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PART I

Entrepreneurship and Small Business Management

CHAPTER 1

Entrepreneurship and Small Business

Only those who will risk going too far
can possibly find out how far one can go.

T. S. Eliot

LEARNING OUTCOMES

- Discuss the roles of entrepreneurship and small business in the economy.
- Describe the global opportunity for entrepreneurs.
- Explain the entrepreneurial mindset and how entrepreneurs approach business ownership.
- List the various types of entrepreneurs.
- Discuss what must be considered before deciding to become a business owner.

LEARNING FROM ENTREPRENEURS, CASE 1.1

Moosejaw Mountaineering

Robert Wolfe never thought that he would be heading a company that produced over $10 million in annual revenues. In the early 1990s, Wolfe graduated from college with a political science degree. What can you do with a political science degree? Well, you can become a backpacking guide. Wolfe and his close friend were avid mountain people, so deciding to support their passion by serving as guides made sense. It wasn't long before they discovered that they consistently recommended one particular store to people looking for backpacking and climbing equipment. It occurred to them that they knew as much about the business as anyone. One day in 1992, the pair decided that instead of giving business to someone else, it was time to get some of that business for themselves.

The two friends began with a 2,200–square foot store in tiny Keego Harbor, Michigan, where they hoped to provide high-end equipment and supplies for serious mountaineers. This concept was not about a trend or fad; it was about serving the die-hard hiker with the best equipment. They named the company Moosejaw Mountaineering and used suppliers for the initial funding. Then they staffed the store with wilderness experts, something no one else was doing. Soon, however, Wolfe's partner and longtime backpacking friend found that he was not passionate about the retail business and sold his interest to Wolfe.

Growing the Business

Undaunted by the departure of his friend, Wolfe quickly opened a second store in East Lansing, Michigan, and six additional stores soon after. It is often the case that when an entrepreneur attempts to grow quickly, especially in a high-overhead business like retail, he or she runs into serious cash-flow problems, and Moosejaw was no exception. The company had seasonal cash-flow needs that required a significant line of credit, particularly because they had to build up their inventory to meet end-of-year demand. Because Wolfe's family had a long-standing relationship with Merrill Lynch, he leveraged that relationship and was able to secure an increased line of credit to better manage the company's working capital.

Wolfe had three goals for his enterprise: (1) to expand the stores, (2) to boost the mail-order business, and (3) to build the brand. What he didn't expect was that Moosejaw's biggest expansion would come in the mid-1990s when the World Wide Web began providing a way for people to buy online. Wolfe didn't know anything about the Internet, but he did see the potential for the Web to overtake their mail-order business. In 1997 Wolfe's brother, Jeffrey, joined the company to make Moosejaw a serious player in the e-commerce business. Their online operating profit was becoming substantially greater than the retail store profit, and they were reaching a global market as well, so they wanted to take advantage of this portion of their business. They spent a lot of time working on the relationships with their suppliers who in turn made sure that Moosejaw appeared on the suppliers' sites 90 percent of the time when a customer searched on where to buy. In addition, because their retail stores hold large quantities of inventory, they were able to fill about 30 percent of their online orders from the retail inventory in their six stores. Today, the online portion of the business accounts for two-thirds of annual sales. As an added bonus, Wolfe sees the Internet as a great way to have fun with his business at low cost. For example, one Christmas he had an "All Pink Sale," and that theme and message was splattered over the website. To learn more about Moosejaw, visit www.moosejaw.com.

Advising the Entrepreneur

1. Would Wolfe's concept work as a start-up today? Given the increased competition in this market, what would be your entry strategy?
2. Wolfe seemed to be lucky in 1992, starting the business with very little planning. Would anything have changed had he done some planning?
3. As he positions the company to face increased global competition, what does Wolfe need to consider?

Sources: "Robert Wolfe's Key Move: Putting the Web to Work," *Startup Nation* (2005), www.startupnation.com; Merrill Lynch, "Moosejaw Mountaineering—Reinventing the Outdoors" (March 2004), http://askmerrill.ml.com; www.moosejaw.com.

If you dream about spending every day working on something about which you are passionate, small business ownership may provide the fulfillment of that dream. If you imagine taking charge of your life so that you have as much control over the work you do as you have over the other parts of your life, entrepreneurship may be the means to do just that. Every day in the United States and around the world, thousands of people are discovering that entrepreneurship is the best path to wealth creation and independence. Entrepreneurship benefits not only the individuals who follow that path but also the communities in which they do business and the economy in general. Entrepreneurs are the driving force behind the technological change that produces economic growth. They are able to recognize new customer segments, new customer needs, and new ways to manufacture and distribute, and they have the courage to create new companies to bring new products and services to market. These companies generate new jobs for the communities in which they operate and new products and services for the global community that they serve.

Today, even the smallest business is part of a rapidly growing global marketplace whether it wants to be or not. Its customers enjoy unprecedented choice in where they can do business and in the variety of products and services available to them. The smallest community likely has Internet access that brings the world to its doorstep. Local agricultural areas in Florida and California that once dominated the fresh-produce market are competing today with fresh fruit and vegetables from Chile, New Zealand, and other parts of the world. Even service companies cannot escape competition from the global community. The Internet has fostered the development of low-cost service companies in India, for example, that offer their programming services economically over the Internet to all parts of the globe.

Entrepreneurs are the primary mechanism by which demand is turned into supply. Entrepreneurs are also the principal source of venture capital to fuel high-growth companies and private investors who provide seed capital to emerging companies. The most successful and innovative entrepreneurs change society as we know it. In the early 1990s, when Marc Andreesen developed the graphical interface Mosaic (which later become Netscape Communications) to make the emerging World Wide Web user friendly and Sky Dayton created Earthlink to make it easy for the average user to connect to the Internet, they had a profound impact on business and on people's daily lives.

