides exclusive rights to creative individuals for the protection of their literary or artistic productions.

corporate angel A type of angel investor, typically a senior manager who has been laid off with a generous severance or has taken early retirement.

corporate entrepreneurship The entrepreneurial behaviour of people within large firms and organisations. (Related terms include *intrapreneurship, innovation* and *venturing*.)

corporate social responsibility A business process that guides a company's activities in the protection and promotion of international human rights, labour and environmental standards by minimising their environmental impact, adhering to international labour standards, contributing to their communities and managing towards a more economically sustainable world.

corporate venturing Another word for intrapreneurship or corporate entrepreneurship.

corporation In the US, a legal business entity that often has similar rights in law to those of a natural person. Equivalent to an incorporated company in Australia, New Zealand, Singapore, the UK and Ireland. They have limited liability and their shareholders are not normally responsible for the company's debts beyond the amount they paid for their shares. Accordingly, while the terminology differs, the concept of a company or corporation is largely the same.

cost behaviour The sensitivity of costs to changes in production or sales volume. Fixed costs are constant. Variable costs vary, but the cost per unit does not.

cost of goods sold (COGS) The value of products sold to customers in a given period, determined by subtracting the value of the ending inventory from the sum of the beginning inventory and purchases made during the period. Gross sales less cost of goods sold gives gross profit.

creative confidence The natural ability to come up with new ideas and the courage to try them out.

creative process A process of exploration, selection, combination, refinement and reflection to create a new idea or innovation.

creativity The generation of ideas that results in improved efficiency or effectiveness of a system.

critical thinking Understanding the world through reasoning and creativity. Involves analysing, evaluating, interpreting or synthesising information and applying creative thought to form an argument, solve a problem or reach a conclusion.

crowdfunding The practice of funding a project or venture by raising monetary contributions from a large number of people, typically via the internet.

cryptocurrencies A class of digital currencies invented to make international monetary exchanges and purchasing easier across the internet.

current assets Items on the balance sheet listed as assets, such as cash, accounts receivable, inventory and short-term investments, that can be converted to cash and/or used to pay current liabilities within 12 months.

current liabilities See *short-term liabilities*.

customer acquisition costs (CAC) The ratio of all costs spent on acquiring customers (marketing expenses) divided by the number of customers acquired.

customer development A process of discovering, validating, recruiting, even creating customers that don't yet exist.

customer discovery This first step in the customer development process, in which you identify your customers by turning your assumptions into testable hypotheses.

customer jobs What customers are trying to get done, solve or satisfy. May be functional (e.g. perform a task), social (e.g. gain status), emotional (e.g. security) or basic needs (e.g. communication).

customer journey A research technique that involves illustrating all of the contact points between the customer and your company, product or service. It relates the story of the customer's experience through the funnel from mystery, to opportunity, to recipe for success (see Figure 6.6).

customer lifetime value (CLV) An estimate of the net profit from one customer over their lifetime; an element in calculating payback of advertising.

customer persona See *persona*.

customer segmentation The process of identifying a specific set of characteristics that differentiate one group of consumers from the rest.

customer segment A targeted group of customers that fit a certain profile. Customer segments aid decisions on where and how a product or service will be marketed. May be defined in many ways, including geographic, demographic, psychographic and combinations of these, or in any other way that narrows the focus toward a group of potential purchasers, either individuals or businesses.

Customer validation A process of using hypotheses and experimentation, you find out whether your assumptions are correct in respect to identifying actual customers who will buy your product.

cybersquatter A person who seeks to profit by registering an unclaimed internet domain name knowing that it is likely to be sought after by another person, business or organisation.

D

dark side of entrepreneurship A destructive side existing within the energetic drive of successful entrepreneurs.

debt financing Financing in which you get a loan and go into debt. You are obliged to repay the loan at a predetermined interest rate.

deductive logic Also known as top-down logic, a type of logic that generates conclusions by reasoning from one or more theoretical statements (premises). (See also *inductive logic*, *abductive logic*.)

demographic variables Statistical information about the customer or beneficiary, such as income, gender, education, location, ethnicity, race and family size. (See also *psychographics*.)

depreciation Lost usefulness; expired utility; the diminution of service yield from a fixed asset or fixed asset group that cannot or will not be restored by repairs or by replacement of parts.

design (1) A complex business activity that uses design tools to meld form and function with manufacturability and marketability. (2) To devise courses of action aimed at changing existing situations into preferred ones.

design challenge A specific problem to address, expressed as a statement. Getting the problem statement right will organise how you think about your solution. When the going gets ambiguous, the design challenge statement should remind you to focus on the ultimate impact and allow a variety of solutions. And it should be fun!

design intelligence A form of intelligence possessed or acquired by designers to use various forms of reasoning to create novel solutions.

design registration A means to protect a product's appearance, shape and/or configuration in either two or three dimensions.

design thinking A proven and repeatable creative problem-solving and product development methodology that combines the needs of real people with the possibilities of technology and the necessary business success.

design thinking process model A multi-stage model that represents the flow of the design thinking process.

designerly ways of knowing A 'culture' of knowing and understanding the natural world that uses pattern formation and modelling and values empathy, practicality and ingenuity above all else, in contrast to knowledge creation in science and the humanities.

destructive entrepreneur An entrepreneur who unethically destroy rents but whose destruction may be recoverable. (See also *productive entrepreneur*, *unproductive entrepreneur*, *annihilative entrepreneur*.)

diaspora entrepreneur An entrepreneur who supports their home country by sending remittances, and combining local business know-how with knowledge of their home country. *Diaspora* (from Greek διασπορά) refers to people who are scattered from their original homeland.

differently-abled entrepreneur An entrepreneur with a mental or physical condition that entails unique abilities. For example, a blind entrepreneur might excel at running a sound studio.

direct exporting Selling directly to customers through establishment of subsidiaries or contractual or partner relationships with foreign companies in destination countries.

disadvantaged entrepreneur An entrepreneur from a background of hardship or suffering.

disclosure Declaration of information relevant to specific transactions that is required by law.

discounted earnings method A method of determining the true value of the firm using a pricing formula that includes earning power as well as adjusted tangible book value.

discovery-driven planning While conventional planning extrapolates the future from the past, discovery-driven planning can envision the unknown and uncertain future to learn as much as possible as cheaply as possible.

displacement school of thought Entrepreneurial school of thought that focuses on factors that prevent (or displace) a person from doing other activities, such as a political regime or a regulatory environment that blocks free enterprise; cultural aspects that might prevent a person from choosing self-employment; or economic factors such as job loss or even full employment, and the effect these factors might have on the choice to become an entrepreneur.

divergent thinking Widening perspective to explore as many ideas and solutions as one can muster in order to see a multiplicity of possible solutions.

dividends Cash, shares or other assets from an incorporated company's profits distributed to shareholders, an equal amount for each share owned. Paid from the total net earnings. Retained earnings are what remain after dividend distribution.

domain name The last part of a URL that includes the organisation's unique name followed by its organisational form, such as .com for 'commercial' or .edu for 'educational'.

downcycling Recycling of a material into a material of lesser quality.

drive to achieve A strong desire to compete, to excel against self-imposed standards and to pursue and attain challenging goals.

due diligence A process undertaken by potential investors to analyse and assess the desirability, value and potential of an investment opportunity.

durable competitive advantage In marketing and strategic management, an advantage that one company has relative to its competitors.

dynamic capabilities The strategic capabilities that lead a business to change the what, the how and/or the why of what it does.

dynamic states model A network of relationships and systems that convert opportunity tension into value for a venture's customers, generating new resources that maintain the dynamic state.

