Chapter 1

ENTREPRENEURS RECOGNIZE OPPORTUNITIES

Learning Objectives

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

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

"Everyone lives by selling something."

—Robert Louis Stevenson, Scottish author

Tom Szaky was a 19-year-old college student in need of inspiration for a business plan competition, when he happened to visit friends who were using red worms to compost waste that they then used as plant fertilizer. The idea captured his imagination, and he created a business plan for an environmentally friendly company that would convert trash into fertilizer. Although he finished in fifth place in the competition, Szaky moved ahead to make the company a viable venture.[1]

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

Entrepreneurship Defined

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

What Is an Entrepreneur?

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

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

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

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

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

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

People who have their own businesses work for themselves and are called small business owners, or **entrepreneurs**. Entrepreneurs are often both owners and employees. For an entrepreneur, the sky is the limit as far as earnings are concerned. Unlike an employee, an entrepreneur owns the profit that his or her business earns, and may choose to reinvest it in the business or take it as payment.

Learning Objective 1

Explain what entrepreneurs do.

An entrepreneur is someone who recognizes an opportunity to start a business that other people may not have noticed, and jumps on it. As economist Jeffry A. Timmons writes in the preface of *New Venture*

[1]TerraCycle Inc., accessed June 23, 2013, http://www.terracycle.net.

Creation: Entrepreneurship for the 21st Century, "A skillful entrepreneur can shape and create an opportunity where others see little or nothing—or see it too early or too late."

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

> An entrepreneur is an economic agent who unites all means of production—the land of one, the labor of another and the capital of yet another, and thus produces a product. By selling the product in the market he pays rent on land, wages to labor, interest on capital and what remains is his profit. He shifts economic resources out of an area of lower and into an area of higher productivity and greater yield.[2]

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

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

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

The Economic Questions

Since the beginnings of human society, people have had to answer the same basic questions:

- What should be produced?
- When will it be produced?
- How will it be produced?
- Who will produce it?
- Who gets to have what is produced?

Families and individuals, as well as businesspeople, charitable organizations, corporations, and governments, all have had to answer these questions. The system created by making these decisions is called an *economy*. The study of how different groups answer the questions is called *economics*.

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

An economy is the wealth and resources of a country or region, including its financial structure. The economy of the United States is a **free-enterprise system** because it is characterized by private (rather than governmental) ownership of capital assets and goods; anyone is free to start

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

a business. Americans do not have to get permission from the government to go into business, although they are expected to obey laws and regulations.

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

- Individuals and companies may compete for their own economic gains.
- Private wealth and property ownership are permissible.
- Free-market forces primarily determine prices.

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

Learning Objective 2

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

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

capital money or property owned or used in business.

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

Voluntary Exchange

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

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

Benefits and Challenges of Free Enterprise

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

Global Impact . . .

Free Trade

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

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

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

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

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

What Is a Small Business?

The public often thinks of business only in terms of "big" business—companies such as Apple, Wal-Mart, Microsoft, McDonald's, and Berkshire Hathaway. However, the vast majority of the world's businesses are small businesses. A small business is defined by the U.S. Small Business Administration's Office of Advocacy as having fewer than 500 employees and selling less than $5 million worth of products or services annually. A neighborhood restaurant, a mattress manufacturer, and a clothing boutique are examples of a small business; even a leading local employer may be classified as "small" under this definition.

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

Why Become an Entrepreneur?

Entrepreneurs put a great deal of time and effort into launching their own businesses. While establishing a business, an entrepreneur may also pour all of his or her money into it. An entrepreneur may not be able to buy new clothes or a fancy car, go on vacation, or spend much time with family—until the business becomes profitable and starts generating cash.