All these economic and societal benefits start with a small business. Small business has been an integral part of American history and is serving as an economic stimulus in developing nations around the world. In the past, it was relatively easy to start and grow a small business and simply focus on a local niche. But the world has changed, and small business owners must change with it. Today, small business owners need to think like entrepreneurs if they are going to successfully maneuver the minefields of a dynamic marketplace. This is an exciting time for small business, an opportunity to share in the wealth that is being created as a result of change. This book takes an entrepreneurial approach to small business creation and management in the firm belief that, for small business to not only survive but also thrive, small business entrepreneurs must innovate, create new value for their customers, and discover creative ways to grow.

This chapter provides an overview of the role of entrepreneurship and small business in the economy, the nature of small business, the global opportunity, and what needs to be considered before deciding to become an entrepreneur.

ENTREPRENEURIAL VENTURES AND SMALL BUSINESSES

In this book, we make a clear distinction between small businesses and entrepreneurial ventures. Generally, small businesses and entrepreneurial ventures are two different types of businesses whose owners have different intentions. **Small businesses** typically start small and stay relatively small, providing a lifestyle, a job, and a modest level of income for their owners and having little impact in their industries. They are often referred to as "mom-and-pop" businesses, suggesting family-owned businesses. (However, many mom-and-pop businesses have grown to become substantial firms with significant impact in their industries. Marriott Corporation and Wal-Mart are notable examples.) **Entrepreneurial ventures,** on the other hand, have founders with different motives and goals. These founders are innovative and growth oriented. Their purpose is not to create a job or an occupation for themselves but to create value and wealth that they can harvest at some future date. Sylvan Learning Systems, Inc., is an outstanding example of an entrepreneurial venture. Douglas Becker and R. Christopher Hoehn-Saric acquired this company and, in just five years with their drive and vision, turned it into one of the fastest-growing and most innovative educational companies in the United States.

Although throughout this text we distinguish between small businesses and entrepreneurial ventures whenever that distinction is important, we use the terms *small-business owner* and *entrepreneur* interchangeably because this book emphasizes the importance of small business owners thinking like entrepreneurs.

Entrepreneurship and Small Business in the Economy

Virtually every company starts out relatively small, but not every company stays small. Unfortunately, most of the research on entrepreneurship does not distinguish between those businesses that remain small and those that grow to become substantial companies. In fact, there is considerable disagreement about what actually constitutes a small business. The Small Business Administration (SBA) traditionally has defined a small business as one employing fewer than 500 employees. However, more than 90 percent of all businesses employ fewer than 500 workers, and most people find it difficult to think of a 400-person firm or even a 200-person firm as "small." In contrast, the Organization for Economic Cooperation and Development (OECD) and the U.S. Chamber of Commerce prefer to designate as a small business any firm employing fewer than 100 people. In the minds of many business owners, however, even a firm with 100 employees does not seem small. Given the current trend toward downsizing, outsourcing, and **virtual companies,** the relevance of using the number of employees as a defining factor for small business has been called into question. How does one measure the size of a company by number of employees when the company **outsources** (uses contract workers rather than permanent employees) for most of its primary functions such as manufacturing, distribution, and possibly marketing? In this book, we employ the definition of the OECD and designate small businesses as those with fewer than 100 employees.

Figure 1.1 depicts the range of categories of small business from the many microbusinesses to the relatively small number of high-growth ventures, or **gazelles.** The term *gazelles* was coined by David Birch of the research company Cognetics to explain young firms with at least $100,000 in revenues that grow at a rate of 20 percent a year for four years. Many of these firms, which number about 350,000 at any

FIGURE 1.1 Categories of Small Businesses

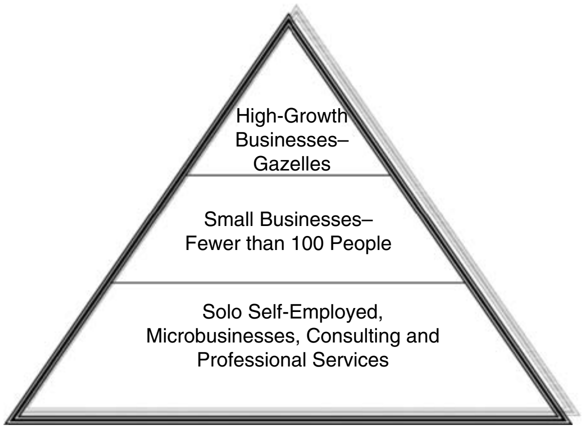


TABLE 1.1 Number of U.S. Firms by Size

	Number of Firms	Payroll (in thousands of dollars)
Firms with no employees (as of March 12, 2001)	703,837	34,289,996
1 to 99 employees	4,851,266	1,193,871,732
100 to 499 employees	85,304	539,384,914
500 employees or more	17,367	2,221,539,681

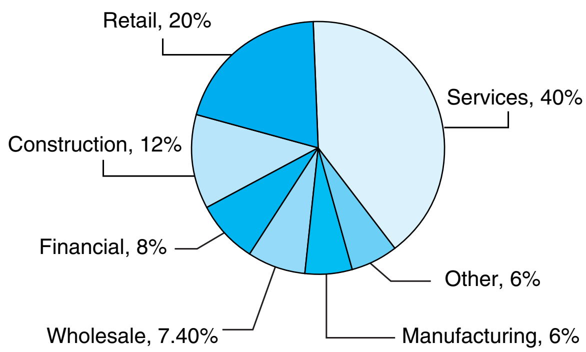
Source: *2002 County Business Patterns and 2002 Economic Census*, U.S. Census Bureau, http://www.census.gov/csd/susb/susb02.htm.

time, are highly visible technology firms, but about 30 percent of all gazelles operate in the wholesale and retail trades as well.[1] This category is generally where the most entrepreneurial-type firms are found.

The United States is unique for its entrepreneurial culture that supports the development of small businesses. It is estimated that about 52 percent of the adult population in the United States is involved in business ownership through owning a full- or part-time business, taking steps to start a business, or investing in another's business.[2] About 11 percent of working Americans over the age of 18 report business ownership as their primary economic activity, and about 18 percent report that they have made an investment in a business.