E

early-stage financing Financing provided to companies that have completed the product development stage and test marketing, but require additional financing to expand commercial manufacturing and sales.

ecological school of thought School of entrepreneurial thought that focuses on our perception of the natural world and our relationship to it as entrepreneurs. Based on the idea that everything is related to everything everywhere. Encompasses intergenerational equity, irreversibility of environmental change, uncertainty of long-term outcomes and sustainable development.

econosphere Total capital stock; that is, the set of all objects, people, organisations and so on that are interesting from the point of view of the system of exchange.

ecopreneur An entrepreneur who combines the unrelenting drive and imagination of the entrepreneur with the stewardship of a conservator.

ecopreneurship The study and practice of nascent and new business owners who innovate, upcycle and offer environmentally friendly services, goods and technology.

effectual logic An approach to entrepreneurial strategy, popularised by Saras Sarasvathy, that is unconstrained by either limited resources or fixed objectives.

effectuation theory A theory that explains how entrepreneurs identify opportunities. Great entrepreneurs do not use 'causal reasoning' like corporate managers do. Instead, they use 'effectual logic' and make decisions in response to 'contingencies'. Entrepreneurs focus on the end and try to find the best means to achieve it. They believe, 'To the extent that I can control the future, I do not need to predict it.'

either/or thinking A way of thinking that supposes there are only two possible positions that establish clear and stark choices. Either/or thinking denies further possibilities and closes down the opportunity to perceive other alternatives.

elevator pitch The brief oral presentation for selling a business plan to potential investors (named for the analogy of riding an elevator and having only two minutes to get your story across to another person in the elevator).

email capture The collection of leads to encourage consumers down the conversion funnel.

emotional bias The tendency of an entrepreneur to believe their enterprise is worth a great deal more than outsiders believe it is worth.

empathic mindset The ability to put yourself into your customer/client/stakeholder's shoes to understand problems from their perspective and to uncover their pains and problems (including some that they didn't even know about), and to generate unexpected solutions (including ones that they had not thought of).

empathy The ability to be aware of and sensitive to other people's feelings, thoughts and experiences.

employee stock ownership plan (ESOP) Plan for passing control of the enterprise to the employees if the owner has no immediate successor in mind.

enterprise The process of identifying, developing and bringing a vision to life, be it an innovative idea or simply a better way of doing something. Enterprise applies not only to business ventures, but also to political decisions and social decisions.

enterprising mindset A mindset marked by imagination, initiative and readiness to undertake new endeavours; reflects a capability to focus on a particular opportunity and how to quickly act upon it while maintaining a broader view of the end position and how the opportunity will be shaped and fit within an enterprise or business model.

enthusiast angel Angel that simply loves to be involved in deals. Typically plays no role in management and rarely seeks to be placed on a board.

entrepreneur (1) An innovator or developer who recognises and seizes opportunities; converts these opportunities into workable/marketable ideas; adds value through time, effort, money or skills; assumes the risks of the competitive marketplace to implement these ideas; and realises the rewards from these efforts. (2) An individual who organises and manages labour, capital and natural resources to produce goods and services to earn a profit, but who also runs the risk of failure.

entrepreneurial Describes a person who has the mindset to spot opportunities, has a social or enterprising spirit, is willing to take calculated risks and wishes to enjoy a good outcome for themselves and the community.

entrepreneurial angel The most prevalent type of investor. Typically owns and operates one or more highly successful businesses.

entrepreneurial behaviour The actions, thoughts and deeds to initiate a new venture regardless of social, project or business form.

entrepreneurial capabilities The set of skills and abilities that support an individual in identifying an entrepreneurial/business opportunity and developing the resource base needed to pursue it.

entrepreneurial career A career that involves the work and effort required to spot opportunities and pursue new endeavours or ventures.

entrepreneurial characteristics The set of attitudes, behaviours and character traits associated with an individual who identifies opportunities and gathers the needed resources to pursue a new endeavour or venture.

entrepreneurial cognition The knowledge structures used to make assessments, judgements or decisions involving opportunity evaluation, venture creation and growth.

entrepreneurial economy A new emphasis on entrepreneurial thinking in the global economy that developed in the 1980s and 1990s and is prevalent now in the twenty-first century.

entrepreneurial ego A self-centred characteristic exhibited by entrepreneurs obsessed with the importance of themselves and their ideas.

entrepreneurial employee activity The activities undertaken by an employee that reflect entrepreneurial behaviours to initiate new-venture formation processes within the context of an existing business

entrepreneurial family A family that provides opportunity for its family members to initiate change, and instils a desire to be innovative.

entrepreneurial leadership An entrepreneur's ability to anticipate, envision, maintain flexibility, think strategically and work with others to initiate changes that will create a viable future for their organisation.

entrepreneurial marketing The proactive identification and exploitation of opportunities for acquiring and retaining profitable customers through innovative approaches to risk management, resource leveraging and value creation.

entrepreneurial mindset All the cognitive characteristics and elements that compose the entrepreneurial potential in every individual.

entrepreneurial motivation The willingness of an entrepreneur to sustain his or her entrepreneurial behaviour.

entrepreneurial opportunity An opportunity for the creation of a new venture that can attain an identified and superior competitive advantage and provide a profitable return to its investors.

entrepreneurial persistence An entrepreneur's choice to continue with an entrepreneurial opportunity regardless of counterinfluences or other enticing alternatives.

Entrepreneurial Revolution A global trend toward increasing associations between entrepreneurship and economic performance, including job creation, growth, firm survival, innovation and technological change, productivity increases and exports.

entrepreneurial strategy System of strategies that underpin long-range plans for the effective management of opportunities and threats in light of an entrepreneur's, an entrepreneurial team's or a venture's strengths and weaknesses.

entrepreneurial stress A function of discrepancies between one's expectations and one's ability to meet demands.

entrepreneurial successor A successor to a venture who is highly gifted with ingenuity, creativity and drive.

entrepreneurial team The small group of people who work together to start a new venture. Often led by an entrepreneur, they all share entrepreneurial characteristics in various combinations.

entrepreneurial trait school of thought A micro view of entrepreneurship that seeks to identify traits common to successful entrepreneurs (e.g. achievement, creativity, determination and technical knowledge). (See also *micro view of entrepreneurship*.)

entrepreneurship The practice of starting new organisations, particularly new businesses; the process of innovation and new-venture creation; the commercialisation of innovation.

environmental crime Illegal acts that harm the environment, such as illegal wildlife trade in endangered species, waste smuggling and dumping, and illegal fishing.

environmental protection The practice by individuals, organisations and/or governments of protecting the natural environment from harm and preserving it for the benefit of current and future human generations.

equity capital Funding of the business in the form of part or whole ownership of the company in order to finance start-up operations.

equity crowdfunding A simplified capital-raising instrument that utilises an internet platform to source relatively small capital amounts from the public in exchange for shares (equity) in the venture. Particularly useful for start-up ventures.

equity financing The sale of some ownership in a venture in order to gain capital for start-up.

ethics A set of principles prescribing a behavioural code that explains what is good and right, or bad and wrong.

eureka moment The 'aha' moment when your consciousness finally realises that an idea might actually be an opportunity. Attributed to Archimedes, 'eureka' means 'I have found it' and is used to celebrate a discovery.

exit strategy Method by which the initial investors in a company can liquidate their investment. The two most common exit strategies are either to take the company public by an initial public offering (IPO) or to sell the company to another firm.

expansion financing Financing for a company that is viable and is reaching break-even; usually used to increase production capacity, market or product development.

expenses An expired cost; any item or class of cost of (or loss from) carrying on an activity; a present or past expenditure defraying a present operating cost or representing an irrecoverable cost or loss; an item of capital expenditures written down or off; a term often used with some qualifying expression denoting function, organisation or time, such as a selling expense, factory expense or monthly expense.

explicit needs Wants or desires specified by a customer. For example, 'I need a new watch to record the data from my elliptical exercise machine.' (See also *implicit needs*.)

exploration method Method of surveying to observe and understand your users, their actions and their habits, using such techniques as re-enactments (simulating the problem), interviews, video observations, web surveys, and Facebook invites and likes.

exporting Participating actively in the international arena as a seller of goods and services into foreign markets.

external locus of control The perception that factors external to the self are responsible for the outcome of an event.

external optimism Ceaseless optimism emanating from entrepreneurs as a key factor in the drive towards success.

F

façade test See *fake inventory*.

factoring Process of purchasing commercial accounts receivable (invoices) from a business at a discount.

fair use doctrine An exception to copyright protection that allows limited use of copyrighted materials.

fake door test A method of testing an idea in which you build the important bits and fake the rest, for example by creating a landing page and putting a big call-to-action button on it.

fake inventory test An initial-level-of-interest test in which an e-commerce site lists 'fake inventory' from other online retailers. Also known as vapour test.

falsifiable hypothesis A statement or assumption that can be proven false (invalidated) through observation.

familiness Those unique resources that emerge from interactions between the family system as a whole, the individual family members and the family business.

family and social risk Type of entrepreneurial risk relating to the energy and time cost of starting a new venture. Entrepreneurs who are married, and especially those with children, expose their families to the risks of an incomplete family experience and the possibility of permanent emotional scars. In addition, old friends may vanish slowly because of missed get-togethers.

family succession The process of transferring the assets of a family business from one generation to the next.

finance company Asset-based lender that lends money against assets such as receivables, inventory and equipment.

financial capital Sometimes just called 'money', this is what entrepreneurs use to leverage other resources in the process of making products and services for the marketplace.

financial/capital school of thought Refers to the need for capital and focuses on the relationship between entrepreneurs and investors, funding sources, performance of entrepreneurial investments and returns for investors and entrepreneurs, and public policy issues.

