
EIGHTH EDITION

New Venture Creation

ENTREPRENEURSHIP FOR THE 21st CENTURY

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Chapter Three

The Entrepreneurial Process

"I don't make movies to make money. I make money to make movies."

—Walt Disney

Results Expected

Upon completion of this chapter, you will be able to

1. Articulate a definition of entrepreneurship and the entrepreneurial process—from lifestyle ventures to high-potential enterprises.
2. Describe the practical issues you will address and explore throughout the book.
3. Discuss how entrepreneurs and their financial backers get the odds for success in their favor by defying the familiar pattern of disappointment and failure.
4. Articulate the Timmons Model of the entrepreneurial process; describe how it can be applied to your entrepreneurial career aspirations and ideas for businesses; and describe how recent research confirms its validity.
5. Provide insights into and analysis of the Roxanne Quimby case study.

Demystifying Entrepreneurship

Entrepreneurship is a way of thinking, reasoning, and acting that is opportunity obsessed, holistic in approach, and leadership balanced for the purpose of value creation and capture.¹ Entrepreneurship results in the creation, enhancement, realization, and renewal of value, not just for owners, but for all participants and stakeholders. At the heart of the process is the creation and/or recognition of opportunities,² followed by the will and initiative to seize these opportunities. It requires a willingness to take risks—both personal and financial—but in a very calculated fashion in order to constantly shift the odds of success, balancing the risk with the potential reward.

Typically entrepreneurs devise ingenious strategies to marshall their limited resources.

Today entrepreneurship has evolved beyond the classic start-up notion to include companies and organizations of all types, in all stages. Thus *entrepreneurship can occur—and fail to occur—in firms that are old and new; small and large; fast and slow-growing; in the private, not-for-profit, and public sectors; in all geographic points; and in all stages of a nation's development, regardless of politics.*

Entrepreneurial leaders inject imagination, motivation, commitment, passion, tenacity, integrity, teamwork, and vision into their companies. They face dilemmas and must make decisions despite ambiguity and contradictions. Very rarely is entrepreneurship a get-

¹ This definition of entrepreneurship has evolved over the past three decades from research by Jeffry A. Timmons, Babson College and the Harvard Business School, and has recently been enhanced by Stephen Spinelli, Jr., former vice provost for entrepreneurship and global management at Babson College, and current president of Philadelphia University.

² J. A. Timmons, D. F. Muzyka, H. H. Stevenson, and W. D. Bygrave, "Opportunity Recognition: The Core of Entrepreneurship," in *Frontiers of Entrepreneurship Research* (Babson Park, MA: Babson College, 1987), p. 409.

rich-quick proposition. On the contrary, it is one of continuous renewal because entrepreneurs are never satisfied with the nature of their opportunity. The result of this value creation process, as we saw earlier, is that the total economic pie grows larger and society benefits.

Classic Entrepreneurship: The Start-Up

The classic expression of entrepreneurship is the raw start-up company, an innovative idea that develops into a high-growth company. The best of these become entrepreneurial legends: Microsoft, Netscape, Amazon.com, Sun Microsystems, Home Depot, McDonald's, Intuit, Staples, and hundreds of others are now household names. Success, in addition to the strong leadership from the main entrepreneur, almost always involves building a team with complementary talents. The ability to work as a team and sense an opportunity where others see contradiction, chaos, and confusion are critical elements of success. Entrepreneurship also requires the skill and ingenuity to find and control resources, often owned by others, in order to pursue the opportunity. It means making sure the upstart venture does not run out of money when it needs it the most. Most highly successful entrepreneurs have held together a team and acquired financial backing in order to chase an opportunity others may not recognize.

Entrepreneurship in Post-Brontosaurus Capitalism: Beyond Start-Ups

As we've seen, the upstart companies of the 1970s and 1980s have had a profound impact on the competitive structure of the United States and world industries. Giant firms, such as IBM (knocked off by Apple Computer and then Microsoft), Digital Equipment Corporation (another victim of Apple Computer and acquired by Compaq Computer Corporation), Sears (demolished by upstart Wal-Mart and recently merged with Kmart), and AT&T (knocked from its perch first by MCI, and then by cellular upstarts McCaw Communications, CellularOne, and others), once thought invincible, have been dismembered by the new wave of entrepreneurial ventures. *The New York Times*, *LA Times*, and most major city newspapers have been losing market share to Internet start-ups for the past 10 years. While large companies shrank payrolls, new ventures added jobs. Between 2003 and 2005, employ-

ment at venture-backed companies grew at an annual rate of 4.1 percent, compared to just 1.3 percent for the U.S. economy as a whole. Venture investment is particularly important in the software and computers and peripherals industries, where nearly 90 percent of all jobs are within venture-backed companies.³ As autopsy after autopsy was performed on failing large companies, a fascinating pattern emerged, showing, at worst, a total disregard for the winning entrepreneurial approaches of their new rivals and, at best, a glacial pace in recognizing the impending demise and the changing course.

"People Don't Want to Be Managed. They Want to Be Led!"⁴

These giant firms can be characterized, during their highly vulnerable periods, as hierarchical in structure with many layers of reviews, approvals, and vetoes. Their tired executive blood conceived of leadership as *managing and administering* from the top down, in stark contrast to Ewing M. Kauffman's powerful insight: "People don't want to be managed. They want to be led!" These stagnating giants tended to reward people who accumulated the largest assets, budgets, number of plants, products, and head count, rather than rewarding those who created or found new business opportunities, took calculated risks, and occasionally made mistakes, all with bootstrap resources. While very cognizant of the importance of corporate culture and strategy, the corporate giants' pace was glacial: It typically takes six years for a large firm to change its strategy and 10 to 30 years to change its culture. Meanwhile, the median time it took start-ups to accumulate the necessary capital was one month but averaged six months.⁵

To make matters worse, these corporate giants had many bureaucratic tendencies, particularly arrogance. They shared a blind belief that if they followed the almost sacred best management practices of the day, they could not help but prevail. During the 1970s and 1980s, these best management practices did not include entrepreneurship, entrepreneurial leadership, and entrepreneurial reasoning. If anything, these were considered dirty words in corporate America. Chief among these sacred cows was staying close to your customer. What may shock you is the conclusion of two Harvard Business School professors:

One of the most consistent patterns in business is the failure of leading companies to stay at the top of their industries when technologies or markets change. . . . But

³ National Venture Capital Association, *Venture Impact: The Economic Importance of Venture Capital Backed Companies to the U.S. Economy*, 2007.

⁴ The authors' favorite quote from Ewing M. Kauffman, founder of Marion Laboratories, Inc., the Ewing Marion Kauffman Foundation, Kansas City, Missouri.

⁵ W. J. Dennis, Jr., "Wells Fargo/NFIB Series on Business Starts and Stops," November 1999.

a more fundamental reason lies at the heart of the paradox: Leading companies succumb to one of the most popular, valuable management dogmas. They stay close to their customers.⁶

When they do attack, the [new] entrant companies find the established players to be easy and unprepared opponents because the opponents have been looking up markets themselves, discounting the threat from below.⁷

One gets further insight into just how vulnerable and fragile the larger, so-called well-managed companies can become, and why it is the newcomers who pose the greatest threats. This pattern also explains why there are tremendous opportunities for the coming e-generation even in markets that are currently dominated by large players. Professors Bower and Christensen summarize it this way:

The problem is that managers keep doing what has worked in the past: serving the rapidly growing needs of their current customers. The processes that successful, well-managed companies have developed to allocate resources among proposed investments are incapable of funneling resources in programs that current customers explicitly don't want and whose profit margins seem unattractive.⁸

Given how many new innovations, firms, and industries have been created in the past 30 years, it is no wonder that brontosaurus capitalism has found its ice age.

Signs of Hope in a Corporate Ice Age

Fortunately, for many giant firms, the entrepreneurial revolution may spare them from their own ice age. One of the most exciting developments of the decade is the response of some large, established U.S. corporations to the revolution in entrepreneurial leadership. After nearly three decades of experiencing the demise of giant after giant, corporate leadership, in unprecedented numbers, is launching experiments and strategies to recapture entrepreneurial spirit and to instill the culture and practices we would characterize as entrepreneurial reasoning. The e-generation has too many attractive opportunities in truly entrepreneurial environments. They do not need to work for a brontosaurus that lacks spirit.