Table 1.1 breaks out the number of firms in the United States by size. It is interesting to note that the number of firms with fewer than 100 employees is fifty-four times greater than the number of firms with more than 100 employees. Looking at which industries attract small business provides a picture of diversity in

FIGURE 1.2 Small Business by Industry



Source: "Major Industries by NAICS Codes," SBA's Office of Advocacy, 1997–2002, http://www.sba.gov/advo/research/data.html. Based on data provided by the U.S. Census Bureau, Statistics of U.S. Business. Percentages do not add to 100% because of rounding.

types of small businesses. Figure 1.2 presents the distribution of industries in which there are businesses with fewer than 500 employees. As expected, services and retail dominate. Delving deeper into the services category provides a picture of the types of services that small business owners typically offer. In order of size, they are as follows:

- Health services (physicians, nursing facilities, at-home care, and the like)
- Business services (advertising, programming, personnel, and so forth)
- Engineering, accounting, research management, and related services
- Membership organizations (trade associations, unions)
- Personal services (janitorial, hair salons)

Although small businesses comprise the largest proportion of businesses globally, it is those small business owners *with intentions to grow* that actually provide the majority of net new jobs to the economy (see the gazelles in Figure 1.1). Pro-growth business owners are driven to overcome the challenges in the marketplace and to interpret their economic world in ways that allow them to grow.[3]

There has been a lot of argument about the degree to which small businesses affect job creation. The SBA claims that from 1996 to 1997 (the most recent figures available) small businesses created 75.8 percent of net new jobs. Yet, many people caution that it is difficult to say that small business in general creates a certain percentage of new jobs. For one thing, recall that the SBA counts any business under 500 employees as a small business. For another, it is really just the fast-growth segment of small businesses that actually produces most of the new jobs. Birch's research reports that from 1995 to 1999 gazelles "generated practically as many jobs (10.7 million) as the entire U.S. Economy (11.1 million)."[4] About half of those gazelles have more than 1,000 employees. So what can be concluded from this debate? It appears that most new jobs come from new companies and new divisions of larger companies. New companies, for the most part, start small, so it is logical to assert that small business does in fact have an impact on the economy through new job creation.

Benefits of Small Business Ownership

In general, research has discovered that small business owners are a happy lot. Overwhelmingly, the public perception is that small business owners work harder than other people and that owning a small business is the best way to get ahead.[5] Although they work long hours and endure more stress, the benefits seem to outweigh the negatives. Some of the benefits of small business ownership include the following:

1. *Control of One's Destiny* Working for someone else leaves an individual at the mercy of the needs of that person, which is not compatible with the personalities of most small business owners. People who start their own business tend to be "control freaks." They want to be in charge of their destiny and take responsibility for what happens to them. Small business ownership provides the opportunity to do that because the owner of a business determines the destiny of that business, who is employed by the business, and how the business operates, among many other tasks.

2. *Wealth Creation* As discussed at the beginning of this chapter, entrepreneurship is the primary vehicle for wealth creation. Business owners not only create well-paying jobs for themselves, but they also amass wealth in the value of the businesses they create that can be harvested through a sale, initial public offering, or other liquidity event. In 2004 a record 8.2 million households in the U.S. had a net worth over $1 million (excluding their primary home). The groundbreaking work of Thomas Stanley and William Danko presented in their best-selling book *The Millionaire Next Door* revealed that the average American millionaire earned his or her wealth through small businesses such as auctioneer services, mobile home–park ownership, or paving contractor enterprises. It is notable that self-employed people comprise less than 20 percent of all the workers in America, but they account for two-thirds of the millionaires.[6] Entrepreneurs typically do not start businesses for the money, but they do know that, if they are passionate about what they are doing and become the best at it, their business will provide a supernormal return on investment.

3. *Fun while Working* One of the biggest advantages of business ownership is that owners create the organizational culture of their businesses; that is, they get to choose the people they work with and design the way the organization operates. This means that the entrepreneur's values are reflected in the organizational culture, so work blends smoothly with the entrepreneur's personal life. In other words, work doesn't feel like work. Entrepreneurs generally wake up every day eager to get to work because the work is so satisfying.

4. *Doing Good while Doing Well* Small business owners as a group are some of the most respected people in any community because they are generally very involved in their communities. It's a highly symbiotic relationship. The more a business owner gives back to the community through such activities as sponsoring sports leagues, being active in the local Chamber of Commerce, and creating new jobs, the more the business benefits from the patronage of the community.

Small Business Challenges

For all the benefits of small business ownership, owners face a number of challenges. Some of these challenges are similar to those faced by their larger counterparts, but others are uniquely their own and the result of size and limited resources. Listed from most critical to least, the top-ten problems that small business owners face as reported by the National Federation of Independent Businesses (NFIB) are the following:

1. Cost of health insurance
2. Cost and availability of liability insurance
3. Workers' compensation
4. Cost of natural gas, propane, gasoline, diesel, fuel oil
5. Federal taxes on business income
6. Property taxes (real, personal, or inventory)
7. Cash flow
8. State taxes on business income
9. Unreasonable government regulations
10. Electricity costs (rates)

It is interesting to note that health insurance costs are a "critical" issue for 65.6 percent of small business owners, which is the highest percentage reported for any problem in the NFIB survey's twenty-two-year history.[7]

If we consider the least severe problems for small businesses, beginning with the least severe, they are the following:

1. Exporting products/services
2. Competing with government or nonprofit organizations
3. Competing with Internet businesses
4. Dealing with increased national security procedures (a new problem in the 2004 survey)
5. Competing with imported products
6. Obtaining short-term (less than twelve months or revolving) business loans
7. Winning contracts from federal/state/local governments
8. Obtaining long-term (five years or more) business loans
9. Protecting intellectual property
10. Finding cost-effective mail service

Clearly, rising costs and taxes are the two biggest areas of concern for small-business owners. But despite these challenges, small business owners seem to be an optimistic group. The NFIB releases its Optimism Index monthly. This index records how confident small business owners are about the economy and its effect on their business prospects. The base year for the index (100) is 1986 when the real gross domestic product grew 3.5 percent and inflation stood at 3 percent. In June 2005 after a five-month decline, the Optimism Index rose to 100.8 from a base of 100. Hiring by small business owners was strong, with 53 percent of owners in a hiring mode, suggesting that businesses were looking to grow.[8]

Small Business Failure

Small business owners cannot always meet the challenges they face, which sometimes lead to business failure. Any aspiring business owner would be well advised to consider

LEARNING FROM MISTAKES

The Case of Streamline, Inc.