If so much work and sacrifice are involved, why become an entrepreneur? The entrepreneur is working for the following rewards:

1. ***Control over time.*** Do you work better at midnight than at 8 A.M.? If you start your own business, you will have control over how you spend your time by the type of business it is. Are you the kind of person who would rather work really hard for two weeks, nonstop, and then take a break? If you are an entrepreneur, you can structure your schedule to make this possible. You can also choose to hire others to perform tasks that you do not like to do or are not good at, so you can stay focused on what you do best. Bill Gates liked to spend his time designing software. He hired people to manage Microsoft's operations and to market and sell its products. Many eBay entrepreneurs have carved out flexible schedules for responding to orders, packaging, and shipping. Bricks-and-mortar retail stores, on the other hand, do not often afford such flexibility.
2. ***Fulfillment.*** Successful entrepreneurs are passionate about their businesses. They are excited and fulfilled by their work. Entrepreneurs who are working to reach their full potential are rarely bored, because there is always plenty to do. If one facet of running the business is uninteresting, and they have the income to support it, they can hire someone else for that task.

   Social entrepreneurs who want to contribute to societal improvement find ways to do this while also earning profits. Founders of not-for-profit organizations create enterprises to address public issues that are personally important. Other entrepreneurs start lifestyle businesses that allow them to earn money while following a passion. For example, avid pilots may operate aviation-oriented businesses in which they can fly often, such as specialty delivery companies or flight instruction. Art lovers may open galleries, create art-rental firms, or operate art tours.

BizFacts

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

Source: U.S. Small Business Administration, accessed June 29, 2013, http://www.sba.gov.

3. ***Creation/ownership.*** Entrepreneurship is a creative endeavor. Entrepreneurs put time and effort into creating a venture that they expect will survive and become profitable. Entrepreneurs own the businesses they create and the profits those businesses earn. *Ownership* is the key to wealth. Your goal is to find a business that will create a continuing stream of earnings. Eventually, you may be able to sell that company for a multiple of those earnings. That is how entrepreneurs create wealth. Many entrepreneurs, such as Bill Gore, the inventor of GORE-TEX fabric, start their own business after becoming frustrated or disillusioned in other roles or having ideas rejected by an employer.
4. ***Control over compensation.*** Entrepreneurs choose how and when they are paid. As owner of your company, when funds permit, you can decide to:
   - Pay yourself a **salary**—a fixed payment made at regular intervals, such as every week or every month. Salaries are not applicable to sole proprietorships, where owners may take a "draw" on revenues, or partnerships, where they may "draw down" profits.
   - Pay yourself a **wage**—a fixed rate per hour. This is not a common choice, but it is available.
   - Take a share of the company's profit. As the owner, you can pay yourself a portion of the business's profits. In a corporation this kind of payment is called a **dividend** and must be paid to all shareholders.
   - Take a **commission** on every sale you make. A commission is a percentage of the value of a sale. If you decide to pay yourself 10 percent commission, and sell an item for $120, your commission on the sale would be $12.
5. ***Control over working conditions.*** As an entrepreneur, you can create a work environment that reflects your values. If you support recycling, you can make sure your company recycles. You will also evaluate your own performance. As long as you have control of the company, no one else has the power to fire you. If equality is essential, you may have an office with equal working spaces, no special privileges for managers, and few management layers.

salary fixed amount of money paid to an employee at regular intervals.

wage fixed payment per hour for work performed.

dividend each stockholder's portion of the profit-per-share paid out by a corporation.

commission a percentage of a sale paid to a salesperson.

Some of the greatest entrepreneurs in the world dealt with problems as they were growing up, such as extreme poverty, abuse, or learning disabilities. Sir Richard Branson, for example, had such severe dyslexia


Jeff Greenberg/Alamy

Step into the Shoes . . .

Balloon Distractions Inc.: Putting a New Twist on Entertainment

When Ben Alexander was a student at Rowan University in Glassboro, New Jersey, he earned spending money by working as a balloon artist. Today, he operates Balloon Distractions in Land O'Lakes, Florida, with hundreds of independent contractors who are balloon artists. Alexander, who started the company in 2003, secures contracts with restaurants to provide balloon artists to amuse customers while they wait to be seated or while they are seated and waiting for their food to be served.