Increasingly, we see examples of large companies adopting principles of entrepreneurship and entrepreneurial leadership in order to survive and to renew. Researchers document how large firms are applying entrepreneurial thinking, in pioneering ways,

to invent their futures, including companies such as GE, Corning, and Motorola,⁹ Harley-Davidson (\$1.35 billion in revenue), Marshall Industries (\$2.2 billion), and Science Applications International Corporation (SAIC) in San Diego. Most large brontosaurus firms could learn valuable lessons on how to apply entrepreneurial thinking from companies such as these.

Metaphors

Improvisational, quick, clever, resourceful, and inventive all describe good entrepreneurs. Likewise, innumerable metaphors from other parts of life can describe the complex world of the entrepreneur and the entrepreneurial process. From music it is jazz, with its uniquely American impromptu flair. From sports many metaphors exist: LeBron James's agility, the broken-field running of Curtis Martin, the wizardry on ice of Wayne Gretzky, or the competitiveness of Tiger Woods. Even more fascinating are the unprecedented comebacks of athletic greats such as Michael Jordan, Picabo Street, and Lance Armstrong.

Perhaps the game of golf, more than any other, replicates the complex and dynamic nature of managing risk and reward, including all the intricate mental challenges faced in entrepreneurship. No other sport, at one time, demands so much physically, is so complex, intricate, and delicate, and is simultaneously so rewarding and punishing; and none tests one's will, patience, self-discipline, and self-control like golf. Entrepreneurs face these challenges and remunerations as well. If you think that the team concept isn't important in golf, remember the 2004 American Ryder Cup team, which failed to work together and lost to the Europeans. And what about the relationship between the caddy and golfer?

An entrepreneur also faces challenges like a symphony conductor or a coach, who must blend and balance a group of diverse people with different skills, talents, and personalities into a superb team. On many occasions it demands all the talents and agility of a juggler who must, under great stress, keep many balls in the air at once, making sure if one comes down it belongs to someone else.

The complex decisions and numerous alternatives facing the entrepreneur also have many parallels with the game of chess. As in chess, the victory goes to the most creative player, who can imagine several alternative moves in advance and anticipate possible defenses.

⁶ J. L. Bower and C. M. Christensen, "Disruptive Technologies: Catching the Wave," *Harvard Business Review*, January–February 1995, p. 43.

⁷ Ibid., p. 47.

⁸ Ibid.

⁹ *Fast Company*, June–July 1997, pp. 32, 79, 104; and U. S. Rangan, "Alliances Power Corporate Renewal," Babson College, 2001.

This kind of mental agility is frequently demanded in entrepreneurial decision making.

Still another parallel can be drawn from the book *The Right Stuff* by Tom Wolfe, later made into a movie. The first pilot to break the sound barrier, Chuck Yeager, describes what it was like to be at the edge of both the atmosphere and his plane's performance capability, a zone never before entered—a vivid metaphor for the experience of a first-time entrepreneur:

In the thin air at the edge of space, where the stars and the moon came out at noon, in an atmosphere so thin that the ordinary laws of aerodynamics no longer applied and a plane could skid into a flat spin like a cereal bowl on a waxed Formica counter and then start tumbling, end over end like a brick . . . you had to be "afraid to panic." In the skids, the tumbles, the spins, there was only one thing you could let yourself think about: what do I do next?¹⁰

This feeling is frequently the reality on earth for entrepreneurs who run out of cash! Regardless of the metaphor or analogy you choose for entrepreneurship, each is likely to describe a creative, even artistic, improvised act. The outcomes are often either highly rewarding successes or painfully visible misses. Always urgency is on the doorstep.

Entrepreneurship = Paradoxes

One of the most confounding aspects of the entrepreneurial process is its contradictions. Because of its highly dynamic, fluid, ambiguous, and chaotic character, the process's constant changes frequently pose paradoxes. A sampling of entrepreneurial paradoxes follows. Can you think of other paradoxes that you have observed or heard about?

An opportunity with no or very low potential can be an enormously big opportunity. One of the most famous examples of this paradox is Apple Computer. Founders Steve Jobs and Steve Wozniak approached their employer, Hewlett-Packard Corporation (HP), with the idea for a desktop, personal computer and were told this was not an opportunity for HP. Hence Jobs and Wozniak started their own company. Frequently business plans rejected by some venture capitalists become legendary successes when backed by another investor. Intuit, maker of Quicken software, for example, was rejected by 20 venture capitalists before securing backing.

To make money you have to first lose money. It is commonly said in the venture capital business that the lemons, or losers, ripen in two and a half years, while the plums take seven or eight years. A start-up, venture-backed company typically loses money, often \$10 million to \$25 million or more, before sustaining profitability and going public, usually at least five to seven years later.

To create and build wealth one must relinquish wealth. Among the most successful and growing companies in the United States, the founders aggressively dilute their ownership to create ownership throughout the company. By rewarding and sharing the wealth with the people who contribute significantly to its creation, owners motivate stakeholders to make the pie bigger. *To succeed, one first has to experience failure.* It is a common pattern that the first venture fails, yet the entrepreneur learns and goes on to create a highly successful company. Jerry Kaplan teamed with Lotus Development Corporation founder Mitch Kapor to start the first pen-based computer. After \$80 million of venture capital investment, the company was shut down. Kaplan went on to launch On-Sale, Inc., an Internet Dutch auction, which experienced explosive growth and went public in 1996.

Entrepreneurship requires considerable thought, preparation, and planning, yet is basically an unplannable event. The highly dynamic, changing character of technology, markets, and competition makes it impossible to know all your competitors today, let alone five years from now. Yet great effort is invested in attempting to model and envision the future. The resulting business plan is inevitably obsolete when it comes off the printer. This is a creative process—like molding clay. You need to make a habit of planning and reacting as you constantly reevaluate your options, blending the messages from your head and your gut, until this process becomes second nature.

For creativity and innovativeness to prosper, rigor and discipline must accompany the process. For years, hundreds of thousands of patents for new products and technologies lay fallow in government and university research labs because there was no commercial discipline.

Entrepreneurship requires a bias toward action and a sense of urgency, but also demands patience and perseverance. While his competitors were acquiring and expanding rapidly, one entrepreneur's management team became nearly

¹⁰ T. Wolfe, *The Right Stuff* (New York: Bantam Books, 1980), pp. 51–52.

outraged at his inaction. This entrepreneur reported he saved the company at least \$50 million to \$100 million during the prior year by just sitting tight. He learned this lesson from the Jiffy Lube case series from *New Venture Creation*, which he studied during a weeklong program for the Young Presidents Organization (YPO), at Harvard Business School in 1991.

The greater the organization, orderliness, discipline, and control, the less you will control your ultimate destiny. Entrepreneurship requires great flexibility and nimbleness in strategy and tactics. One has to play with the knees bent. Overcontrol and an obsession with orderliness are impediments to the entrepreneurial approach. As the great race car driver Mario Andretti said, "If I am in total control, I know I am going too slow!"

Adhering to management best practice, especially staying close to the customer that created industry leaders in the 1980s, became a seed of self-destruction and loss of leadership to upstart competitors. We discussed earlier the study of "disruptive technologies."

To realize long-term equity value, you have to forgo the temptations of short-term profitability. Building long-term equity requires large, continuous reinvestment in new people, products, services, and support systems, usually at the expense of immediate profits.

The world of entrepreneurship is not neat, tidy, linear, consistent, and predictable, no matter how much we might like it to be that way.¹¹ In fact, it is from the collisions inherent in these paradoxes that value is created, as illustrated in Exhibit 3.1. These paradoxes illustrate just how contradictory and chaotic this world can be. To thrive in this environment, one needs to be very adept at coping with ambiguity, chaos, and uncertainty, and at building management skills that create predictability. Exhibit 3.2 exemplifies this ambiguity and need for patience. For example, Apple shipped the first iPod in November 2001. Eighteen months later Apple sold the one millionth unit and six months later sold another million units. In 2005 Apple shipped 13 million units. A Merrill Lynch analyst predicts iPod sales could eventually reach 300 million.