Tim DeMello's business concept was a variation on a theme. The theme was home delivery of groceries and services that would allow customers to place orders by midnight and receive their goods in a supplied refrigerator in their garages or basements by 6:00 p.m. on their designated day. The business model of DeMello's company, Streamline, Inc., called for 70 percent of sales to come from groceries and the rest from higher-margin products and services such as dry cleaning, shoe repair, and so forth. In addition, Streamline would enjoy the advantage of not having the high overhead costs of retail space. For the business model to work, however, customers needed to order regularly once a week. One of the initial concerns going into this business was whether customers would be satisfied with once-a-week delivery and not being home when the groceries were delivered.

By June 1999, Web shopping had exploded, and Streamline bought into the dot-com frenzy, changing its name to Streamline.com just before doing an initial public offering. Streamline raised $45 million in that offering, but in the first six months of 2000, it lost $23 million and its stock price plummeted from its $10 initial offering price to $3 per share. In September of that year, Streamline's primary competitor Peapod acquired its assets and in November of that same year, Streamline closed its doors. Peapod's acquisition of Streamline does not mean that Peapod is out of the woods when it comes to long-term success. Peapod benefited from the enormous amount of capital available during the dot-com era, but it still needs to prove that online grocers can make a profit while operating warehouses around the country and in the face of major chains like Safeway entering the game.

The reason for Streamline's failure? DeMello forgot a cardinal rule of entrepreneurship: knowing that the customer is everything. People tend to be very particular about the vegetables, fruits, and meats that they purchase. Not many people are comfortable letting a stranger pick their food items. Furthermore, the margins in the grocery business are miniscule at best, which means that high volumes are essential. It is far more difficult to achieve those volumes in a new type of home-delivery service.

Lesson Learned: *Know your customer*.

Sources: J. A. Redmond, "Is Your Company at Risk?" *Inc.* (November 2000), www.inc.com; J. D. Macht, "Errand Boy," *Inc.* (November 1996), www.inc.com.

the risk of failing before making the decision to start or acquire a business. Some of the major risks for the small business owner include the following:

1. *Incorrect Estimation of the Market* A business is not a business without customers. It is one thing to come up with a great business idea that is validated by the enthusiasm of friends and family. It is quite another to make sure that there are enough other people interested in the business so that it has a chance to thrive. Lack of sufficient market research is often the major contributor to business failure in the first couple years, but market research is a manageable risk. If entrepreneurs conduct independent market research on their customers, they can eliminate much of this risk. (Chapter 11 focuses on helping entrepreneurs understand how to conduct effective market research to increase their chances of success.)

2. *Uncertainty* Even entrepreneurs who do thorough market research are lucky if their forecasts about market demand are correct 50 percent of the time. Today's global marketplace is constantly changing, and entrepreneurs must be prepared to accept uncertainty as a way of life. Successful entrepreneurs always have a plan B and keep their eyes open for the opportunities that always come with change.

3. *No Salary for the Owner* It is not uncommon in new businesses for the owner to pour all the early revenues back into the business to grow it. The owner is always the last to be paid, so it is important to prepare for business ownership by building up savings to cover the owner's personal expenses until the business can afford to pay the owner a salary.

4. *Loss of Investment* If starting or acquiring a business carries with it significant risk, the prospective business owner must be prepared for the possibility that the business might fail. Therefore, it is prudent to protect personal assets so that if the business does fail the owner will not be completely devastated. If the owner has received outside investment capital for the business, it is important to take money only from people who can afford to lose it. Unfortunately, friends' and family's money is the most expensive money that entrepreneurs can take because if the business fails, they pay for it for the rest of their lives.

5. *Long Hours and High Stress* Although there have been cases of successful entrepreneurs starting their businesses part time, the vast majority of business owners work approximately sixty to eighty hours a week in the beginning to get their businesses into survival mode. Stress in the early days of the business comes principally from uncertainty about demand for the product or service being offered. If the business has employees, there is stress when revenues do not materialize and employees must be paid. More than one entrepreneur has used a personal credit card to make sure that payroll was met until revenues were collected.

6. *Disillusionment* If this is the first business, it is likely that the entrepreneur will go through a period of disillusionment as unforeseen obstacles begin to appear. The best-laid plans may not pan out, and the entrepreneur may wonder if the right decision was made in starting or acquiring the business. Understanding that becoming discouraged is a normal part of the process helps the entrepreneur be patient and realize that all the planning and forethought will eventually pay off. Perseverance is a strong suit with entrepreneurs, and it helps them get through the inevitable downtimes.

Businesses that fold usually do so in one of two ways. **Failures** are firms that go out of business or reorganize through Chapter 11 bankruptcy, resulting in losses to creditors. **Discontinuances** are firms that cease operations with no outstanding debts. Failures include (1) ceasing to exist (discontinuance for any reason), (2) closing or a change in ownership, (3) filing for bankruptcy, (4) closing to limit losses, and (5) failing to reach financial goals. In 2000, the SBA reported that about 550,000 small businesses closed and that the business failure rate for one-person businesses was about 38.2 percent. These figures are not very encouraging unless some additional factors are considered. In general, if a small business makes it through the first two years of operation, its chance of succeeding increases with each passing year. This is generally because many business failures are casual businesses, or businesses on paper, in which either no significant effort was expended or it was determined that the concept was not feasible. An enormous number of these casual businesses are reported to the IRS on tax returns, so they also end up in the business-failure statistics. The Business Information Tracking Series (BITS) reports that about half of new employer firms survive beyond four years and about a third of closed businesses were successful at closure.[9]

For reasons explained earlier, out of the businesses that fail, only about one in seven closed with unpaid debts. So if a business doesn't close due to bankruptcy, what other factors would precipitate a closure? Business owners often close their businesses because they want to do something else, including starting a different business or retiring. In other cases, the owner has died without providing for succession. But, according to Dun & Bradstreet statistics, 88.7 percent of all business failures are due to management mistakes. Here are some of those mistakes:

- Owning a business for the wrong reasons
- Relying on advice from family and friends
- Underestimating how long it will take to be successful
- The entrepreneur's ego
- Poor market research
- Falling in love with the product or service
- Lack of experience with financial issues
- No clear focus
- Irrational exuberance
- Too much money

One might question how "too much money" could hurt a business. When entrepreneurs start with a lot of money, they tend to be less careful about how they make decisions because they know if they make a bad decision they have the money to recover. There is a fine balance between having too much money and not having enough.