financial ratio A ratio of two reported levels or flows of a company, e.g. two financial flow categories: profit/revenue or earnings/equity.

financial ratio analysis A way of organising and interpreting information from financial data. This analysis quantifies relative performance by analysing the ratio of one performance measure against another and is used to manage a firm's performance by comparative analysis with industry standards or other benchmarks derived from similar firms.

financial risk Type of entrepreneurial risk relating to the money or resources at stake in a new venture.

financial statement An accounting term for an account or formal record that shows the financial activities of a firm, person or other entity.

five forces model A famous model developed by Michael Porter that determines competitive intensity and market attractiveness of an industry in the context of profitability. An industry approaching 'pure competition' would be very unattractive.

five-minute reading A process venture capitalists use when they are reviewing a business plan for potential investment.

fixed assets Land, building, equipment and other assets expected to remain with the firm for an extended period.

fixed costs Part of the operating budget, costs that do not change in response to changes in activity for a given period of time, such as rent, depreciation and certain salaries. (See also *variable costs*, *mixed costs*.)

forcing events Unavoidable events that cause the replacement of the owner-manager, such as death, illness, legal problems or poor mental health.

four Cs The marketing mix of co-creation, communities, customisation and choice, all of which means content is king. (See also *marketing mix*, *four Ps*, *new four Cs*.)

four Fs Types of informal investors: Friends, family, founders and other 'foolhardy investors'.

four Ps The marketing mix of product, price, promotion and place. (See also *marketing mix*, *four Cs*, *new four Cs*.)

framework of frameworks A synthesis of entrepreneurial frameworks that allows for entrepreneurship theory to move forward in identifying the static and dynamic elements of new theories, typologies or frameworks.

franchise Any arrangement in which the owner of a trademark, trade name or copyright has licensed others to use it to sell goods or services.

franchisee An independent business that sells or markets the products and/or services of a larger firm (the franchisor). The franchisee receives training and marketing support from the franchisor and pays a fee for ongoing support.

franchising A form of licensing that involves selling the rights to a complete package of trademarks, processes, technologies, designs and copyrights, as they are all involved in the operation of a specific business.

franchisor A company or person that grants franchises.

free and open business model Making money not from the product but from data collected and user eyeballs (advertising).

free enterprise Private ownership of the means of production and enterprise management that is free and independent from state control. The allocation of productive resources is decentralised and obeys the decisions of free individuals who act guided by their own interest.

freemium strategy for pricing in which a product or service (e.g. games or web services) is offered for free, but money (premium) is charged for higher functionality and more advanced or additional features.

fully diluted Basis for calculating ownership and valuation in which all securities – including preferred stock, options and warrants – that can result in additional ordinary shares are counted in determining the total amount of shares outstanding.

futures Financial contracts in which the buyer agrees now to buy a product (e.g. pork bellies) at a predetermined future date and price.

G

Gaia hypothesis Hypothesis developed by chemist James Lovelock in 1972 that proposes that living organisms work together with their mineral surroundings to form a complex, self-regulating system that maintains life on Earth.

gains The benefits your customer expects, desires or would be surprised by. These can include its functions, social gains, positive emotions and cost savings.

gazelle A business establishment with at least 20 per cent sales growth every year for five years, starting with a base of at least $100 000.

Generation C marketing Generation C (for content) is a social media demographic that includes all the new four C's: creation, curation, connection and community. (See also *new four Cs*, *marketing mix*.)

geo-engineering Deliberate large-scale manipulation of environmental processes so as to change the Earth's climate, in an attempt to counteract the effects of global warming, e.g. reflective aerosols or (atmospheric) dust, cloud seeding, reforestation and space sunshade.

gig economy An economy in which lifetime careers no longer exist, and instead people make their livelihood from temporary, flexible jobs. Derives from musicians playing 'gigs' (one-time musical events).

Global Entrepreneurship Monitor (GEM) A global study conducted yearly since 1999 that analyses the level of entrepreneurship in nearly 100 countries.

global financial crisis (GFC) Also known as the 'Great Recession', the worst financial crisis since the Great Depression of the 1930s which resulted in the collapse of large financial institutions, the bailout of banks by national governments and downturns in stock markets around the world. In many areas, the housing market also suffered.

global sourcing A cross-border search for suitable suppliers that meet specific quality, time and price requirements.

goal orientation A predisposition to defining priorities and monitoring progress toward specific high but attainable goals to maintain focus and manage energy when faced with multiple opportunities.

goodwill The residual value created by an owner of a business in terms of their time, effort and public image after the value of the physical and tangible assets is deducted from the total value of a business.

governpreneurship Entrepreneurship within the government sector.

great chef strategies System of strategy involving leveraging and building the business around great and unique people with special skills or talents.

gross margin The percentage difference between revenue (or income from sales) and the costs associated with producing the goods or services of a business before deduction of administration and overheads, interest and taxes.

gross profit Sales less the cost of goods sold. For example, if you sell $100 000 worth of merchandise for which you paid $80 000, your gross profit would be $20 000.

growth hacking A process of experimentation to identify the best way to grow the business that combines the skills of marketers, user interface designers and product managers.

growth rate The percentage rate of change (usually by year) in any financial characteristic of a company or an economy, such as population, jobs or sales.

growth stack A set of tools to market, sell and communicate with customers, including such tools as Mailchimp, Hootsuite and Google Analytics.

growth stage The third stage of a new-venture life cycle, typically involving activities related to reformulating strategy in light of the competition.

growth wall A psychological wall against change that prevents entrepreneurs from developing a managerial ability to deal with venture growth.

guerrilla marketing An unconventional way of performing marketing activities (primarily promotion) on a very low budget.

H

hackathon A social design-sprint event that brings together programmers, coders and many others to build or improve a software program.

harvest strategy A strategy of how and when the owners and investors will realise an actual cash return on their investment in a venture.

high fidelity Describes a prototype that is quite close to being the final product or service. (See also *low fidelity*.)

hindsight bias Also known as the 'knew-it-all-along effect', refers to entrepreneurs' increasingly realistic estimate of their own success with the benefit of hindsight.

hire purchase The purchase of an asset according to a pre-agreed payment method, often calculated with a high-interest component compared to regular debt finance. The user may be the owner for tax purposes.

holistic view Comprehension of the physical, emotional, mental and spiritual needs of customers or stakeholders so that together you can co-create the world.

human-centred design (HCD) Is all about usability. HCD looks at real people with real 'pains'. It seeks to design solutions useful to their exact needs and requirements.

hybrid business model A business model adopted by social organisations that combine public, private and voluntary sectors; includes non-profits with for-profit business models, and for-profits with social missions.

hypermarket A business model focusing on high-volume, low-margin sales, offering usually a broad range of products or services at prices close to cost. Walmart and Amazon have implemented this business model.

hypnagogia The state of consciousness between wakefulness and sleep, in which the mind has lucid thoughts and dreaming, hallucinations and deep insights.

hypothesis-driven entrepreneurship A lean method of entrepreneurship whereby a start-up enterprise is guided by falsifiable hypotheses (tentative answers to a question) based on observations and controlled experiments. We test, pivot and change the hypothesis using 'minimum viable products' until it is 'validated' such that we can expect a particular outcome.

I

ideation Literally, the act of forming ideas. In ideation, you combine your conscious and unconscious thoughts, your imagination and your rationality to go wide in terms of concepts and outcomes (see Figure 6.2, 'Divergent and convergent thinking').

impact investor A person who invests with the intention to generate a measurable, beneficial social or environmental impact, as well as financial return.

impersonator test A method of testing an idea in which you impersonate the new product you have in mind. For example, take a Lotus Roadster, rip out the fossil fuel and install all-electric (along with slightly different body). It was this idea that enticed Tesla to form a relationship with the Lotus in building the Tesla electric vehicle.

implicit needs Needs that people do not talk about, may not be aware of or might even deny if confronted with. (See also *explicit needs*.)

importing Buying and shipping foreign-produced goods for domestic consumption.

inbound marketing Capture of users/seekers by pulling them into a sales relationship through website, social media, email, content, blogging and other techniques rather than by pushing ads out to them.

income The difference between a business' total revenues and total expenses after taxes, depreciation and interest charges are deducted from the operating profit. Also called net profit and commonly referred to as the 'bottom line'.

income statement Also called profit and loss (P&L) statement, a statement summarising the income of a business during a specific period. The income statement illustrates the projected operating results based on profit and loss.

incorporated company A company that is legally seen as being quite separate from the owner. While more expensive to set up than a sole trader, it offers some protection to the owner should things go wrong.

incorporated limited partnership (ILP) In Australia, a form of a limited partnership (confusingly entitled a limited liability company or LLC in the US) with the capacity and powers of an individual as well as the powers of a company. Limited partners are not entitled to participate in management and general partners have unlimited liability.

incorporation The birth of a company, where it is given legal form. The Certificate of Incorporation is like a birth certificate. Incorporated businesses become separate legal entities in their own right and are recognised therefore as separate from their owners.

incrementalist approach An approach to entrepreneurship guided by the notion that firms go through a predictable pattern of escalating activities when they develop export strategies – from non-exporting domestic producer through to fully globalised operations. This is the opposite of the 'born global' firm.