The Higher-Potential Venture: Think Big Enough

One of the biggest mistakes aspiring entrepreneurs make is strategic. They think too small. Sensible as it

EXHIBIT 3.1

Entrepreneurship IS a Contact Sport

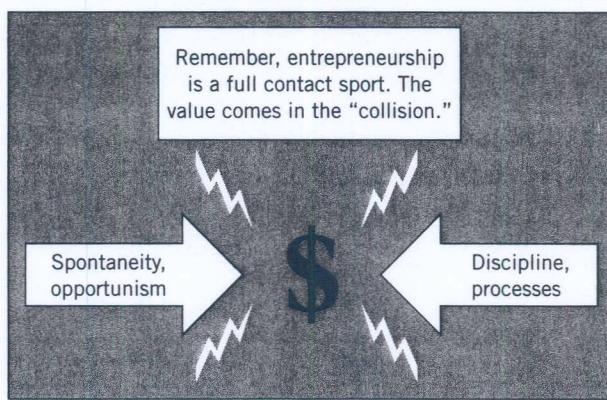


EXHIBIT 3.2

Time for New Technologies to Reach 25% of the U.S. Population

Household electricity (1873)	46 years
Telephone (1875)	35 years
Automobile (1885)	55 years
Airplane travel (1903)	54 years
Radio (1906)	22 years
Television (1925)	26 years
Videocassette recorder (1952)	34 years
Personal computer (1975)	15 years
Cellular phone	13 years
Internet	7 years
iPod	5 years

Source: *The Wall Street Journal*, 1997. Used by permission of Dow Jones & Co. Inc. via The Copyright Clearance Center with adaptation for the inclusion of Internet and iPod.

may be to think in terms of a very small, simple business as being more affordable, more manageable, less demanding, and less risky, the opposite is true. The chances of survival and success are lower in these small, job-substitute businesses, and even if they do survive, they are less financially rewarding. As one founder of numerous businesses put it, unless this business can pay you at least five times your present salary, the risk and wear and tear won't be worth it.

Consider one of the most successful venture capital investors ever, Arthur Rock. His criterion for searching for opportunities is very simple: *Look for business concepts that will change the way people live or work.* His home-run investments are legendary, including Intel, Apple Computer, Teledyne, and

¹¹ See H. H. Stevenson, *Do Lunch or Be Lunch* (Boston, MA: Harvard Business School Press, 1998) for a provocative argument for predictability as one of the most powerful of management tools.

dozens of others. Clearly his philosophy is to think big. Today an extraordinary variety of people, opportunities, and strategies characterize the approximately 30 million proprietorships, partnerships, and corporations in the country. Remember, high-potential ventures become high-impact firms that often make the world a better place!

Nearly 11 percent of the U.S. population is actively working toward starting a new venture.¹² More than 90 percent of start-ups have revenues of less than \$1 million annually, while 863,505 reported revenues of \$1 million to \$25 million—just over 9 percent of the total. Of these, only 296,695 grew at a compounded annual growth rate of 30 percent or more for the prior three years, or about 3 percent. Similarly, just 3 percent—1 in 33—exceeded \$10 million in revenues, and only 0.3 percent exceeded \$100 million in revenues.

Not only can nearly anyone start a business, but also a great many can succeed. While it certainly might help, a person does not have to be a genius to create a successful business. As Nolan Bushnell, founder of Atari, one of the first desktop computer games in the early 1980s, and Pizza Time Theater, said, “If you are not a millionaire or bankrupt by the time you are 30, you are not really trying!”¹³ It is an entrepreneur’s preparedness for the entrepreneurial process that is important. Being an entrepreneur has moved from cult status in the 1980s to rock star infamy in the 1990s to become de rigueur at the turn of the century. Amateur entrepreneurship is over. The professionals have arrived.¹⁴

A stunning number of mega-entrepreneurs launched their ventures during their 20s. While the rigors of new ventures may favor the “young at start,” age is *not* a barrier to entry. One study showed that nearly 21 percent of founders were over 40 when they embarked on their entrepreneurial careers, the majority were in their 30s, and just over one-fourth did so by the time they were 25. Further, numerous examples exist of founders who were over 60 at the time of launch, including one of the most famous seniors, Colonel Harland Sanders, who started Kentucky Fried Chicken with his first Social Security check.

¹² *The Global Entrepreneurship Monitor*, Babson College and the London Business School, May 2007.

¹³ In response to a student question at Founder’s Day, Babson College, April 1983.

¹⁴ Bob Davis, Partner, Highland Capital, June 2007.

¹⁵ *The State of Small Business: A Report of the President, Transmitted to the Congress*, 1999 (Washington, DC: Small Business Administration, 1999).

¹⁶ *The State of Small Business*, 1992, p. 128.

¹⁷ Information has been culled from the following studies: D. L. Birch, MIT Studies, 1979–1980; M. B. Teitz et al., “Small Business and Employment Growth in California,” Working Paper No. 348, University of California at Berkeley, March 1981, table 5, p. 22; U.S. Small Business Administration, August 29, 1988; B. D. Phillips and B. A. Kirchhoff, “An Analysis of New Firm Survival and Growth,” *Frontiers in Entrepreneurship Research: 1988*, ed. B. A. Kirchhoff et al. (Babson Park, MA: Babson College, 1988), pp. 266–67; and *BizMiner 2002 Startup Business Risk Index: Major Industry Report*, Brandow Co., Inc., 2002.

¹⁸ Summaries of these are reported by A. N. Shapero and J. Gigerano, “Exits and Entries: A Study in Yellow Pages Journalism,” in *Frontiers of Entrepreneurship Research: 1982*, ed. K. Vesper et al. (Babson Park, MA: Babson College, 1982), pp. 113–41, and A. C. Cooper and C. Y. Woo, “Survival and Failure: A Longitudinal Study,” in *Frontiers of Entrepreneurship Research: 1988*, ed. B. A. Kirchhoff et al. (Babson Park, MA: Babson College, 1988), pp. 225–37.

Smaller Means Higher Failure Odds

Unfortunately, the record of survival is not good among all firms started. One of the most optimistic research firms estimates the failure rate for start-ups is 46.4 percent. While government data, research, and business mortality statisticians may not agree on the precise failure and survival figures for new businesses, they do agree that failure is the rule, not the exception.

Complicating efforts to obtain precise figures is the fact that it is not easy to define and identify failures, and reliable statistics and databases are not available. However, the Small Business Administration determined that in 1999 there were 588,900 start-ups, while 528,600 firms closed their doors.¹⁵

Failure rates also vary widely across industries. In 1991, for instance, retail and services accounted for 61 percent of all failures and bankruptcies in that year.¹⁶

The following discussion provides a distillation of a number of failure rate studies over the past 50 years.¹⁷ These studies illustrate that (1) failure rates are high, and (2) although the majority of the failures occur in the first two to five years, it may take considerably longer for some to fail.¹⁸

Government data, research, and business mortality statisticians agree that start-ups run a high risk of failure. Another study, outlined in Exhibit 3.3, found that of 565,812 firms one year old or less in the first quarter of 1998 only 303,517 were still alive by the first quarter of 2001. This is an average failure rate of 46.4 percent.

Failure rates across industries vary as seen in Exhibit 3.3. The real estate industry, with a 36.8 percent rate of start-up failure, is the lowest. The technology sector has a high rate of failure at 53.9 percent. The software and services segment of the technology industry has an even higher failure rate; 55.2 percent of start-ups tracked closed their doors. Unfortunately the record of survival is not good among all firms started.

To make matters worse, most people think the failure rates are actually much higher. Since actions

EXHIBIT 3.3**Starts and Closures of Employer Firms, 2002–2006**

Category	2002	2003	2004	2005	2006
New Firms	569,750	612,296	628,917	653,100*	649,700*
Closures	586,890	540,658	541,047	543,700*	564,900*
Bankruptcies	38,540	35,037	39,317	39,201	19,695

*Estimate.