The flip side of failure is survival. The SBA conducted a ten-year longitudinal study of companies of all sizes (including sole proprietorships) that were founded in 1976 and revealed some interesting outcomes. The survival rates for companies of all sizes, including sole proprietors, were dismal, from 76 percent after two years of business to 21 percent after ten years. On the bright side, if those companies survived long enough to hire employees, their survival rates went up significantly, from 94 percent after two years to 62 percent after ten years.[10] The most recent SBA findings from BITS show that 66 percent of new employers survive two years or more; 50 percent survive four years or more; and 40 percent survive six years or more.

So, what can an entrepreneur do to improve the chances of succeeding? The SBA research finds that the likelihood of small businesses surviving goes up if they are employer firms, they have starting capital greater than $50,000, the owner has a college degree, and the business is being started for personal reasons. Survivability is also increased by previous experience owning a business, starting with a team, and starting from home. The goal of this text is to give business owners the information and skills required to increase the probability of success. In addition, going through the process of writing a business plan prepares the entrepreneur as much as possible for all contingencies. (The business plan is discussed in detail in Chapter 5.)

THE ENTREPRENEURIAL PORTRAIT

Much has been written about entrepreneurs, what makes them tick, and what makes them different from everyone else. In recent times, a celebrity status has accrued to the likes of Microsoft cofounder Bill Gates, domestic diva Martha Stewart, and Internet innovator Meg Whitman of eBay. This notoriety is evident in the proliferation of magazines, books, and television documentaries that examine every detail of the entrepreneur's business and personal life. Entrepreneurship has become the new breeding ground for legends, superstars, and heroes.

Over the years, academic researchers have tried to identify the characteristics, personalities, and behaviors of entrepreneurs in a vain attempt to categorize, define, and analyze them. It has been an impossible task largely because entrepreneurs seem to defy categorization. They come in all shapes, sizes, and colors, with a diverse range of motivations and intentions. However, these researchers have found that entrepreneurs all have one fundamental characteristic: variously called "fire in the belly," "intense desire," or "the burning gut"; it is essentially passion. Passion drives entrepreneurs to seek opportunity, take risk, and keep going forward when all around them are saying, "It'll never work."

Along with passion, entrepreneurs commonly display several other characteristics. For example, research has generally concluded that entrepreneurs are not high-risk takers; they are, in fact, moderate-risk takers.[11] They don't leave their future to chance; on the contrary, entrepreneurs tend to identify the risks inherent in their ventures and then look for ways to minimize those risks. At the same time, however, security is not something they consciously seek to achieve because most entrepreneurs understand that opportunity lies in a changing environment. In that sense, they see change and the risks associated with it as a positive. Research has identified two major sources of uncertainty that entrepreneurs attempt to minimize: (1) uncertainty about market demand and (2) uncertainty regarding their own capabilities.[12] They tend to be risk averse when it comes to market demand but very confident about their own abilities.

Entrepreneurs seem to have a tremendous drive to succeed. They enjoy problem solving and setting goals for themselves and their businesses. Consequently, they also have a strong desire to be their own bosses, to have total control of their lives and the work they do. This need for independence, however, often makes it difficult for entrepreneurs to delegate authority to others. In most businesses, the ability of an entrepreneur to give up the reins of the business to those who have the management skills needed to take it beyond the start-up and growth phases is a crisis point that must be recognized. Failure to do so has often led to the downfall of the company.

Parallel to the need for independence is the entrepreneur's typically high internal locus of control. **Locus of control** refers to the degree to which people believe events in their lives are within their control as opposed to being under the control of external forces. Many studies have found a strong internal locus of control among entrepreneurs.[13] This leads to more proactive behavior in comparison to the reactive behavior of people with an external locus.

Finally, because of the inherent nature of the entrepreneurial environment, entrepreneurs tend to have a higher tolerance for ambiguity and change. They seem to prefer environments that offer more challenge and opportunity.

It is important to note that these characteristics are based on average tendencies. For every entrepreneur who has one or more of them, there is one who doesn't yet is successful. This is the dilemma faced by those trying to characterize the entrepreneur.

Researchers have also looked at the entrepreneur's experience prior to starting the new venture and have found that entrepreneurs tend to start businesses in industries with which they are familiar or in which they have some knowledge about the product, service, or market.[14] But experience in and of itself has not been shown definitively to increase the chances of success in starting and growing the business.

Of all the behaviors considered as particular to the entrepreneur, the entrepreneur as decision maker or problem solver has pervaded the research literature. Contributing much to the understanding of the relationship between decision making and environmental uncertainty, the seminal work of G. L. S. Shackle rejected mainstream economic theory and determinism for their failure to recognize the importance of time and uncertainty as a factor in entrepreneurial decision making.[15] In other words, what induces someone to be enterprising is essentially different from what induces someone to avoid uncertainty. Decision making under conditions of uncertainty is a way of life for most entrepreneurs.

Entrepreneurs as resource acquirers and creators of value are another behavior often found in the definition of entrepreneur.[16] And, of course, the opportunistic nature of entrepreneurs can't be denied. According to Stanley Kaish and Benjamin Gilad, "Opportunity, by definition, is unknown until discovered or created."[17] I. M. Kirzner calls this ability "entrepreneurial alertness."[18] In their study, Kaish and Gilad found that "entrepreneurs do seem to expose themselves to more information, and their alertness takes them to the less obvious places."[19]

Today, entrepreneurship is not just an art practiced solely by people who intuitively understand the nature of it. On the contrary, potential entrepreneurs can learn and practice a great many of the skills and practices needed to succeed in an entrepreneurial venture. More people are studying the "art" and systematizing it so that everyone can understand what it takes to be an entrepreneur. "Professional entrepreneurs don't just do, they understand what they're doing."[20] However, the one characteristic of entrepreneurs that can't be taught is the passion, the desire to accomplish something at all costs. That is an inherent characteristic that reveals itself when an individual discovers a business concept that he or she cannot let go of. Entrepreneurs who find themselves thinking, plotting, and planning day and night how to make a particular business concept happen have probably found their passion. That passion will carry them through the tough times ahead.