Indigenous entrepreneur An Indigenous person who creates, manages and develops new ventures by and for Indigenous people. The organisations thus created can pertain to the private, public or non-profit sectors.

Indigenous people Cultural groups that have a historical continuity with a region before its colonisation and who have lived largely independent or isolated from the influence of the larger nation state. These people have maintained at least in part their distinct linguistic, cultural and social/organisational characteristics. Characteristics common across many Indigenous groups include reliance upon subsistence-based production and a predominantly non-urbanised society.

indirect exporting Selling goods to foreign buyers through third parties such as export agents, export merchants or buying houses.

individualism Degree of emphasis placed on individual accomplishment rather than on collectivism or group accomplishment.

inductive logic Logic that reaches conclusions by generalising or extrapolating from specific cases in the real world to create general theoretical rules. (See also *deductive logic*.)

Industrial Revolution Usually dated from 1750 to 1900, the movement from an agricultural economy to an industrial economy based on production of factories and machine labour. A period characterised by many industrial innovations and discoveries.

influencer A person who influences other people in a market, particularly their buying behaviour. (See also *thought leader*.)

influencer marketing Marketing focused on key individuals or customer segments who can influence potential buyers, rather than the market as a whole.

informal investor Any of the four Fs – friends, family, founders and other 'foolhardy' investors (such as neighbours, work colleagues and even strangers).

initial level of interest (ILI) test A test of the customer's starting interest level, usually measured by asking for an email or a download.

initial public offering (IPO) The raising of capital through the sale of company securities on the public markets.

insolvent Describes the state of a business that cannot pay its debts as and when they fall due.

integrative approach An entrepreneurial approach that incorporates a 'from outside' analysis of five key components to justify the choice of one opportunity over another.

integrative thinking The incorporation of two or more opposing ideas to form a new idea that resolves the tension between them and is superior to both.

intellectual property (IP) The proprietary knowledge created through mind and intellect that is a valuable asset to the business.

intellectual property rights (IPR) Legal protection of intellectual property, such as patents, trademarks or copyrights, against infringement by others.

interactive learning Methods of learning within an innovative environment that cut across traditional, functional lines in the organisation.

interdisciplinary Relating to more than one branch of knowledge.

interest The price paid for borrowed money or the return earned from money deposited or lent.

interest expense Interest expense on long-term loans, also known as debt service.

internal locus of control The perception that factors internal to the self – that is, one's own actions – are responsible for the outcome of an event.

internal rate of return (IRR) method A method of capital budgeting in which the future cash flows are discounted at a rate that makes the net present value of the project equal to zero. The internal rate of return represents the interest yield promised by a project over its useful life.

intracapital Special capital set aside for the intrapreneur to use whenever investment money is needed for further research ideas.

intrapreneurs Entrepreneurs who start ventures *from within* larger companies.

intrapreneurship Entrepreneurial activities within a company that receive organisational sanction and resource commitments for the purpose of innovative results. It means the infusion of entrepreneurial thinking into large bureaucratic structures, including corporations and governments. Known as 'corporate entrepreneurship' in the US.

intraprise A company created by an intrapreneur; a spin-off of a larger company.

intuitive thinking The ability to acquire knowledge through sensing, pattern recognition or instinct.

inventory Merchandise, goods and materials held by a company for eventual (re)sale to customers.

investing activities An item on the cash-flow statement that reports cash-flow effects from long-term investing activities, such as purchase or sale of plant and equipment. The net cash flow from investing activities can be either positive or negative.

investment (1) In finance, the purchase of a financial product or other item of value with an expectation of favourable future returns; the use of money in the hope of making more money. (2) In business, the purchase by a producer of a physical good, such as durable equipment or inventory, in the hope of improving future business.

investor protection Guarantee that investments made will not be lost due to misuse of corporate assets by directors for their personal gain, fraud, self-dealing, expropriation, etc.

Islamic finance A financial system that operates according to Islamic law (sharia), which emphasises justice and partnership. Islamic entrepreneurs have very tight strictures on what they may and may not transact as business.

J

joint venture An organisation owned by more than one company; a popular approach to doing business overseas.

L

labour regulations The body of laws passed by a government that regulates the legal rights and restrictions that apply to employees, workers and organisations.

landing page A specially designed web page used in ad campaigns that a visitor 'lands' on, for example, a lead-generation landing page to capture user data would contain a form along with a description of what the user will get in return for submitting their personal data.

late-stage funding Financing for new-product development or introduction, or to support major capacity expansion. Offered before public offering investments to strengthen the company.

lead scoring A technique of assigning scores to contacts to indicate how likely it is to close a deal with that customer, usually based on that contact's engagement, persona or demographics.

lean canvas (LC) Created by Ash Maurya, a one-page visualisation or depiction of the content, structure and operation of how you create customer value. The LC focuses more on start-up businesses and entrepreneurs, while the BMC can be used by investors, consultants, advisors and larger businesses. (See also *business model canvas (BMC)*.)

lean entrepreneurship Launched in 2008 by Eric Ries, a methodology for developing businesses and products through hypothesis-driven experimentation, iterative product releases and validated learning.

lean marketing Marketing focused on agility, viewing each campaign or marketing activity as one step in the ever-improving progress toward customer acquisition and ultimately customer satisfaction.

left brain The part of the brain that helps an individual to analyse, verbalise and use rational approaches to problem solving. (See also *right brain*.)

legal restraint of trade A legal document signed by the seller of a business that restricts him or her from operating in the same industry for a reasonable amount of time and within a reasonable geographic jurisdiction.

lemonade principle From effectuation theory, refers to the proverbial phrase 'When life gives you lemons, make lemonade'. It means leveraging contingencies, because surprises generally mean a new need or market can open up.

letter of intent (LOI) A non-binding document meant to record two or more parties' intentions to enter into a future agreement based on specified (but incomplete or preliminary) terms. Many LOIs contain provisions that are binding, such as non-disclosure agreements, a covenant to negotiate in good faith or a 'stand-still' provision promising exclusive rights to negotiate.

liabilities Amounts owing to creditors, such as a bank loan, accounts payable and so on. They represent a claim against your assets.

licensing A business arrangement in which the manufacturer of a product (or a firm with proprietary rights over technology or trademarks) grants permission to a group or an individual to manufacture that product in return for specified royalties or other payments.

life cycle stages The stages through which a venture progresses, including venture development, start-up, growth, stabilisation and innovation or decline.

lifestyles of health and sustainability (LOHAS) An upscale demographic category of consumers who value sustainable living, organic foods, alternative healthcare, renewable energy and energy-efficient cars and appliances.

limited liability A restriction on the amount of financial responsibility assumed by a partner or shareholder. (See also *unlimited liability*.)

limited liability partnership (LLP) A relatively new form of partnership that allows professionals the tax benefits of a partnership without personal liability for the malpractice of other partners.

limited partnership An organisational arrangement that allows investors to put money into a partnership without assuming liability for any losses beyond this initial investment.

linear regression The process of fitting the best possible straight line through a series of points.

liquidation A legal process to close trading for insolvent business legal entities who are unable to pay debts as they fall due.

liquidation preference When the company is sold or liquidated, the amount that must be distributed to the preferred stockholders before remaining assets are distributed to common stockholders.

liquidity A property of any asset that can be sold without causing a significant price change and with minimum loss of value.

liquidity event The way in which an investor plans to close out an investment; also known as 'exit strategy'.

live product test The highest level of pretotype testing, in which you let your customers eat, feel, touch, smell, play with and use your live product. Can be undertaken anywhere you run into live customers.

loan payable Current instalment on a long-term debt that must be paid this year; part of the current liabilities.

loan with warrants Type of loan that provides the investor with the right to buy shares at a fixed price at some future date. Terms on the warrants are negotiable.

long tail Potential customers that seek goods with unusual characteristics, whose needs can now be met through reduced marketing costs (internet) and distribution costs.

long-tail marketing Marketing to the long tail based on the Google Search phenomenon that while some keywords are searched relatively infrequently, they can be aggregated into profitable markets. For example, 500 people search each month for the niche market 'cocoa beans from Samoa'.

long-term debt Debts not payable within one year; usually loans maturing in the three- to five-year range that are used to finance the purchase of property or equipment, with the purchased asset serving as collateral for the loans.

long-term liabilities Items or long-term debts on a balance sheet that fall due or require paying off beyond a timeframe of one year.

low fidelity Describes a low cost prototype, usually an illustrated design or concept sketched on paper or created as flat images. (See also *high fidelity*.)