Balloon Distractions provides its artists with a four-hour DVD training kit to teach them 25 shapes. The artists can recruit other artists, generally college students, and thereby become trainers. Artists book their restaurant locations online through the company's interactive Web site. These independent contractors work to earn tips plus bonuses. Balloon Distractions uses entertainment skills Alexander developed during college, as well as selling skills learned in over 10 years as an automobile salesman and natural gas marketer. Alexander seized an opportunity and grew a business.

Source: Balloon Distractions Inc., accessed June 26, 2013, http://www.balloondistractions.com.

that he dropped out of high school. He became a successful entrepreneur, however, creating more than 200 companies—including Virgin Airlines, Virgin Galactic, and Virgin Records. The Virgin Group employs about 50,000 people in 34 countries and has revenues of approximately \$21 billion.[3] Branson has a personal net worth of about \$4.6 billion, making him number 272 on the Forbes list of billionaires.[4] As an entrepreneur, he was able to create an environment in which he could succeed.

The Desire to Make Money Is Not the Only Reason to Start a Business

Starting a business is an opportunity and, like any opportunity, it should be evaluated by taking a careful look at the costs and benefits it offers. One thing is for certain, though: *The desire to make money, alone, is not a good enough reason to start one's own business.*

The financial rewards of owning your own business may not occur until you have put in years of hard work. The desire to make money may not be enough to keep you going through the difficult early period. Most successful companies have been founded by an entrepreneur with a powerful and motivating vision and passion, balanced by a strong work ethic and dedication.

Entrepreneurs have declared that they are "not in business for the money" so often that it has become a cliché, but, like most clichés, it is based on a degree of truth.

Definitions of Success—Monetary and Other

The Millennial Generation (born between 1977 and 1995) has redefined success. It is more individualized than the traditional concept and based on factors beyond those of income and wealth. Business owners may start an enterprise to create a more environmentally friendly approach to a product or process, to provide jobs for a disadvantaged population, or to improve the mental or physical health of themselves or others. For these entrepreneurs, success might be measured by the ability to have an impact on the population they serve. Or, success may mean working to provide a

[3]Virgin Group, accessed June 26, 2013, http://www.virgin.com.

[4]"The World's Billionaires," *Forbes*, March 2013, accessed June 26, 2013, http://www.forbes.com.

lifestyle that permits a shortened work week or telecommuting. Recognition from peers and others could also be a goal. Financial success may be just one of many measures of achievement for an entrepreneur.

Taking the Long View

Successful entrepreneurs know that it is important to begin with the end in mind, so that they can have an idea of where they want the organization to be at their personal exit point, even before they make the first sale. Because the daily tactical decisions they make will be affected by what they hope to create in the short *and* long term, a clear vision is vital. As you consider an entrepreneurial path, consider these questions:

- Are you planning to be active in the business until retirement? At what age will you retire? Who will take over then? A family member? A new owner?
- Do you plan to grow the business to a certain size or level of maturity and then sell it? If so, what is the target level? Are you looking at an initial public offering or a small private sale? Would you stay with the business after it was sold?
- Would you want to stay active for a given number of years? Then what would you do?

Taking the long view also means considering personal satisfaction, including conformance with individual values and ethics. Entrepreneurs make hundreds of choices and decisions every day. These decisions may conform to their values and ethics or violate them to meet a customer need, provide an expedient or cost-effective solution to an immediate problem, or the like. If you find yourself facing such a decision, for your long-term wellness and the benefit of those around you, it will be critical to keep your core values in the forefront. Consider the legacy you want to leave behind for your successors.

Benefits and Costs of Becoming an Entrepreneur

Even if you have a clear vision that you believe will motivate you through the ups and downs of running a business, look closely at the costs and benefits of being an entrepreneur before you decide whether this is the life for you. The scope of this examination will vary considerably from person to person and is essential in the decision to become an entrepreneur.