Sources: U.S. Dept. of Commerce, Bureau of the Census; Administrative Office of the U.S. Courts; U.S. Dept. of Labor, Employment and Training Administration.

often are governed by perceptions rather than facts, this perception of failure, in addition to the dismal record, can be a serious obstacle to aspiring entrepreneurs.

Still other studies have shown significant differences in survival rates among Bradstreet industry categories: retail trade, construction, and small service businesses accounted for 70 percent of all failures and bankruptcies. One study calculates a risk factor or index for start-ups by industry, which sends a clear warning signal to the would-be entrepreneur.¹⁹ At the high end of risk is tobacco products, and at the low end you find the affinity and membership organizations such as AAA or Welcome Wagon. “The fishing is better in some streams versus others,” is a favorite saying of the authors. Further, 99 percent of these failed companies had fewer than 100 employees. Through observation and practical experience one would not be surprised by such reports. The implications for would-be entrepreneurs are important: Knowing the difference between a good idea and a real opportunity is vital. This will be addressed in detail in Chapter 5.

A certain level of failure is part of the “creative self-destruction” described by Joseph Schumpeter in his numerous writings, including *Business Cycles* (1939) and *Capitalism*. It is part of the dynamics of innovation and economic renewal, a process that requires both births and deaths. More important, it is also part of the learning process inherent in gaining an entrepreneurial apprenticeship. If a business fails, no other country in the world has laws, institutions, and social norms that are more forgiving. Firms go out of existence, but entrepreneurs survive and learn.

The daunting evidence of failure poses two important questions for aspiring entrepreneurs. First, are there any exceptions to this general rule of failure, or are we faced with a punishing game of entrepreneurial roulette? Second, if there is an exception, how does one get the odds for success in one’s favor?

¹⁹ BizMiner 2002 Startup Business Risk Index.

Getting the Odds in Your Favor

Fortunately, there is a decided pattern of exceptions to the overall rate of failure among the vast majority of small, marginal firms created each year. Most smaller enterprises that cease operation simply do not meet our notion of entrepreneurship. They do not create, enhance, or pursue opportunities that realize value. They tend to be job substitutes in many instances. Undercapitalized, undermanaged, and often poorly located, they soon fail.

Threshold Concept

Who are the survivors? The odds for survival and a higher level of success change dramatically if the venture reaches a critical mass of at least 10 to 20 people with \$2 million to \$3 million in revenues and is currently pursuing opportunities with growth potential. Exhibit 3.4 shows that based on a cross-section of all new firms, one-year survival rates for new firms increase steadily as the firm size increases. The rates jump from approximately 54 percent for firms having up to 24 employees to approximately 73 percent for firms with between 100 and 249 employees.

One study found that empirical evidence supports the liability of newness and liability of smallness arguments and suggests that newness and small size make survival problematic. The authors inferred, “Perceived satisfaction, cooperation, and trust between

EXHIBIT 3.4**One-Year Survival Rates by Firm Size**

Firm Size (Employees)	Survival Percentage
1–24	53.6%
25–49	68.0
50–99	69.0
100–249	73.2

Source: BizMiner 2002 Startup Business Risk Index: Major Industry Report, © 2002 BizMiner. Reprinted by permission.

the customer and the organization [are] important for the continuation of the relationship. High levels of satisfaction, cooperation, and trust represent a stock of goodwill and positive beliefs which are critical assets that influence the commitment of the two parties to the relationship.”²⁰ The authors of this study noted, “Smaller organizations are found to be more responsive, while larger organizations are found to provide greater depth of service. . . . The entrepreneurial task is to find a way to either direct the arena of competition away from the areas where you are at a competitive disadvantage, or find some creative way to develop the required competency.”²¹

After four years, the survival rate jumps from approximately 35 to 40 percent for firms with fewer than 19 employees to about 55 percent for firms with 20 to 49 employees. Although any estimates based on sales per employee vary considerably from industry to industry, this minimum translates roughly to a threshold of \$50,000 to \$100,000 of sales per employee annually. But highly successful firms can generate much higher sales per employee. According to several reports, the service (38.6 percent), distribution (28.7 percent), and production (17.8 percent) industries have the most closed businesses after four to five years.

Promise of Growth

The definition of entrepreneurship implies the promise of expansion and the building of long-term value and durable cash flow streams as well.

However, as will be discussed later, it takes a long time for companies to become established and grow. Historically, two of every five small firms founded survive six or more years, but few achieve growth during the first four years.²² The study also found that survival rates more than double for firms that grow, and the earlier in the life of the business that growth occurs, the higher the chance of survival.²³ The 2007 INC. 500 exemplify this, with a three-year growth rate of 939 percent.²⁴

Some of the true excitement of entrepreneurship lies in conceiving, launching, and building firms such as these.

Venture Capital Backing

Another notable pattern of exception to the failure rule is found for businesses that attract start-up financing from successful private venture capital companies. While venture-backed firms account for a very small percentage of new firms each year, in 2000, 238 of 414 IPOs, or 57 percent, had venture backing.²⁵

Venture capital is not essential to a start-up, nor is it a guarantee of success. Of the companies making the 2007 INC. 500, about 18 percent raised venture capital and only 3 percent had venture funding at start-up.²⁶ Consider, for instance, that in 2000 only 5,557 companies received venture capital.²⁷ However, companies with venture capital support fare better overall. Only 46 companies with venture capital declared bankruptcy or became defunct in 2000.²⁸ This is less than 1 percent of companies that received venture capital in 2000.

These compelling data have led some to conclude that a threshold core of 10 to 15 percent of new companies will become the winners in terms of size, job creation, profitability, innovation, and potential for harvesting (and thereby realize a capital gain).

Private Investors Join Venture Capitalists

As noted previously, harvested entrepreneurs by the tens of thousands have become “angels” as private investors in the next generation of entrepreneurs. Many of the more successful entrepreneurs have created their own investment pools and are competing directly with venture capitalists for deals. Their operating experiences and successful track records provide a compelling case for adding value to an upstart company. Take, for example, highly successful Boston entrepreneur Jeff Parker. His first venture, Technical Data Corporation, enabled Wall Street bond traders to conduct daily trading with a desktop computer. Parker’s software on the Apple II created a new industry in the early 1980s.

After harvesting this and other ventures, he created his own private investment pool in the 1990s. As the Internet explosion occurred, he was one of the early investors to spot opportunities in start-up

²⁰ S. Venkataraman and M. B. Low, “On the Nature of Critical Relationships: A Test of the Liabilities and Size Hypothesis,” in *Frontiers in Entrepreneurship Research: 1991* (Babson Park, MA: Babson College, 1991), p. 97.

²¹ Ibid., pp. 105–6.

²² B. D. Phillips and B. A. Kirchhoff, “An Analysis of New Firm Survival and Growth,” in *Frontiers in Entrepreneurship Research: 1988* (Babson Park, MA: Babson College, 1988), pp. 266–67.

²³ This reaffirms the exception to the failure rule noted above and in the original edition of this book in 1977.

²⁴ S. Greco, “The INC. 500 Almanac,” INC., October 2001, p. 80.

²⁵ “Aftermarket at a Glance,” *IPO Reporter*, December 10, 2001; and “IPO Aftermarket,” *Venture Capital Journal*, December 2001.

²⁶ www.inc.com/inc5000

²⁷ Venture Economics, <http://www.ventureeconomics.com/vec/stats/2001q2/us.html>, July 30, 2001.

²⁸ *VentureXpert*, Thompson Financial Data Services, 2001.

ventures. In one case, he persuaded the founders of a new Internet firm to select him as lead investor instead of accepting offers from some of the most prestigious venture capital firms in the nation. According to the founders, it was clear that Parker's unique entrepreneurial track record and his understanding of their business would add more value than the venture capitalists at start-up.