M

macro view of entrepreneurship A view of entrepreneurship that examines the huge array of external processes and factors that are sometimes beyond the control of the individual entrepreneur, such as the environment and financial markets. (See also *micro view of entrepreneurship, external locus of control*.)

mall intercepts A method of experimental validation in which people are intercepted while shopping in malls and asked to respond to a survey.

management succession The transition of managerial decision making in a business, one of the greatest challenges confronting owners and entrepreneurs, especially in family businesses.

management team The founders of a new venture who plan on managing the company, as well as any advisers, consultants or members of the board.

managerial successor A successor to a venture who is interested in efficiency, internal control and the effective use of resources.

market gap An identifiable market segment that addresses customer needs not being addressed by competitors; also called niche market or market niche.

marketing mix Actions a marketer can take to promote a brand or product. Usually referred to as the four Ps: price, product, promotion and place, but could today be replaced with the four Cs: co-creation, communities, customisation and choice.

marketing strategy The general marketing philosophy of the company, which should include the kinds of customer groups to be targeted by the initial intensive selling effort; the customer groups to be targeted for later selling efforts; methods of identifying and contracting potential customers in these groups; features of the product or service (quality, price, delivery, warranty) to be emphasised to generate sales; and innovative or unusual marketing concepts that will enhance customer acceptance.

mechanical Turk test A method of experimental validation that uses a hidden human to simulate a technology in order to deliver potential customers the same experience with a fraction of the cost, thus postponing development until you prove market interest. Also known as Wizard of Oz test

mental models The knowledge structures that people use to make sense of the world.

mergers and acquisitions (M&A) A market entry strategy with two varieties. A merger occurs when two corporations join together into one, with one corporation surviving and the other disappearing. An acquisition occurs when one company takes control of another, often through an 'unfriendly' or 'hostile' acquisition.

metrics Assumptions and calculations used for any revenue projections.

micro-credit Small loans (micro-loans) to aspiring entrepreneurs who lack collateral to offer as security to a bank, who are not steadily employed, who have no credit history or who only need a small loan.

micro-finance A full range of banking services for under-privileged people.

micro-management angel An angel investor who imposes tactics that worked for their own company. Can be a bothersome angel.

micro view of entrepreneurship A view of entrepreneurship that examines factors that are within the entrepreneur's ability to direct or adjust. (See also *macro view of entrepreneurship, internal locus of control*.)

milestone schedule The section of a business plan that provides investors with timetables for the accomplishment of various activities, such as completion of prototypes, hiring of sales representatives, receipt of first orders, initial deliveries and receipt of first accounts receivable payments.

mind map A diagram used to visually organise information, showing hierarchical relationships among disparate concepts. Mind maps help generate, visualise, structure and classify ideas to look for patterns and insights that provide key design criteria.

minimum viable product (MVP) A temporary product with just enough functionality to satisfy early adopters; solicits early feedback to be fed into future development with which you are able to test a product hypothesis

mission In an entrepreneurship context, a stated mid-term objective that will affect or change a venture's position by incremental steps toward a particular strategic direction.

mixed costs Part of the operating budget, a blend of fixed and variable costs. An example is utilities, since part of this expense would be responsive to change in activity and the rest would be a fixed expense, remaining relatively stable over the budget period. (See also *fixed costs*, *variable costs*.)

moral failure A violation of internal trust.

mountain gap strategies Strategies that leverage new and unique markets by identifying existing major market segments and going after the gaps in between larger markets.

muddling mindsets Habits such as either/or thinking, security hunting, stereotyping and probability thinking that block or impede creative thinking.

mutuals business model Business model of a private company in which the customers are also the owners, and receive profits and benefits.

N

necessity-driven Describes an entrepreneur who starts a business because there are no better options for work, rather than because they see an opportunity. (See also *opportunity-driven*.)

need to achieve Characteristic of people with a high need for achievement, who seek to excel and thus tend to avoid both low-risk and high-risk situations.

need to control The strong desire entrepreneurs have to control both their venture and their destiny.

negative entrepreneurship Entrepreneurship characterised by an undervaluation of biodiversity and natural resources. Rather than adding value to living materials, negative entrepreneurs only aim to reduce (e.g. through recycling) the quantity of dead resources. (See also *positive entrepreneurship*.)

net income The excess of revenue over expenses during a particular period. If revenues exceed expenses, the result is a net profit. If the reverse is true, the firm suffers a net loss.

net present value (NPV) method A method used in decision-making that measures the equivalent lump-sum value of a stream of payments over time. In effect, the NPV represents the amount that would need to be invested at a commercial interest rate at the beginning of the period of payments in order to meet all the payments as they fell due.

net profit Sometimes referred to as the 'bottom line', the difference between the revenue (or income from sales) and all associated business expenses, including production or service delivery costs, sales, marketing, payroll, overheads, interest and taxes.

new business start-up A business that is newly originated by an entrepreneur in response to some form of recognised opportunity to provide products and/or services to satisfy a perceived market demand.

new four Cs In the marketing mix for social media, co-creation, communities, customisation and choice. (See also *four Cs*, *four Ps*, *marketing mix*.)

new-new approach A start-up approach to business in which a brand-new concept is introduced to a brand-new marketplace.

new-old approach A start-up approach to business in which the concept provides a new angle to something that already exists in the marketplace.

new-venture development The activities during the first or early stage of a new business or project that involves creativity and evaluation in forming the business.

niche advantage An advantage created by offering a valuable and unique product and/or service specifically to a single, narrow market or customer segment. A market niche is usually a subset of a larger market or customer segment that has specific needs not addressed by competitors who seek volume sales from less-defined and larger customer groupings.

non-compete clause An agreement as part of the purchase of an existing venture that the previous owner will refrain from conducting business in the same industry within a reasonable distance for a reasonable period of time. Also known as legal restraint of trade or an agreement to not compete.

non-disclosure agreement An agreement between parties that the information specified by the agreement will not be disclosed to others. It binds the parties to protect the information discussed and keep it confidential.

non-profit organisation An organisation whose main objective is not profit, such as a religious, charitable or educational institution.

note payable See *promissory note*.

O

one-night-stand test A method of experimental validation whereby you offer an early pretotype version of your service or product for a very limited time to a limited customer base to see if there is any interest. Also known as pop-up test.

online marketing Advertising and marketing efforts using web and email to drive direct sales.

ontology An way of explaining the nature of things that have existence and the relationships among them, usually depicted in some graphic form. (See also *business model ontology*.)

open innovation Innovation that turns to sources of ideas and support outside of an organisation, openly sharing the trials and rewards of innovation, as opposed to approaches that seek to protect, own and keep ideas and commercial development within an organisation.

operating budget A detailed projection of all estimated income and expenses during a given future period.

operating cash flows Cash generated from or used in the course of business operations of the firm. The net operating cash flows will be positive for most firms, because their operating inflows (primarily from revenue collections) will exceed operating outflows (for example, payment for raw materials and wages).

operating expenses The major expenses of a firm, exclusive of costs of goods sold. These represent the resources expended, except for inventory purchases, to generate revenue. (See also *selling expenses, administrative expenses*.)

operational capabilities The capabilities inherent in maintaining the routine organisation and management of a firm in conducting its regular business.

opportunity cost The cost of using a resource in terms of the loss of its alternative uses, measured by the value of the next-best alternative use of that resource.

opportunity-driven Describes an entrepreneur who opts to start a business because they have spotted an available opportunity, and is prepared for and has the resources to carry it out. (See also *necessity-driven*.)

opportunity identification The recognition of a viable business opportunity within a variety of good ideas.

opportunity orientation Focus on and relentless pursuit of opportunities by marshalling resources and utilising one's knowledge and understanding.

opportunity propensity The predisposition to see and take on new ideas as new-venture opportunities

optimism bias When you think you are less likely to experience a negative event compared to others, for example, smokers who think they are less likely to contract lung cancer than other smokers.

ordinary shares Shares, also known as common shares, that make up the vast majority of financial equity assets traded on the stock exchange. Shareholders with ordinary shares have the normal (or ordinary) rights as set out in the *Corporations Act, 2001*. (See also *common shares*.)

organisata The corporate equivalent to persona analysis that looks at the 'personality' of a company. (See also *persona*.)

outbound marketing Marketing that uses traditional tools such as cold calling, email blasts or television ads, whether or not the customer wants it.

owners' equity Assets minus liabilities.