Assembling what is known about the entrepreneur reveals someone who recognizes an opportunity and has the passion and perseverance to put together the necessary resources to develop that opportunity into a concept, test its feasibility, and turn that feasible concept into a business. We also see someone who knows how to create value, value that can be measured and converted to wealth. This ability to create value provides a variety of exit strategies that enable the entrepreneur to realize the wealth that the business has created by selling a portion of his or her stock, selling the business outright, doing an initial public offering of stock, or merging with another company.

The Many Faces of Entrepreneurs

Today, much is known about the diversity of individuals who choose to become entrepreneurs. In this section, we explore what is currently known about women and minority entrepreneurs as well as the various types of entrepreneurs.

Women-Owned Businesses The rate at which women are starting businesses is increasing. In general, this growth stems from women's dissatisfaction with corporate life and the desire to have more control over how they balance work and family. The Center for Women's Business Research estimates that as of 2004:

> *nearly half (48%) of all privately-held businesses in the U.S. are owned 50% or more by women, for a total of 10.6 million enterprises. This includes 6.7 million majority (51% or more) women-owned firms, and another 4.0 million equally (50-50) women- and men-owned firms.*[21]

LEARNING FROM SUCCESS

A World-Class Venture in the Recording Industry

You may not think of a rock group as a world-class business. But world-class entrepreneurship is almost a necessity to succeed in the intensely competitive recording industry.

From 1965 until the death of lead singer Jerry Garcia thirty years later in 1995, the Grateful Dead proved to be much more than a traveling 1960s retro show. In fact, the Grateful Dead is recognized as being responsible for many innovations that are now widely accepted practices in the music industry:

1. In the 1970s, they pioneered the use of a floor pedal on the microphone on stage, allowing the singers to turn off their microphones with their feet when they weren't singing. This prevented unwanted sounds, such as talking between songs or during instrumentals, from being carried to the audience.
2. They were the first to set up their own mail-order system to sell tickets to hard-core fans. About 50 percent of their tickets were sold in this manner.
3. Their extensive merchandising operation involving promotional items has been emulated throughout the music industry.
4. Against tradition, they initiated the notion of touring even when they weren't bringing out a new album. They learned from their customers, the fans, that more important than the music was the event of being at the concert.
5. They pioneered the "cool opener" at stadium concerts, using such name performers as Bob Dylan, Traffic, and Sting and turning the show into a mega-event. This practice is standard procedure today.
6. They created a telephone hotline that provided tour and recording information to their mailing list of more than 160,000 loyal fans.

Clearly, the Grateful Dead took the notion of "customer driven" to the max. They built an innovative, worldwide organization that lived for the customer. That is the essence of "world class." Today, the band, without its leader, can still be found touring the country and spreading the word.

On average, women-owned businesses are smaller than their male-owned counterparts, and this difference is often explained by the motivations of women to start businesses and by how they define success.[22] Women's goals relative to the companies that they start are more about changing the way business is done than making a huge impact on the economy. It is also noteworthy that approximately 55 percent of all women-owned businesses are in services, and these businesses are smaller and younger by nature.[23] In 1994, chai, the milky tea that has been a staple in India, had not yet penetrated the U.S. market. Oregon environmentalist Heather Howitt saw an opportunity to offer coffee drinkers an interesting alternative and left her job to start Oregon Chai. To attract the American palette, she spiced up the traditional chai. With superhigh-profit margins and Howitt pouring all profits back into growing the business, she achieved number 18 on the 1999 Inc. 500 list of the fastest-growing private companies in the United States. Her products are found in natural-food stores, chic cafes, and even supermarkets like Safeway.

Minority-Owned Businesses In 2000, 15 percent of all businesses in the United States were owned by ethnic minorities. Within the minority-owned sector, Asian

Americans earned more than 51 percent of all business revenues, with Hispanics following at 31 percent, African Americans at 12 percent, and Native Americans at 6 percent.[24]

Despite their minority status, Asian Americans have been extraordinarily successful as entrepreneurs, owning about one-third of the high-technology firms in Silicon Valley.[25] The Korean American community displays the highest rate of self-employment, with more than one in ten Koreans owning businesses.

Older Entrepreneurs When it comes to starting a business, research has found that people over the age of 50 years are more likely than their younger counterparts to assume the risk of starting a new business. Self-employment among people over 50 years of age is about 16 percent compared to 10 percent for all workers.[26] They tend to start businesses, not only because it is difficult to find another job but also because they want to supplement retirement income, experience a new challenge, or simply take control of their lives. At age 50, Janice Taylor left her investor relations position at a New York City media company to pursue her dream. While trying to lose weight, Taylor developed an approach to dieting that worked. It consisted of making art about food instead of eating it. She was then able to sell the art at art fairs and through her website. The line is called "Our Lady of Weight Loss." Although she is making less money than she did at her former job, she is far happier.[27]

Entrepreneurial Types

There are many types of entrepreneurs, and although they have many characteristics in common, they differ in their approach to entrepreneurship.

The Home-Based Entrepreneur Ned Berkowitz reached burnout and left the world of the road warrior as a regional sales manager with a six-figure salary to purchase a franchise that let him work from home. Today, he feels in charge of his life and can spend more time with his family because he no longer has to travel farther than from his office to the kitchen.[28] Today more than ever before, people are choosing to work from home for a variety of reasons: to avoid commuting, to get away from corporate bureaucracy, to spend more time with family, and to work in a pleasant and relaxed environment. The types of businesses that they operate include consulting, financial services, real estate development, e-commerce, independent film production, and even manufacturing. The home-based entrepreneur's ability to avoid the traditional office results from designing a company in which the founders and employees usually collaborate virtually via technology and meet in person when they need to. It is estimated that there are 34–36 million home-based businesses comprising 52 percent of all small businesses and contributing about $314 billion to the economy.