Benefits include:

- ***Independence/autonomy.*** Because they are not reporting to managers or supervisors, business owners do not have to follow orders or observe working hours set by someone else. They have control over their decisions.
- ***Satisfaction.*** Doing what they love to do or turning a skill, hobby, or other interest into a business can be highly satisfying. The words of Confucius, "Choose a job that you love, and you will never have to work a day in your life" are often cited with respect to entrepreneurship.
- ***Financial reward.*** Entrepreneurs can build income and wealth through their endeavors. Although income potential is generally capped for employees, entrepreneurs are limited only by their own imagination and tenacity. Entrepreneurs built most of our country's

great fortunes. At the same time, many part-time, seasonal, and lifestyle entrepreneurs find ways to fund gaps in household income, pay for college, or support extraordinary expenses through their business endeavors.

- ***Self-esteem.*** Knowing that they created something valuable can give business owners a strong sense of accomplishment. It can help them feel good about themselves and increase their self-confidence.
- ***Contribution to society.*** Business owners decide how they can add value to their communities and the wider world. The issues they care about can be "designed-in" when they form their companies.

Costs include:

- ***Business failure.*** About one in five new businesses fails in the first eight years, although this is sometimes attributed to entrepreneurs not getting proper training. Another third close because the entrepreneurs become discouraged and give up. Entrepreneurs risk losing not only their own money but also the financial investments of others.
- ***Obstacles.*** Entrepreneurs run into problems that they will have to solve, primarily by themselves. In addition, their families and friends may not support their visions and may actively discourage them.
- ***Loneliness.*** It can be lonely and even a little scary to be completely responsible for the success or failure of a business. While owners have control, they also have responsibility and cannot defer to someone else for decisions.
- ***Financial insecurity.*** Owners are not guaranteed a set salary or benefits. They may not always have enough money to pay themselves, particularly in the first 18 months or so of a new enterprise. They also have to set up and fund their own retirement funds.
- ***Long hours/hard work.*** Entrepreneurs have to work long hours to get their businesses off the ground. Many entrepreneurs work six or even seven days a week, often for 12 hours or more per day. While they decide when to work, they often end up working or thinking about their businesses many more hours as entrepreneurs than they would as employees.
- ***Strain on personal relationships.*** Even with the strong support of family and friends, the inherent challenges of a small business can strain relationships to the breaking point.

Not everyone is cut out to be an entrepreneur. Entrepreneurs have to be able to tolerate a higher degree of risk and uncertainty than people who work steady jobs for established employers. With higher risk, however, comes the potential of higher rewards.

Cost/Benefit Analysis

cost/benefit analysis a decision-making process in which the costs of taking an action are compared to the benefits.

Using a comparison of benefits and costs to make a decision is called **cost/benefit analysis**. It is a helpful tool because people often make decisions based on emotions, not intellect, to evaluate pros and cons. Strong emotions may take over to the point where they see only the benefits and not the costs of an action (or vice versa).

For example, Xavier plans to buy a car. He might be overwhelmed by the idea of making such a large purchase, even if the benefits are greater than the costs. On the other hand, he might decide to buy a car at a cost that outweighs the benefits it will bring, simply because he is temporarily blinded by a desire to own a really impressive vehicle. Making a list that includes the dollars and cents of the costs and benefits of a purchase is a concrete way to take the emotion out of the decision, while also considering nonfinancial factors.

To turn an opportunity into a business, entrepreneurs invest both time and money. Before making this kind of investment, think carefully about:

Costs. The money, energy, and time you will have to invest, as well as the opportunities you will be giving up, to operate the business.

Benefits. The wealth you will accrue and the knowledge, skills, self-esteem, and experience you will gain.