Private investors and entrepreneurs such as Parker have similar selection criteria to the venture capitalists: They are in search of the high-potential, higher-growth ventures. Unlike the venture capitalists, however, they are not constrained by having to invest so much money in a relatively short period that they must invest it in minimum chunks of \$3 million to \$5 million or more. Private investors, therefore, are prime sources for less capital-intensive start-ups and early-stage businesses. Bob Davis (Lycos) and Tom Stemberg (Staples) followed a similar path with Highland Capital.

This overall search for higher-potential ventures has become more evident in recent years. The new e-generation appears to be learning the lessons of these survivors, venture capitalists, private investors, and founders of higher-potential firms. Hundreds of thousands of college students now have been exposed to these concepts for more than two decades, and their strategies for identifying potential businesses are mindful of and disciplined about the ingredients for success. Unlike 20 years ago, it is now nearly impossible not to hear and read about these principles whether on television, in books, on the Internet, or in a multitude of seminars, courses, and programs for would-be entrepreneurs of all types.

Find Financial Backers and Associates Who Add Value

One of the most distinguishing disciplines of these higher-potential ventures is how the founders identify financial partners and key team members. They insist on backers and partners who do more than bring just money, friendship, commitment, and motivation to the venture. They surround themselves with backers who can add value to the venture through their experience, know-how, networks, and wisdom. Key associates are selected because they are smarter and better at what they do than the founder, and they raise the overall average of the entire company. This theme will be examined in detail in later chapters.

Option: The Lifestyle Venture

For many aspiring entrepreneurs, issues of family roots and location take precedence. Accessibility to a preferred way of life, whether it is access to fishing,

skiing, hunting, hiking, music, surfing, rock climbing, canoeing, a rural setting, or the mountains, can be more important than how large a business one has or the size of one's net worth. Others vastly prefer to be with and work with their family or spouse. They want to live in a nonurban area that they consider very attractive. Take Jake and Diana Bishop, for instance. Both have advanced degrees in accounting. They gave up six-figure jobs they both found rewarding and satisfying on the beautiful coast of Maine to return to their home state of Michigan for several important lifestyle reasons. They wanted to work together again in a business, which they had done successfully earlier in their marriage. It was important to be much closer than the 14-hour drive to Diana's aging parents. They also wanted to have their children—then in their 20s—join them in the business. Finally, they wanted to live in one of their favorite areas of the country, Harbor Spring on Lake Michigan in the northwest tip of the state. They report never to have worked harder in their 50 years, nor have they been any happier. They are growing their rental business more than 20 percent a year, making an excellent living, and creating equity value. If done right, one can have a lifestyle business and actually realize higher potential.

Yet couples who give up successful careers in New York City to buy an inn in Vermont to avoid the rat race generally last only six to seven years. They discover the joys of self-employment, including seven-day, 70- to 90-hour workweeks, chefs and day help that do not show up, roofs that leak when least expected, and the occasional guests from hell. The grass is always greener, so they say.

The Timmons Model: Where Theory and Practice Collide in the Real World

How can aspiring entrepreneurs—and the investors and associates who join the venture—get the odds of success on their side? What do these talented and successful high-potential entrepreneurs, their venture capitalists, and their private backers do differently? What is accounting for their exceptional record? Are there general lessons and principles underlying their successes that can benefit aspiring entrepreneurs, investors, and those who would join a venture? If so, can these lessons be learned?

These are the central questions of our lifetime work. We have been immersed as students, researchers, teachers, and practitioners of the *entrepreneurial process*. As founding shareholders and investors of several high-potential ventures (some of

which are now public), directors and advisors to ventures and venture capital funds, a charter director and advisor to the Kauffman Center for Entrepreneurial Leadership at the Ewing Marion Kauffman Foundation, and as director of the Arthur M. Blank Center for Entrepreneurship at Babson College, we have each applied, tested, refined, and tempered academic theory as fire tempers iron into steel: in the fire of practice.

Intellectual and Practical Collisions with the Real World

Throughout this period of evolution and revolution, *New Venture Creation* has adhered to one core principle: In every quest for greater knowledge of the entrepreneurial process and more effective learning, there must be intellectual and practical collisions between academic theory and the real world of practice. The standard academic notion of something being all right in practice but not in theory is unacceptable. This integrated, holistic balance is at the heart of what we know about the entrepreneurial process and getting the odds in your favor.

Value Creation: The Driving Forces

A core, fundamental entrepreneurial process accounts for the substantially greater success pattern among higher-potential ventures. Despite the great variety of businesses, entrepreneurs, geographies,

and technologies, central themes or driving forces dominate this highly dynamic entrepreneurial process.

- It is *opportunity driven*.
- It is driven by a *lead entrepreneur* and an *entrepreneurial team*.
- It is *resource parsimonious and creative*.
- It depends on the *fit and balance* among these.
- It is *integrated and holistic*.
- It is *sustainable*.

These are the controllable components of the entrepreneurial process that can be assessed, influenced, and altered. Founders and investors focus on these forces during their careful due diligence to analyze the risks and determine what changes can be made to improve a venture's chances of success.

First, we will elaborate on each of these forces to provide a blueprint and a definition of what each means. Then using Google as an example, we will illustrate how the holistic, balance, and fit concepts pertain to a start-up.

Change the Odds: Fix It, Shape It, Mold It, Make It

The driving forces underlying successful new venture creation are illustrated in Exhibit 3.5. The process starts with opportunity, not money, strategy, networks, team, or the business plan. Most genuine opportunities are much bigger than either the talent

EXHIBIT 3.5
The Timmons Model of the Entrepreneurial Process



and capacity of the team or the initial resources available to the team. The role of the lead entrepreneur and the team is to juggle all these key elements in a changing environment. Think of a juggler bouncing up and down on a trampoline that is moving on a conveyor belt at unpredictable speeds and directions, while trying to keep all three balls in the air. That is the dynamic nature of an early-stage start-up. The business plan provides the language and code for communicating the quality of the three driving forces of the Timmons Model and of their fit and balance.

In the entrepreneurial process depicted in the Timmons Model, the shape, size, and depth of the opportunity establish the required shape, size, and depth of both the resources and the team. We have found that many people are a bit uncomfortable viewing the opportunity and resources somewhat precariously balanced by the team. It is especially disconcerting to some because we show the three key elements of the entrepreneurial process as circles, and thus the balance appears tenuous. These reactions are justified, accurate, and realistic. The entrepreneurial process is dynamic. Those who recognize the risks better manage the process and garner more return.

The lead entrepreneur's job is simple enough. He or she must carry the deal by *taking charge of the success equation*. In this dynamic context, ambiguity and risk are actually your friends. Central to the homework, creative problem solving and strategizing, and due diligence that lie ahead is analyzing the fits and gaps that exist in the venture. What is wrong with this opportunity? What is missing? What good news and favorable events can happen, as well as the adverse? What has to happen to make it attractive and a fit for me? What market, technology, competitive, management, and financial risks can be reduced or eliminated? What can be changed to make this happen? Who can change it? What are the least resources necessary to grow the business the farthest? Is this the right team? By implication, if you can determine these answers and make the necessary changes by figuring out how to fill the gaps and improve the fit and attract key players who can add such value, then the odds for success rise significantly. In essence, the entrepreneur's role is to manage and redefine the risk-reward equation—all with an eye toward *sustainability*. Because part of the entrepreneur's legacy is to create positive impact without harming the environment, the community, or society, the concept of sustainability appears as the underlying foundation in the model.

The Opportunity At the heart of the process is the opportunity. Successful entrepreneurs and investors know that a good idea is not necessarily a good opportunity. For every 100 ideas presented to investors in the form of a business plan or proposal, usually fewer than 4 get funded. More than 80 percent of those rejections occur in the first few hours; another 10 to 15 percent are rejected after investors have read the business plan carefully. Fewer than 10 percent attract enough interest to merit a more due diligence thorough review that can take several weeks or months. These are very slim odds. Countless hours and days have been wasted by would-be entrepreneurs chasing ideas that are going nowhere. An important skill for an entrepreneur or an investor is to be able to quickly evaluate whether serious potential exists, and to decide how much time and effort to invest.