P

pain The problem that you actually solve by your venture, that satisfies the needs, fears and desires of the consumer. A 'painkiller' solves the pain that the customer experiences. (See also *PITA products*.)

partnership An association of two or more people acting as co-owners of a business for profit.

patchwork quilt principle From effectuation theory, this principle means that, like a quilt made of small pieces sewn together, entrepreneurs love to create something new with their personal patches: 'who I am', 'what I know' and 'whom I know'.

patent An intellectual property right granted to an inventor giving him or her exclusive right to make, use or sell an invention for a limited time period (usually 20 years).

pathways principle Belief that proper preparation in the interdisciplinary business segments will enhance the ability to recognise venture opportunities.

payback method A method of capital budgeting that measures the length of time taken for the return on an investment to exactly equal the amount originally invested.

peer-to-peer lending (P2P) Loans typically funded by specific individuals lending their own money on a fractional basis at interest to specific borrowers.

persona A semi-fictional representation of a customer segment in the B2C market. (If you B2B, there's an alternative called the *organisata*) based on real data and some educated conjecture about demographics, consumer behaviour, perceived pains and expected gains. Personas help to understand and visualise your target customers by describing the personality, interests, pains, goals and behaviour of a typical customer.

personal failure A form of failure brought about by a lack of skill or application.

petty crime entrepreneurship Lower forms of social enterprises, ranging from quasi-legal street peddling, which is an easy way to enter the market, to more criminal activities such as DVD pirating and money laundering.

pilot-in-the-plane principle In effectuation theory, this principle means that although the future cannot be predicted, entrepreneurs are in control, much like a pilot, who can control factors which determine the future course.

Pinocchio test A method of experimental validation whereby you create a non-working version of your service or product so that customers can imagine that it is actually functional.

piracy Copyright infringement (or copyright violation) in a manner that violates one of the copyright owner's exclusive rights.

PITA product A product or service that solves the customer's 'Pain In The Arse'. (See also *pain*.)

pitch method Method of experimental validation whereby you essentially 'sell' your value proposition to see if it will 'earn' some form of currency, such as email addresses, tweets, cash or anything your customer gives up.

planning fallacy A cognitive bias whereby entrepreneurs tend to underestimate the duration, costs and risks associated with a venture.

platform business model A business model whereby the business acts as an intermediary between buyers and sellers, providing a platform that enables easy exchange. eBay has successfully implemented this model, with a network of sellers who access customers through the eBay online platform.

point of view (POV) A meaningful and actionable problem statement resulting from a successful design challenge, when you are convinced that you have discovered the right problem to address.

Ponzi scheme A scam in which high returns are promised and new investors must continue to be drawn in to pay off earlier investors.

pop-up test See *one-night stand test*.

positive entrepreneurship Entrepreneurship characterised by a commitment to making positive impacts by creating added value through eliminating designed waste, duplication, disposability, planned obsolescence and wasteful end purposes. (See also *negative entrepreneurship*.)

preferred shares Shares that pay dividends at a specified rate and that have preference over common shares in the payment of dividends and the liquidation of assets. The word 'stock' is used in the US instead of 'shares'.

pre-orders A pretotype test that lets you offer your product to potential customers before you even build it.

prepaid expenses Expenses the firm already has paid, but that have not yet been used. For example, insurance paid on the company car every six months is a prepaid expense because it will be six months before the entire premium has been used.

pretotype A preliminary version of your product, usually a minimum viable product, that may fail or not even work, but allows feedback to be obtained from potential customers.

pretotyping The stage, before prototyping, where we develop early, low-cost virtual, physical and experiential artefacts for the purpose of gaining feedback. Also may be called a 'mock-up'.

price/earnings ratio A method of valuing a business by dividing the price of the common shares in the market by the earnings per share and multiplying the result by the number of shares issued.

principal The amount of the entire mortgage loan, not counting interest.

private equity market The collective pool or community of high-wealth individuals who are willing to invest significantly into later-stage ventures in exchange for shares in the venture (equity) accessed through private placement agents.

private limited company See *proprietary limited company (Pty Ltd)*.

private offerings Raising of capital from friends, employees, customers, relatives and local professionals.

private placement A method of raising capital through securities; often used by small ventures.

probability thinking A reliance on probability to make decisions in the struggle to achieve security.

problem-solution fit Correspondence between problem and solution, achieved when you have correctly identified your customers and why they need the product, and found an efficient and feasible way to solve their problem.

product ecosystem A cluster of products and services that complement each other and work symbiotically to generate value for each other, for example, Nespresso, Apple or Jamie Oliver.

product life cycle (PLC) The stages of time on the market through which a product progresses. Typically, life stages can be divided into introduction, growth, maturity and decline. Life cycles vary in stage duration with every type of product.

productive entrepreneur An entrepreneur who captures rents ethically through innovation and also furthers growth. (See also *unproductive entrepreneur, destructive entrepreneur, annihilative entrepreneur*.)

product-market fit Correspondence between product and market, achieved when your early adopters love your product, you start bringing in late adopters and you are expanding the market.

product-solution fit Perfect intersection between product value and customer needs such that you are sure you are building something that people want, you are making money and a significant portion of customers indicate that they would be 'very disappointed' if they no longer have access to the product or service.

professional angel A professional, such as a doctor or lawyer, who invests in companies that offer a product or service with which they have some experience. Also may refer to angel investors who invest as an occupation and in a manner that is rigorous and systematic, developed through repeated and intentional investment strategies.

profit and loss statement Also known as an income statement, a financial record or account of all of a firm's revenues and all of the expenses and costs incurred by the firm in achieving those revenues, which shows the level of profit or loss produced by the firm over a period of time.

pro forma balance sheet A financial statement that projects the results of future business operations, excluding 'unusual and non-recurring transactions'. The term *pro forma* (Latin for 'as a matter of form') applies to practices that seek to satisfy the minimum requirements or to conform to convention.

pro forma statement A financial statement projecting anticipated income, expenses and cash flow for some specified future period.

promissory note Tangible recognition of a supplier's claim or a note given in connection with an acquisition of funds.

property laws The laws passed by governments that govern the ownership and rights of various forms of tangible and intangible property.

proprietary limited company (Pty Ltd) In Australia, a form of privately held company that has limits defined with respect to its financial responsibility. Unlike a public company, a proprietary company cannot offer shares to the public for equity capital raising. Limits and meaning may vary depending on the regulatory law of the country in which the company is created. Same as private limited company in Australia.

prospectus A document, published prior to the issue of shares to the public, that explains all aspects of a company's business.

prototype In contrast to a pretotype, a preliminary version of a product that costs a lot of money and is produced as a final step before producing the actual product. In the prototype you want to show all the features the product will have. (See also *prototyping*.)

prototyping The stage, after pretotyping, where you develop an early version of the product or service for the purpose of testing design and assembly before producing the final marketable product.

provinces test See *one-night-stand test*.

psychic risk Risk relating to the great psychological impact on the entrepreneur who is creating a new venture.

psychographics Attributes relating to personality, values, attitudes, interests or lifestyles, as opposed to demographic variables such as age and gender.

psychological disequilibrium An imbalance between beliefs and reality resulting from incidents or life experiences that demand adjustment or highlight discrimination; according to Hagen's social marginality theory, may drive a person into enterprising behaviour to compensate.

public limited company A company whose liability is limited by shares which are traded publicly in Commonwealth countries (other than Australia).

public sector entrepreneurship Entrepreneurship that combines public and private resources in pursuit of social objectives.

pyramid scheme An illegal scheme whereby sellers attract payment from people on the promise of a return on their investment based on their selling to others who also buy into the scheme. This continues in a pyramid fashion, with a percentage or proportion of the sales always flowing to those who recruit sellers. Those at the top collect fees from all those below until there are no further recruits and the sales are saturated. This forces the pyramid to collapse, with no further sellers recruited or funds collected by those at the base of the pyramid. Those at the top, initiating or getting into the scheme early, win; those at the bottom, late into the scheme, lose.