The Traditional Entrepreneur The traditional entrepreneur is an individual or team of individuals who identify an opportunity and launch a company to execute the opportunity. Generally the business concept is one that the entrepreneur is passionate about, and the start-up route is chosen because the venture is either completely unique and therefore there are no existing businesses to acquire or the entrepreneur simply has the desire to build the company from the ground up. These entrepreneurs may build bricks-and-mortar businesses, delve into e-commerce, or operate a virtual company in which most of the activities of the business are outsourced. Robert Criscuolo believes that there is nothing better than owning a business. In 1997, he started a skilled labor–staffing company with money that he had saved from the various jobs that he had taken on, everything from being a house painter and gas station attendant to a deejay. His last job had been a customer-service position with a New Jersey–based Macy's department store. When that company wanted to transfer him to New York City, he left to take a sales position with a job-placement firm. That is where the idea for his business was born. With a partner to take over the administrative side of the business, Criscuolo was free to focus on sales and marketing, his strength. Not taking a paycheck for the first year motivated him to work hard to make the business a success. In 2004, Criscuolo's business was doing about $2.5 million in sales.[29] (We will explore in detail the activities of this type of entrepreneur in Chapter 3.)

The Serial Entrepreneur Some entrepreneurs enjoy the chase; that is, they like identifying opportunities, gathering resources, and building a company. What they don't like is running the company, so once things are operating fairly smoothly, this type of entrepreneur tends to move on to the next adventure. They may sell the business, but more often than not, they hand the management of the business to a partner and they take a secondary role that leaves them time to explore other opportunities. Consummate serial entrepreneur Wayne Huizenga started with one garbage truck and soon built the biggest waste-management company in the world. Then he took on the video rental business with Blockbuster and the used-car business with Auto Nation. In addition, he owns several sports teams, a very different type of business.

The Corporate Venturer With the recognition by large corporations that they were losing ground to scrappy entrepreneurial companies, a new type of entrepreneur was born: the corporate venturer. Not an entrepreneur in the traditional sense, this individual is one who typically works in a large company and acts in an entrepreneurial way to develop new products, new divisions, or spinoff companies. Corporate venturers do not risk their own capital, but they do risk their reputation. Corporate venturers proliferate when the capital markets make it difficult to start ventures that require a lot of funding and when the incentives within the organization make it worthwhile to do so. Bruce Griffing was the corporate venturer behind General Electric's digital x-ray project that ultimately became a huge division of the company.

The Opportunistic Entrepreneur Whereas the traditional entrepreneur conceives and builds a sustainable business out of something that he or she is passionate about and then stays with it for some time, the opportunistic entrepreneur is looking for a way to make something happen quickly and then exit, having made a lot of money. That something may be a fad product, a marketing play with an existing product that has a short window of opportunity, or an arbitrage opportunity in which the entrepreneur can acquire a product at a low price and then turn around and sell it at a higher price, thereby making money on the spread. One entrepreneur had quite a successful business for a time by purchasing the goods off damaged railway cars and trucks at a fraction of their cost and then selling the products into discount stores like the highly successful 99 Cent Stores chain.

MAKING THE DECISION TO OWN A BUSINESS

World extreme-snowboarding champion Steve Klassen wanted a career that supported his lifestyle and his love of snowboarding and the outdoor life. So after graduation from college, he opened a snowboard shop in Mammoth, California, one of his favorite skiing destinations. By hiring knowledgeable snowboarders to staff it and building a loyal customer base, Klassen built Wave Rave Snowboard Shop into a successful venture. Because Klassen understood that to survive in a competitive industry he continually had to innovate and find new markets, what began as a lifestyle small business has grown to include products, guided global snowboard safaris, and product representation.

Before deciding to become an entrepreneur or a small business owner, it's important to examine personal values, beliefs, and goals and to look for business opportunities that are compatible with them. Before launching his business, Klassen considered an exciting opportunity for an extreme-sports theme park in the Los Angeles area. However, the more Klassen got into the planning and the search for capital, the more he found it was taking him away from what he wanted most—to live and work in an area where he could do his favorite sport, snowboarding. Ultimately, he decided not to pursue the venture and is happily growing his business in Mammoth Lakes in new directions. To see what Klassen has to offer, visit www.waveravesnowboardshop.com.

Before beginning to search for opportunities, prospective entrepreneurs should address a number of issues so that they are in a better position to judge whether or not a venture opportunity is the right one for them.

Reasons to Own a Business

This is an important issue. Most entrepreneurs would say they start businesses for reasons other than money: independence, freedom, creativity, power, and fun. Individuals who want to start a business just to make money should step back and examine their reasoning. There are easier, less risky, less time-consuming ways to make money than starting a business. The NFIB reports that the median earning for a small business owner is just $30,000, the same as for wage and salaried workers. Therefore, it is important to understand the personal reasons behind wanting to start a business. Starting a business takes a huge commitment of time, money, energy, and devotion.

Some types of ventures are more demanding than others in terms of time, level of stress, and level of physical exhaustion. Some ventures take several years to develop and are far riskier than others. At 22 years of age, an entrepreneur can afford to fail many times and recover to start another venture. At age 38 or 45, the picture may look quite different. Obligations in the form of family, mortgage, and other responsibilities need to be managed while needed resources are diverted to the new business.

Feelings About Security and Ambiguity

Some new ventures can take up to two years or more to show a profit or at least be in a cash position that allows the entrepreneur to receive a salary. Prospective entrepreneurs who currently enjoy a regular paycheck and a certain lifestyle may have to make serious changes to enable them to launch or acquire a business. And if they are undertaking entrepreneurship with responsibilities such as a spouse and children, they need to have the family's support as well.