John Doerr is a senior partner at one of the most famous and successful venture capital funds ever, Kleiner, Perkins, Caulfield & Byers, and is considered by some to be the most influential venture capitalist of his generation. During his career, he has been the epitome of the revolutionaries described earlier, who have created new industries as lead investors in such legends as Sun Microsystems, Compaq Computer, Lotus Development Corporation, Intuit, Genentech, Millennium, Netscape, and Amazon.com. Regardless of these past home runs, Doerr insists, "There's never been a better time than now to start a company. In the past, entrepreneurs started businesses. Today they invent new business models. That's a big difference, and it creates huge opportunities."²⁹

Another venture capitalist recently stated, "Cycles of irrational exuberance are not new in venture investing. The Internet bubble burst, we came back to earth, and then we began another period of excessive valuation that is subsiding in late 2007 with a credit squeeze."³⁰

Exhibit 3.6 summarizes the most important characteristics of good opportunities. Underlying market demand—because of the value-added properties of the product or service, the market's size and 20-plus percent growth potential, the economics of the business, particularly robust margins (40 percent or more), and free cash flow characteristics—drives the value creation potential.

We build our understanding of opportunity by first focusing on market readiness: the consumer trends and behaviors that seek new products or services. Once these emerging patterns are identified, the aspiring entrepreneur develops a service or product concept, and finally the service or product delivery

²⁹ "John Doerr's Start-Up Manual," *Fast Company*, February–March 1997, pp. 82–84.

³⁰ Ernie Parizeau, Partner, Norwest Venture Partners, June 2007.

EXHIBIT 3.6**The Entrepreneurial Process
Is Opportunity Driven***

Market demand is a key ingredient to measuring an opportunity:

- Is customer payback less than one year?
- Do market share and growth potential equal 20 percent annual growth and is it durable?
- Is the customer reachable?

Market structure and size help define an opportunity:

- Emerging and/or fragmented?
- \$50 million or more, with a \$1 billion potential?
- Proprietary barriers to entry?

Margin analysis helps differentiate an opportunity from an idea:

- Low-cost provider (40 percent gross margin)?
- Low capital requirement versus the competition?
- Break even in 1–2 years?
- Value added increase of overall corporate P/E ratio?

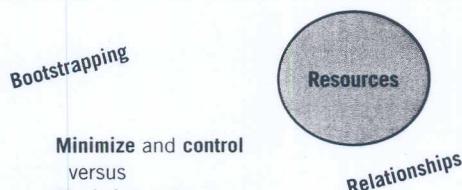
*Durability of an opportunity is a widely misunderstood concept. In entrepreneurship, durability exists when the investor gets her money back plus a market or better return on investment.

system is conceived. We then ask the questions articulated in the exhibit.

These criteria will be described in great detail in Chapter 5 and can be applied to the search and evaluation of any opportunity. In short, the greater the growth, size, durability, and robustness of the gross and net margins and free cash flow, the greater the opportunity. The more *imperfect* the market, the greater the opportunity. The greater the rate of change, the discontinuities, and the chaos, the greater is the opportunity. The greater the inconsistencies in existing service and quality, in lead times and lag times, and the greater the vacuums and gaps in information and knowledge, the greater is the opportunity.

Resources: Creative and Parsimonious

One of the most common misconceptions among untried entrepreneurs is that you first need to have all the resources in place, especially the money, to succeed with a venture. Thinking money first is a big mistake. Money follows high-potential opportunities conceived of and led by a strong management team. Investors have bemoaned for years that there is too much money **chasing too few deals**. In other words, there is a shortage of quality entrepreneurs and opportunities, not money. Successful entrepreneurs devise ingeniously

EXHIBIT 3.7**Understand and Marshall Resources,
Don't Be Driven by Them**

Minimize and control
versus
Maximize and own

Unleashing creativity

Financial resources
Assets
People
Your business plan

Think cash last!

creative and stingy strategies to marshal and gain control of resources (Exhibit 3.7). Surprising as it may sound, investors and successful entrepreneurs often say one of the worst things that can happen to an entrepreneur is to have *too much money too early*.

Howard Head is a wonderful, classic example of succeeding with few resources. He developed the first metal ski, which became the market leader, and then the oversize Prince tennis racket; developing two totally unrelated technologies is a rare feat. Head left his job at a large aircraft manufacturer during World War II and worked in his garage on a shoestring budget to create his metal ski. It took more than 40 versions before he developed a ski that worked and could be marketed. He insisted that one of the biggest reasons he finally succeeded is that he had so little money. He argued that if he had complete financing he would have blown it all long before he evolved the workable metal ski.

Bootstrapping is a way of life in entrepreneurial companies and can create a significant competitive advantage. Doing more with less is a powerful competitive weapon. Effective new ventures strive to minimize and control the resources, but not necessarily own them. Whether it is assets for the business, key people, the business plan, or start-up and growth capital, successful entrepreneurs *think cash last*. Such strategies encourage a discipline of leanness, where everyone knows that every dollar counts, and the principle “conserve your equity” (CYE) becomes a way of maximizing shareholder value.

The Entrepreneurial Team There is little dispute today that the entrepreneurial team is a key **ingredient in the higher-potential venture**. Investors are captivated “by the creative brilliance of a company’s head entrepreneur: A Mitch Kapor, a Steve

Jobs, a Fred Smith . . . and bet on the superb track records of the management team working as a group.”³¹ Venture capitalist John Doerr reaffirms General George Doriot’s dictum: I prefer a Grade A entrepreneur and team with a Grade B idea, over a Grade B team with a Grade A idea. Doerr stated, “In the world today, there’s plenty of technology, plenty of entrepreneurs, plenty of money, plenty of venture capital. What’s in short supply is great teams. Your biggest challenge will be building a great team.”³²

Famous investor Arthur Rock articulated the importance of the team more than a decade ago. He put it this way: “If you can find good people, they can always change the product. Nearly every mistake I’ve made has been I picked the wrong people, not the wrong idea.”³³ Finally, as we saw earlier, the ventures with more than 20 employees and \$2 million to \$3 million in sales were much more likely to survive and prosper than smaller ventures. In the vast majority of cases, it is very difficult to grow beyond this without a team of two or more key contributors.

Clearly a new venture requires a lead entrepreneur that has personal characteristics described in Exhibit 3.8. But the high-potential venture also requires interpersonal skills to foster communications and, therefore, team building.

Exhibit 3.8 summarizes the important aspects of the team. These teams invariably are formed and led by a very capable entrepreneurial leader whose track record exhibits both accomplishments and several qualities that the team must possess. A pacesetter and culture creator, the lead entrepreneur is central to the team as both a player and a coach. The ability and skill in attracting other key management members and then building the team is one of the most valued capabilities investors look for. The founder who becomes the leader does so by building heroes in the team. A leader adapts a philosophy that rewards success and supports honest failure, shares the wealth with those who help create it, and sets high standards for both performance and conduct. We will examine in detail the entrepreneurial leader and the new venture team in Chapter 8.

Importance of Fit and Balance Rounding out the model of the three driving forces is the concept of fit and balance between and among these forces. Note that the team is positioned at the bottom of the triangle in the Timmons Model (Exhibit 3.5). Imagine the founder, the entrepreneurial leader of the venture, standing on a large ball, balancing the

EXHIBIT 3.8

An Entrepreneurial Team Is a Critical Ingredient for Success

An entrepreneurial leader

- Learns and teaches—faster, better
- Deals with adversity, is resilient
- Exhibits integrity, dependability, honesty
- Builds entrepreneurial culture and organization



Passion

Quality of the team

- Relevant experience and track record
- Motivation to excel
- Commitment, determination, and persistence
- Tolerance of risk, ambiguity, and uncertainty
- Creativity
- Team locus of control
- Adaptability
- Opportunity obsession
- Leadership and courage
- Communication

triangle over her head. This imagery is helpful in appreciating the constant balancing act because opportunity, team, and resources rarely match. When envisioning a company’s future, the entrepreneur can ask, What pitfalls will I encounter to get to the next boundary of success? Will my current team be large enough, or will we be over our heads if the company grows 30 percent over the next two years? Are my resources sufficient (or too abundant)? Vivid examples of the failure to maintain a balance are everywhere, such as when large companies throw too many resources at a weak, poorly defined opportunity. For example, Lucent Technologies’ misplaced assumption of slowness to react to bandwidth demand resulted in an almost 90 percent reduction in market capitalization.