R

razor and blades A business model where the introductory item is sold at a low or no price so that the consumer must buy complementary products later, for example, razors and razorblades, or printers and cartridges.

reachable market The immediate reachable group of customers that will be targeted by a new venture.

re-engineering organisations Organisations engaging in the practice of renovating and re-configuring organisational cultures, management techniques, structures, systems, processes and values, particularly to achieve high levels of innovation and enterprise.

reflective reframing Re-interpretation of solutions through social interaction of 'co-designists' using mindfulness and collective feedback to rewrite the original questions using each individual's contributions.

regulatory body A regulatory regime, composed of legislation and a regulatory authority, that dictates how businesses are started, operated and wound up.

relativist ethics The belief that moral propositions do not reflect absolute and universal moral truths, but instead make claims relative to social, cultural, historical or personal references. Moral relativists hold that no universal standard exists by which to assess an ethical proposition's truth.

remarketing Positioning of targeted ads to a defined audience that have previously visited a particular website as they browse elsewhere around the internet.

retail investor Formally, an individual or small business that is not a wholesale investor; generally a high-wealth individual who is not acting as an institutionalised, professional investor. A wholesale investor must meet the test of individual wealth of at least $2.5 million in net assets, or a gross income for each of the last two financial years of at least $250 000 per annum.

retained earnings Accumulated net income not distributed to owners over the life of the business to date. Every year this amount increases by the profit the firm makes and keeps within the company.

return on investment (ROI) Net profit divided by investment.

revenues Gross sales the business made during the particular period under review.

rewards crowdfunding A simple means of raising funds that utilises an internet platform to source relatively small donated sponsorship amounts from the public in exchange for recognition and small rewards. Particularly useful for innovative products and services to enable market testing for start-up ventures.

right brain The part of the brain that helps an individual understand analogies, imagine things and synthesise information. (See also *left brain*.)

risk In an entrepreneurship context, the possibility of economic, personal or reputational loss faced by the entrepreneur and their backers, financial or otherwise, acquired through new-venture activity and as a result of the initiation, conversion and exploitation of an idea as a new venture. (See *calculated risk taking, career risk, financial risk, psychic risk, risk propensity*.)

risk propensity The predisposition to take on more risk than the average person.

riskiest assumption The riskiest of the assumptions used in creating hypotheses to validate your business idea, which is the one you should start with.

royalty Sum of money paid for the use of a licence, or for use of works covered by copyright, patent, registered design or trademark.

rugged individualist A person who cherishes individual liberty and self-reliance.

S

sales forecast The projected or predicted pattern or estimate of sales at some future point or period.

school of thought Opinion subscribed to by a group of scholars, theorists or researchers.

Schumpeterian Someone who believes that innovation and technological change comes from the 'wild spirits' or 'fiery souls' of entrepreneurs who engage in a process of 'creative destruction'.

search engine marketing (SEM) Internet marketing that promotes website visibility using tools such as keyword research, web analytics, HTML validators, spiders and website checkers.

search engine optimisation (SEO) Maximisation of the number of visitors to a particular website by ensuring that the site appears high on the list of 'organic' results returned by a search engine through index crawlers, sitemaps and cross-linking.

securities A tradeable financial asset of company equity that includes company shares, bonds and options.

security hunting Persistence to eliminate risk. A common mental habit that inhibits creativity and innovation by hindering creative thought processes.

seed financing Initial funds for a business concept to be developed.

segmentation variables Variables used to categorise consumers by geography, demographics, psychographics and behaviour in order to target specific types of people and not just people in a certain geographic area. (See also *customer segmentation*.)

self-efficacy Self-assessed conviction or confidence about personal abilities to muster the motivation, perform the cognitive tasks and conduct the actions needed to successfully execute a specific task within a given context.

selling expenses Expenses from displaying, selling, delivering and installing products or performing a service.

seniorpreneur Someone who starts a business after the age of 55.

sensitivity analysis An analysis that evaluates to what extent under- or overestimated assumptions may influence cash needs and profitability and therefore the financial strength of the business.

serial entrepreneur An entrepreneur who starts not one but repeated new business ventures.

shareholder One who owns shares in a corporation or mutual fund, often evidenced by a stock or share certificate. The word 'stockholder' is used in the US instead of 'shareholder'.

shares An equity or ownership interest in a corporation, demonstrated by share certificates. The word 'stock' is used in the US instead of 'shares'.

sharing economy Also known as the peer-to-peer economy, an economic system in which assets and services are shared; the system's thesis is that goods that are shared (typically via an online marketplace) gain value. For example, expert networks, crowdfunding and open data. Also encompasses the monetisation of idle or unused products, services and talents, for example, spare seats in one's car (Uber) or an unused spare bedroom (AirBnB).

short-term liabilities Debts you must pay within a year. Includes cash owing for merchandise that the business has received, but has not yet paid for. This often occurs when a company receives merchandise during the third week of the month and does not pay for it until it pays all of its bills on the first day of the next month. Also called current liabilities.

skunkworks A highly innovative enterprise that uses groups functioning within an organisation but outside traditional lines of authority. Also known as a gumboot factory.

small-business owners As opposed to entrepreneurs, those business owners who, once they have captured an opportunity, do not seek to expand or grow the business, preferring a more stable and less aggressive approach to running the business.

smoke test A method of experimental validation whereby there is no real product there; it is still all 'smoke and mirrors', for example fake inventory or e-books not yet published.

social and cultural school of thought The school of thought that deals with external factors, surrounding conditions and influences that affect a potential entrepreneur's lifestyle.

social business A venture that addresses a social problem, where profits are reinvested in the business itself with the aim of increasing social impact. The community, rather than the owners, receives the dividends.

social cognition theory Theory that introduces the idea of knowledge structures – mental models (cognitions) that are ordered in such a way as to optimise personal effectiveness within given situations – to the study of entrepreneurship. (See also *cognition*.)

social enterprise A business that fulfils social aims.

social entrepreneur An entrepreneur driven by a mission, who seeks to find innovative ways to develop and promote solutions or products that add value both to the company's bottom line as well as to society and the planet. Also called corporate social entrepreneur.

social exclusion theory Theory that people who suffer from social exclusion – for example, relating to housing, education, property ownership or voting – are more likely to become entrepreneurs.

social intrapreneur A person working in a large business or social organisation developing and promoting solutions or products that add value both to the company's bottom line as well as to society and the planet. Also called corporate social entrepreneur. (See also *intrapreneur*.)

social marginality theory Theory that the perceived incongruity between an individual's (self-perceived) prodigious personal attributes and the position they hold in society might propel them to be entrepreneurial.

social venturing A form of entrepreneurship that seeks to resolve or address social issues through the use of economic models and the practice of business-like behaviours.

sociosphere All the people in a social system, all the roles they occupy, all their patterns of behaviour, all their inputs and outputs relevant to other human beings, and all the organisations and groups they belong to.

sole proprietor of the rest of their life Controller of one's own destiny. A free and sovereign individual.

sole trader Also known as a sole proprietor, a business that is owned and operated by one person, that has no existence apart from its owner.

sophisticated investor Wealthy individual who invests more or less regularly in new, early- and late-stage ventures. They are knowledgeable about the technical and commercial opportunities and risks of the businesses in which they invest. They know the kind of information they want about their prospective investment, and they have the experience and ability to obtain and analyse the data.

sovereign individual A person or a business that is not beholden to a nation. For example, someone who resides on the internet and selects where to do business based on cost versus profit.

stabilisation stage The 'swing' stage of new venture growth, characterised by increased competition, consumer indifference, market saturation, 'me too' lookalikes and sales plateauing. Either the firm swings into higher gear or moves toward decline.

stage-gate process A new product development technique divided into distinct stages, separated by decision points (known as gates).

stakeholder A person, group, organisation or system that affects or can be affected by an organisation's actions.

start-up A new business or new venture – such as self-employment, a new business organisation or the expansion of an existing business by starting a new related venture – by an individual, team of individuals or established business.

start-up activities The second stage of a new-venture life cycle, encompassing the foundation work needed for creating a formal business plan, searching for capital, carrying out marketing activities and developing an effective entrepreneurial team.

start-up financing Funding for use in prototyping and product development as well as initial marketing before sales. Most start-up funding comes from the four Fs. (See also *four Fs*.)

stereotyping Applying a description to a person based on generalised population norms and observations without a genuine basis for doing so.

strategic alliance Any formal relationship, short of a merger or acquisition, between two companies, formed for the purpose of gaining synergies.

strategic formulation school of thought A micro view of entrepreneurship that views strategic planning as interwoven into the entire fabric of management, not as something with a separate office and staff. Emphasises planning, leveraging of unique markets, unique people, unique products and unique resources. (See also *micro view of entrepreneurship*.)

strategic intent A statement that envisions a desired leadership position for a venture for the purpose of guiding resource allocation, providing stability under changing circumstances, focusing attention on the essence of winning and motivating people by communicating value while leaving room for individual and team contributions.

strategic planning The primary step in determining the future direction of a business, influenced by the abilities of the entrepreneur, the complexity of the venture and the nature of the industry.

strategic positioning The process of perceiving new positions that attract customers from established positions or draw new customers into the market.

strategic renewal Transformation of an organisation to put it in a more competitive position and improve financial performance; an important part of intrapreneurship.

strategic uncertainty Uncertainty arising from the lack of a unified approach to product positioning, advertising, pricing and the like, as well as differences in product configurations or production technologies.

stress See *entrepreneurial stress*.

succession plan Process whereby the firm identifies, recruits and cultivates internal candidates to fill key positions; particularly important in family businesses.

sunk cost fallacy A cognitive bias reflecting the misgivings one has to waste resources. Also called loss aversion.

survivalist entrepreneur An entrepreneur who starts a business because it is the only choice or a survival strategy.

sustainability Avoidance of depletion of natural resources; pursuit of solutions with the long term (several hundred years or more) in mind. Applies to many disciplines, including economic development, environment, food production, energy and lifestyle.

sustainability entrepreneur An entrepreneur who recognises, develops and exploits opportunities that create economic, ecological and social value.