Lifestyle Needs

The decision to start or purchase a business directly affects the kind of lifestyle a person will lead. Moreover, where a person wants to live has an equal impact on the type of business that person can own. Two approaches can be used. Decide where to live first and then investigate a business opportunity that could be run from that location or come up with a business concept and then find the best place to implement that business. The route chosen depends on how important lifestyle is. For example, if the best place to locate a new manufacturing venture is near a port of entry for shipping, choices of areas to live are somewhat limited if involvement in the day-to-day operations of the company is essential, as it typically is. On the other hand, if living in a major city is not important, the operations of the manufacturing venture can be outsourced to an existing company in the port of entry, thus freeing the entrepreneur to live in an outlying, smaller community some distance away and operate the company as a virtual company.

Feelings About the Business Environment

Entrepreneurs find that a lot of feelings and beliefs that they didn't know they had often surface when they begin to think about starting and owning a business. Prospective business owners should ask themselves how they stand on the following issues:

- The use of debt or having a business that is highly leveraged
- Unions and the use of union workers
- Employees and the entrepreneur's ability to manage them
- Religious beliefs and how they might affect the people in the organization and the kind of business the entrepreneur chooses
- Government regulation and paperwork (some industries are much more highly regulated than others)
- Dealing with people from other parts of the world or even other parts of the United States
- Getting involved in the community
- Travel, if the business requires that the entrepreneur be "on the road" a lot
- Ownership and the entrepreneur's willingness to share ownership of the business with an investor or other person or persons

The entrepreneurial journey is an exciting and rewarding one. Every day brings new opportunities and new challenges, but for most entrepreneurs, the biggest reward is being in charge of their life. This book will help aspiring business owners and entrepreneurs decide if they want to take the journey to business ownership and independence.

ISSUES FOR REVIEW AND DISCUSSION

1. What is an entrepreneur?
2. What is the difference between an entrepreneurial company and a small business?
3. What are the benefits and challenges of business ownership?
4. Give three reasons why small businesses fail.
5. Discuss three reasons for expanding globally.
6. What are three typical characteristics of entrepreneurs?
7. Describe three different types of entrepreneurs.
8. What three questions do you need to ask yourself before you decide on a business to start or purchase?

EXPERIENCING ENTREPRENEURSHIP

1. Interview an entrepreneur with a business less than five years old. How did this entrepreneur come up with the idea for the business? What other issues related to start-up did she or he face? What qualities made this person more likely to become an entrepreneur than the "average" person? Present your analysis in a report.
2. Interview a small business owner and compare his or her mindset, goals, and business to those of the entrepreneur in question 1. How are they the same? How are they different? What conclusions can you draw?

LEARNING FROM ENTREPRENEURS, CASE 1.2

Flying High for a Living

On a clear day, Curt Westergard parked his trailer on an industrial street in Washington, DC, the site of the new Washington Nationals ballpark, which was scheduled to be completed in 2008. Using a map of the development, he quickly located home plate, a lamppost on the corner nearby. Satisfied that he was positioned well for what he was about to do, he jumped back into his trailer—his "mobile launch vehicle"—and from the "command and control" center, he activated the cargo doors on the roof of the trailer and released Momma Doc, a brain-shaped balloon with a long tail. Unwinding the cord to which Momma Doc was attached, Westergard and his assistant let the balloon rise to 110 feet. Then, they remotely snapped the shutters of the cameras that hung from the belly of the balloon. Within a matter of minutes, Westergard had downloaded the pictures that Momma Doc took to a laptop. These pictures would prove critical to the success of the ballpark project because they revealed that the future development slated to surround the new ballpark would actually block the sweeping view of the Capitol for fans. Changes had to be made.

Westergard, who hails from northern Virginia, is the founder and owner of Digital Design & Imaging Service Inc., which owns a fleet of unmanned helium aerostats, which are small blimplike vehicles, the largest of which is 12 feet long. He invested $400,000 in the business to launch it. It is a niche business with only a few dozen companies around the country. But as cities become denser and buildings grow taller, residents and tenants often want to know before a building is built what they will see from their windows. Aerostats are not new technology. In fact, they date back to the French Revolution when they were used to spy on Dutch and Austrian troops. They were also used during the Civil War to spy on the Confederate army. In the late 1970s, aerostats were replaced for a time by airplanes and manned forms of blimps, but these smaller, unmanned vehicles are now enjoying a renaissance for two reasons. First, you cannot bring an airplane or a larger manned blimp into a city at lower altitudes up to about 500 feet. Second, they make excellent surveillance vehicles in war zones. In Iraq, the U.S. Army maintains a fleet of 100-foot-long aerostats that serve as stationary platforms for surveillance cameras and lightweight radar.

There is also another market emerging for these miniblimps—surveillance for antiterrorism. Westergard is betting his money on this market. Larger high-altitude balloons have long been deployed effectively for surveillance, but they are extremely expensive to maintain and they can't be moved as quickly as targets shift. Today, terrorist threats are geographically dispersed and therefore require widespread surveillance over longer periods of time. The smaller aerostats take about four minutes to deploy and can remain aloft for three to four days or more. Westergard is proposing that a fleet of much smaller aerostats could be used in conjunction with a larger "mother ship" to more effectively and quickly gather data from numerous sites. These aerostats can carry payloads of 1 to 18 pounds depending on their size and can be deployed for longer periods of time at less cost.

To keep revenues coming in until he can get a government contract, Westergard does work like the ballpark project. His biggest city project may be capturing the views and wind measurements for the proposed 1776-foot Freedom Tower on the site of the World Trade Center in New York. It is not an easy business, but Westergard loves what he does and believes that he can beat the odds.

Advising the Entrepreneur

1. What are some of the unique issues that Westergard faces with a business like this?
2. Are there any other markets suitable for his aerostats?

Sources: A. Frangos, "Business Is Booming for High-Altitude Photos," *Wall Street Journal Startup Journal, Wall Street Journal* (April 20, 2005), www.startupjournal.com; C. Westergard, "Letter to the Editor," *Intelligence, Surveillance & Reconnaissance Journal* 3(3) (April 2004); M. Hewish, "Small Aerostats Provide Inexpensive Surveillance Platforms," *Jane's International Defense Review,* Jane's Information Group; Digital Design & Imaging Service (June 1, 2004). http://www.balloontest.com/.