Sustainability as a Base Building a sustainable venture means achieving economic, environmental, and social goals without compromising the same opportunity for future generations. The sea change in entrepreneurship regarding environment, community, and society is driven by many factors. We are seeing an elevated social awareness concerning a wide range of sustainability-related issues, including human rights, food quality, energy resources, pollution, global warming, and the like. By understanding these factors, the entrepreneur builds a firmer base, girding the venture for the long term.

³¹ W. D. Bygrave and J. A. Timmons, *Venture Capital at the Crossroads* (Boston: Harvard Business School Press, 1992), p. 8.

³² *Fast Company*, February–March 1997, p. 84.

³³ A. Rock, “Strategy vs. Tactics from a Venture Capitalist,” *Harvard Business Review*, November–December 1987, pp. 63–67.

While the drawings oversimplify these incredibly complex events, they help us to think conceptually—an important entrepreneurial talent—about the company-building process, including the strategic and management implications of striving to achieve balance, and the inevitable fragility of the process. Visually, the process can be appreciated as a constant balancing act, requiring continual assessment, revised strategies and tactics, and an experimental approach. By addressing the types of questions necessary to shape the opportunity, the resources, and the team, the founder begins to mold the idea into an opportunity, and the opportunity into a business, just as you would mold clay from a shapeless form into a piece of art.

Exhibit 3.9 shows how this balancing act evolved for Google from inception through its initial public and secondary offerings. Back in 1996, online search was a huge, rapidly growing, but elusive opportunity. There were plenty of early entrants in the search space, but none had yet broken out of the pack. Stanford graduate students Larry Page and Sergey Brin began to collaborate on a search engine called BackRub, named for its unique ability to analyze the “back links” pointing to a given Web site. Within a year, their unique approach to link analysis was earning their dorm-room search engine a growing reputation as word spread around campus. Still, they had no team and no capital, and their server architecture was running on computers they borrowed from their computer science department.

Such a mismatch of ideas, resources, and talent could quickly topple out of the founders’ control and

fall into the hands of someone who could turn it into a real opportunity. At this tenuous point, the founders would have seen something like the first figure, Exhibit 3.9(a), with the huge search engine opportunity far outweighing the team and resources. The gaps were major.

Enter entrepreneur and angel investor Andy Bechtolsheim, one of the founders of Sun Microsystems. The partners of the search engine (now named Google, a variant of *googol*, an immense number), met Bechtolsheim very early one morning on the porch of a Stanford faculty member’s home in Palo Alto. Impressed, but without the time to hear the details, Bechtolsheim wrote them a check for \$100,000. From there, Page and Brin went on to raise a first round of \$1 million. The partners were now in a position to fill the resource gaps and build the team.

In September 1998 they set up shop in a garage in Menlo Park, California, and hired their first employee: technology expert Craig Silverstein. Less than a year later, they moved to a new location, which quickly became a crush of desks and servers. In June 1999 the firm secured a round of funding that included \$25 million from Sequoia Capital and Kleiner, Perkins, Caufield & Byers—two of the leading venture capital firms in Silicon Valley. The terrible office gridlock was alleviated with a move to Google’s current headquarters in Mountain View, California.

This new balance in Exhibit 3.9(b) created a justifiable investment. The opportunity was still huge and growing, and some competitors were gaining market acceptance as well. To fully exploit this opportunity,

EXHIBIT 3.9(a)

Google—Classic Resource Parsimony, Bootstrapping—Journey through the Entrepreneurial Process: At Start-Up, a Huge Imbalance

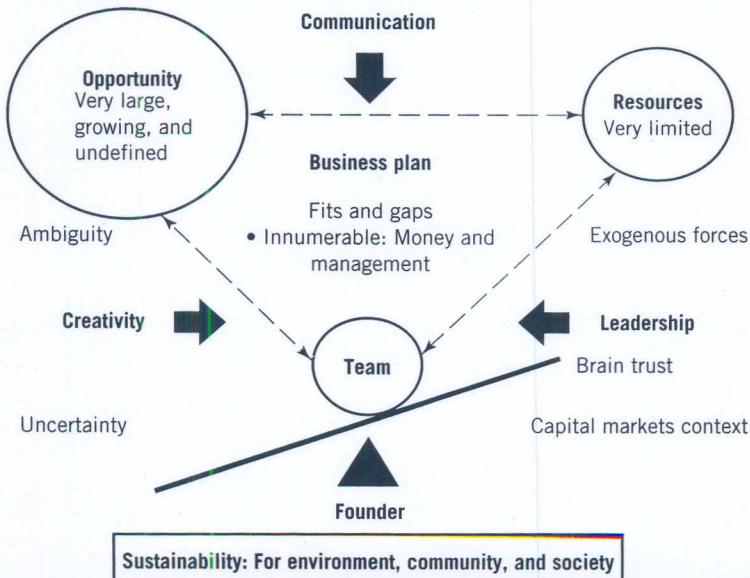
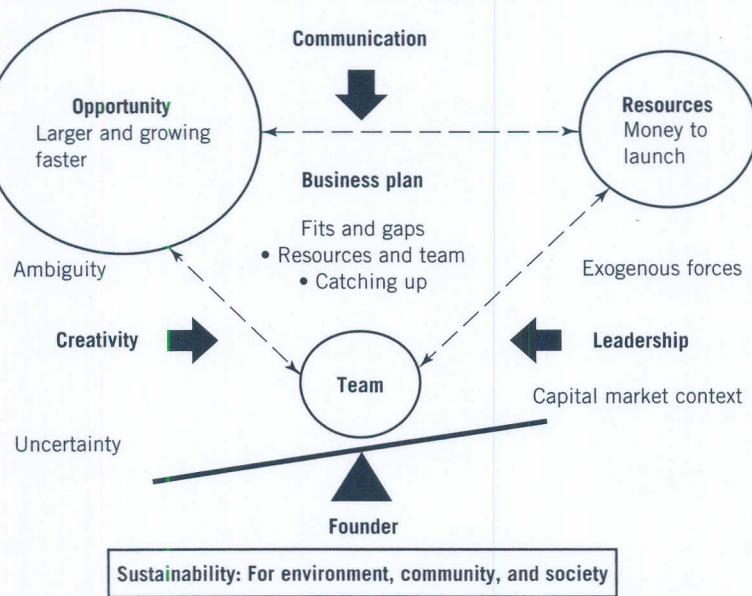
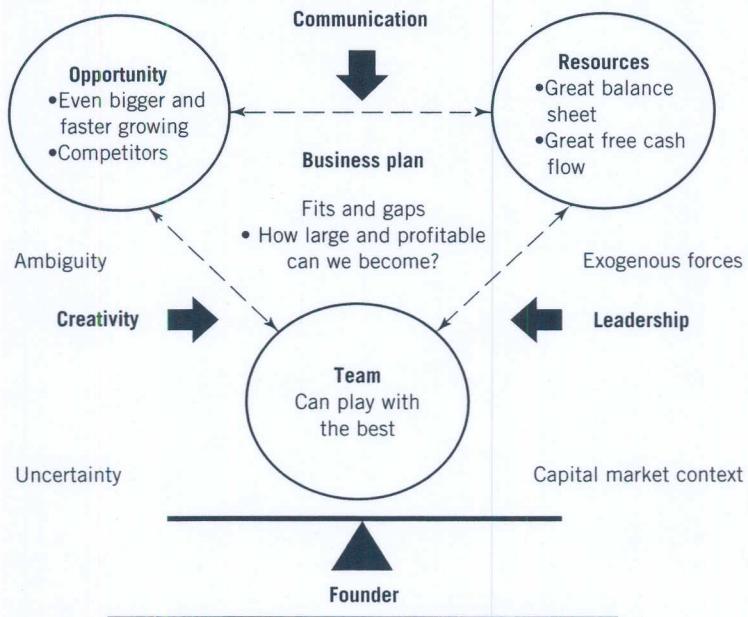


EXHIBIT 3.9(b)**Google—Marshaling of Team and Resources to Pursue Opportunity—Journey through the Entrepreneurial Process: At Venture Capital Funding, toward New Balance****EXHIBIT 3.9(c)****Google—Building and Sustaining the Enterprise; Rebalancing—Journey through the Entrepreneurial Process: At IPO, a New Balance**

attract a large and highly talented group of managers and professionals, and create even greater financial strength than competitors like Yahoo!, the company had to complete an initial public stock offering (IPO). Following the close of that IPO in the summer of 2004, Google was worth more than \$25 billion, giving it a first-day market capitalization greater than that of Amazon.com, Lockheed Martin, or General Motors. Within a year the company had raised another \$4 billion in a secondary public offering.