SWOT analysis A strategic analysis of strengths, weaknesses, opportunities and threats.

T

tacit knowledge As opposed to formal knowledge, knowledge that is difficult to transfer to another person through books or talking, which must be shown (*tacit* comes from the Latin 'to touch') in order to understand, for example, how to knead bread dough.

taxation Liabilities owed to the government such as GST (goods and services tax), sales or value-added taxes, revenue or income taxes.

taxes payable The amount payable to governments or statutory bodies calculated as a percentage of income according to government-devised formulae.

technological uncertainty Uncertainty as to which product configuration will prove to be the best, which production technology will prove to be the most efficient or how easy it will be to develop or even copy the technological breakthroughs in the industry.

term sheet Document that outlines the material terms and conditions of a venture agreement and lists deal terms in bullet-point format.

theory A well-substantiated explanation of some aspect of the natural world; an organised system of accepted knowledge that applies in a variety of circumstances to explain a specific set of phenomena.

thought leader Similar to an influencer, an individual whom other customers recognise as an authority and who can influence others' adoption of a product or service.

three-circles model Describes the three overlapping groups that comprise the family business system: family, business and ownership. Including the overlaps, there are seven interest groups, each with its own legitimate perspectives, goals and dynamics.

time value of money The idea that money available today is worth more than the same amount in the future due to its potential interest-earning capacity. Any amount of money is worth more the sooner it is received.

tolerance for ambiguity Tolerance of the uncertainty inherent in new-venture formation, which is compounded by constant changes introducing ambiguity and stress into every aspect of the enterprise.

tolerance for failure Tolerance of the inevitable serious setbacks and disappointments that come with the iterative, trial-and-error nature of successful new-venture formation; an integral part of the entrepreneur's learning experience.

trade credit Temporary financing extended by suppliers of goods and services pending customer settlement.

trade secrets Customer lists, plans, research and development, pricing information, marketing techniques and production techniques. Generally, anything kept secret that makes an individual company unique and has value to a competitor.

trademark A distinctive name, mark, symbol or motto identified with a company's product(s).

trading trust In Australia and New Zealand, similar to a family trust; a trust that allows the beneficiaries to be paid money (profits) without them having to work in the business (unlike a company). Generally taxed on a 'flow-through' basis.

traditional business plan A bank or investment-ready document of generally 30–40 pages and with three- to five-year financial projections, as opposed to a lean business plan.

traits Personal characteristics that distinguish individuals, including entrepreneurs.

transformative innovation Innovation that provides significant improved value and change in economic, social and/or environmental systems and the way societies are accustomed to doing things; can create opportunity spaces for entrepreneurs and give rise to entirely new industries.

transgenerational entrepreneurship Entrepreneurship that extends through multiple generations of a family; focuses on the processes that help family firms – the dominant form of business around the world – succeed beyond the first generation.

triple bottom line An accounting method that captures the values and criteria for measuring organisational (and societal) success: economic, ecological and social.

two-step flow of communication A model that posits that most people form their opinions under the influence of influencers or thought leaders.

Type A behaviour Impatient, demanding and highly-strung behaviours that comprise the 'Type A' personality.

U

unbundling business model A business model whereby the parts of a company are divided up to maximise their earning potential, for example, telecommunications companies that unbundle their cable, internet and phone networks into separate entities.

uncontrollable failure A form of failure caused by external factors that are outside the control of employees, such as resource limitations, strategic direction and market changes.

undercapitalisation When a company has insufficient capital to conduct normal business operations and pay creditors.

undertaker The original translation of the French word *entrepreneur*, taken from the verb *entreprendre*, 'to undertake'. Unfortunately the term 'undertaker' in English language is already used by another profession, namely funeral directors.

unfair advantage An advantage that cannot easily be copied or bought.

unicorn A rapid-growth private company that reaches a valuation of $1 billion or greater within 10 years of start-up.

unincorporated business A business, such as a sole tradership or a partnership, that is not organised and maintained as a legal corporation.

unlimited liability A condition existing in sole proprietorships and partnerships wherein someone is responsible for all the enterprise's debts.

unproductive entrepreneur An entrepreneur who unethically appropriates rents without adding to collective value through devious use of the legal system or through organised crime. They divert rents through payoffs, litigation, takeovers and tax evasion. See also *productive entrepreneur, destructive entrepreneur, annihilative entrepreneur*.)

upcycling Reusing a waste material in a way that increases its value.

user experience The experience a visitor has on a website; the goal of an entrepreneur should be to give the user a positive experience through look and feel, design, navigation and content.

usury The lending of money at exorbitant interest rates.

V

validated learning Learning whether you have satisfied the customer need or not by testing your idea and measuring it to validate its effect.

validation board A key canvas used in lean entrepreneurship to test unproven assumptions about our idea, value proposition and pretotype using testable assumptions that can be invalidated or validated.

value chain analysis A diagram identifying a company's primary suppliers and support activities that add value to the final product; the corporate version of customer journey mapping. By analysing the value chain, you can highlight the 'pain points' in the supplier stream.

value innovation Innovation that considers new conceptions or means to create value for customers that step outside of pre-existing or established industry and market norms and practices.

value proposition A strategic concept that accounts for the value of a firm's product or service offering to a particular customer or to a market segment. The product or service must provide customer value in terms of one or more of functionality (it must do something the customer needs to be done), emotional considerations (it must make the customer feel good by or about the purchase) or expected ideals or beliefs (it must align with the value system of the customer) for a price the customer is prepared to pay.

vapour test See *fake inventory test*.

variable costs Part of the operating budget, costs that vary with the level of production or sales, such as shipping supplies and sales commissions. These costs change in the same direction as, and in direct proportion to, changes in operating activity, for example, direct labour, direct materials and sales commissions. (See also *fixed costs, mixed costs*.)

venture capitalist Person who syndicates the money of others to invest in a company start-up assessed as having high potential to create extraordinary returns for the syndicated investors.

venture opportunity school of thought A micro view of entrepreneurship that focuses on sources of ideas and development of concepts within the context of creativity and market awareness: developing the right idea at the right time for the right market. (See also *micro view of entrepreneurship*.)

vertical integration An arrangement whereby the same company owns multiple or all aspects of making, selling and delivering a product or service.

vetpreneur A military veteran who becomes an entrepreneur after service.

vision In an entrepreneurship context, a stated long-term objective for a venture to create or achieve an altered future that to some may seem incredible or impossible but to the entrepreneur and others working with the venture is a very real possibility.

W

water well strategies Strategies that leverage unique resources (land, labour, capital, raw materials) that no one else has.

web scraping Harvesting or extraction of data from websites using a bot or web crawler.

white knight Someone with better credit than you who might buy the products and resell them to you for a few percentage points. Also a company that rescues another that is in financial difficulty, especially one that saves a company from an unwelcome takeover bid.

wicked problem A problem that is difficult or impossible to solve due to incomplete, contradictory and difficult-to-recognise information.

wireframe Visual representation of the skeletal framework of a website to help designers in arranging elements.

Wizard of Oz test See *mechanical Turk test*.

word of mouth (WOM) Form of message transmission, formerly limited to oral communication, that now involves passing information through all means of communication, including electronic media such as websites and social networks.

working capital Otherwise known as operating liquidity, the difference between short-term (or current) assets and short-term (or current) liabilities. It is a measure of the financial health of a business that demonstrates that a firm has sufficient surplus of cash generated from its operations to pay its debts as they fall due.

Z

zero-budget marketing Entrepreneurial marketing techniques that require few or no resources.

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