By 2007 Google (see Exhibit 3.9(c)) had a share price in the range of \$500 and was larger and stronger in people and resources than any direct competitor. The company was *the* place to work and employed over 10,000 of the best and brightest in the industry. Could such an unstoppable force as Google be blindsided and eclipsed by a new disruptive technology, just as Apple Computer and Microsoft bludgeoned IBM and Digital Equipment? While right now such a prospect might seem impossible given Google's momentum, scale, and ability to attract talent, history is quite clear on this: The answer is not whether, but when, Google will be overtaken.

This iterative entrepreneurial process is based on both logic and trial and error. It is both intuitive and consciously planned. It is a process not unlike what the Wright brothers originally engaged in while creating the first self-propelled airplane. They conducted more than 1,000 glider flights before succeeding. These trial-and-error experiments led to the new knowledge, skills, and insights needed to actually fly. Entrepreneurs have similar learning curves.

The fit issue can be appreciated in terms of a question: This is a fabulous opportunity, but for whom? Some of the most successful investments ever were turned down by numerous investors before the founders received backing. Intuit received 20 rejections for start-up funding by sophisticated investors. One former student, Ann Southworth, was turned down by 24 banks and investors before receiving funding for an elderly extended care facility. Ten years later, the company was sold for an eight-figure profit. Time and again, there can be a mismatch between the type of business and investors, the chemistry between founders and backers, or a multitude of other factors that can cause a rejection. Thus how the unique combination of people, opportunity, and resources come together at a particular time may determine a venture's ultimate chance for success.

The potential for attracting outside funding for a proposed venture depends on this overall fit and how the investor believes he or she can add value to this fit and improve the fit, risk-reward ratio, and odds for success. Exhibit 2.12 in the previous chapter shows the possible outcome.

Importance of Timing Equally important is the timing of the entrepreneurial process. Each of these unique combinations occurs in real time, where the hourglass drains continually and may be friend, foe, or both. Decisiveness in recognizing and seizing the opportunity can make all the difference. Don't wait for the perfect time to take advantage of an opportunity: There is no perfect time. Most new businesses run out of money before they can find enough customers and the right teams for their great ideas. Opportunity is a moving target.

Recent Research Supports the Model

The Timmons Model originally evolved from doctoral dissertation research at the Harvard Business School, about new and growing ventures. Over nearly three decades, the model has evolved and been enhanced by ongoing research, case development, teaching, and experience in high-potential ventures and venture capital funds. The fundamental components of the model have not changed, but their richness and the relationships of each to the whole have been steadily enhanced as they have become better understood. Numerous other researchers have examined a wide range of topics in entrepreneurship and new venture creation. The bottom line is that the model, in its simple elegance and dynamic richness, harnesses what you need to know about the entrepreneurial process to get the odds in your favor. As each of the chapters and accompanying cases, exercises, and issues expand on the process, addressing individual dimensions, a detailed framework with explicit criteria will emerge. If you engage this material fully, you cannot help but improve your chances of success.

Similar to the INC. 500 companies mentioned earlier, the Ernst & Young LLP Entrepreneur of the Year winners were the basis of a major research effort conducted by the National Center for Entrepreneurship Research at the Kauffman Center for Entrepreneurial Leadership, with a specific focus on 906 high-growth companies.³⁴ These findings provide important benchmarks of the practices in a diverse group of industries among a high-performing group of companies.

Most significantly, these results reconfirm the importance of the model and its principles: the team, the market opportunity, the resource strategies, most of the individual criteria, the concept of fit and balance, and the holistic approach to entrepreneurship.

Exhibit 3.10 summarizes the 26 leading practices identified in four key areas: marketing, finances, management, and planning. (A complete version of the study is available from the National Center for Entrepreneurship Research, <http://www.kauffman.org>.)

³⁴ D. L. Sexton and F. I. Seale, *Leading Practices of Fast Growth Entrepreneurs: Pathways to High Performance* (Kansas City, MO: Kauffman Center for Entrepreneurial Leadership, 1997).

EXHIBIT 3.10**Leading Practices****Leading marketing practices of fast-growth firms**

- Deliver products and services that are perceived as highest quality to expanding segments.
- Cultivate pacesetting new products and services that stand out in the market as best of the breed.
- Deliver product and service benefits that demand average or higher market pricing.
- Generate revenue flows from existing products and services that typically sustain approximately 90% of the present revenue base, while achieving flows from new products and services that typically expand revenue approximately 20% annually.
- Generate revenue flows from existing customers that typically sustain approximately 80% of the ongoing revenue base, while achieving flows from new customers that typically expand revenue flows by about 30% annually.
- Create high-impact, new product and service improvements with development expenditures that typically account for no more than approximately 6% of revenues.
- Utilize a high-yield sales force that typically accounts for approximately 60% of marketing expenditures.
- Rapidly develop broad product and service platforms with complementary channels to help expand a firm's geographic marketing area.

Leading financial practices of fast-growth firms

- Anticipate multiple rounds of financing (on average every 2.5 years).
- Secure funding sources capable of significantly expanding their participation amounts.
- Utilize financing vehicles that retain the entrepreneur's voting control.
- Maintain control of the firm by selectively granting employee stock ownership.
- Link the entrepreneur's long-term objectives to a defined exit strategy in the business plan.

Leading management practices of fast-growth firms

- Use a collaborative decision-making style with the top management team.
- Accelerate organizational development by assembling a balanced top management team with or without prior experience of working together.
- Develop a top management team of three to six individuals with the capacity to become the entrepreneur's entrepreneurs. Align the number of management levels with the number of individuals in top management.
- Establish entrepreneurial competency first in the functional areas of finance, marketing, and operations. Assemble a balanced board of directors composed of both internal and external directors.
- Repeatedly calibrate strategies with regular board of directors meetings.
- Involve the board of directors heavily at strategic inflection points.

Leading planning practices of fast-growth firms

- Prepare detailed written monthly plans for each of the next 12 to 24 months and annual plans for three or more years.
- Establish functional planning and control systems that tie planned achievements to actual performance and adjust management compensation accordingly.
- Periodically share with employees the planned versus actual performance data directly linked to the business plan.
- Link job performance standards that have been jointly set by management and employees to the business plan.
- Prospectively model the firm based on benchmarks that exceed industry norms, competitors, and the industry leader.

Chapter Summary

- We began to demystify entrepreneurship by examining its classic start-up definition and a broader, holistic way of thinking, reasoning, and acting that is opportunity obsessed and leadership balanced.
- Entrepreneurship has many metaphors and poses many paradoxes.
- Getting the odds in your favor is the entrepreneur's perpetual challenge, and the smaller the business, the poorer are the odds of survival.
- Thinking big enough can improve the odds significantly. Higher-potential ventures are sought by successful entrepreneurs, venture capitalists, and private investors.
- The Timmons Model is at the heart of spotting and building the higher-potential venture and understanding its three driving forces: opportunity, the team, and resources. The concept of fit and balance is crucial.
- Recent research on CEOs of fast-growth ventures nationwide adds new validity to the model.