Opportunity Cost

Cost/benefit analysis is incomplete without considering **opportunity cost**. This is the cost of your "next-best investment." Perhaps your goal is to become a composer who writes scores for movies. You get a full-time job at a local music store for $400 a week to support yourself, so you can write and record music in the evenings that you hope to sell to producers, agents, or film companies.

opportunity cost the value of what must be given up in order to obtain something else.

You find, however, that whenever a producer or agent wants to meet with you, you cannot get out of work to go. You realize that, even though you are making $400 a week, you are missing some important opportunities. Perhaps it would be smarter to take a part-time job for $300 a week that would leave your mornings free for meetings. The opportunity cost of the $100 a week you will lose is offset by the potential income from film-scoring jobs you are missing by not being free to see people in the business. If your first film-scoring job pays $5,000, for example, you definitely would have made the right decision to earn $100 a week less for a few months.

People often make decisions without considering the opportunity cost and then wonder why they are not happy with the outcome. Each time you make a decision about what to do with your time, energy, or money, think about the cost of the opportunities you are giving up. **Exhibit 1-1** presents a simple quiz that can help you decide whether you have what it takes to be an entrepreneur.

Seeking Advice and Information to Succeed

While experience is an excellent teacher, using knowledge, skills, and abilities to avoid errors, problems, and delays is much healthier. A savvy entrepreneur learns from the mistakes of others and appreciates the wisdom and experience of trusted advisors and mentors.

Preparation and planning are key to avoid making mistakes. Thoughtful consideration of the entrepreneurship option is an excellent starting point. Thorough research and taking advantage of training and/or technical assistance to bridge gaps in your preparation can make a world of difference.

Two of the best resources for keeping on track are mentors and advisors. A **mentor** is a trusted advisor with whom a person forms a developmental partnership through which information, insight, skills, and knowledge are shared to promote personal and/or professional growth. Finding a committed business mentor with industry-specific knowledge and experience, broad general business experience, or both, is a worthwhile endeavor. A successful entrepreneur in your field, perhaps outside of your geographic area, may prove invaluable if she will mentor you. Many successful entrepreneurs will carve out time for promising newcomers. Unfortunately, becoming a mentor may be more of a commitment than your identified entrepreneur is willing or able to make. Perhaps she will become an advisor instead.

mentor a trusted advisor with whom a person forms a developmental partnership through which information, insight, skills, and knowledge are shared to promote personal and/or professional growth.

Exhibit 1-1 *"Do You Have What It Takes?" Quiz*

Take the following quiz to learn more about yourself and whether you may have what it takes to be an entrepreneur. Circle the answer that best represents how you feel.

1. You are at a party and a friend tells you that the guy in the expensive-looking suit recently invested in another friend's business. What do you do?
   a. Race over to him, introduce yourself, and tell him every detail of your business idea while asking if he would be interested in investing in it.
   b. Ask your friend to introduce you. Once introduced, you hand the potential investor your business card and politely ask whether you might be able to call on him sometime to present your business plan.
   c. Decide that it is probably not a good idea to bother the man at a party. After all, he is here to relax. Maybe you will run into him again somewhere else.
2. Your boss asks you to take charge of researching office supply stores and choosing the one that you think would be best for the company to use. What is your response?
   a. Yes! Finally, a chance to show the boss what you are made of—plus, you will be able to spirit a few of the supplies away for your own business.
   b. You are terrified; this is more responsibility than you really want. What if you make a mistake and cost the company money? You do not want to look bad.
   c. You are excited. This is a good opportunity to impress your boss and also learn how to compare and negotiate with suppliers . . . something you will need to do for your own business.
3. You are already going to school full time when you are offered a part-time job that is in the same field as the business you want to start when you graduate next year. What do you do?
   a. Take the job, after talking with your student advisor about how to juggle your schedule so it will fit, because you believe the experience and the contacts you will develop will be invaluable when you start your business.
   b. Take the job. In fact, you ask for extra hours so you can finally start making some real money. Who needs sleep?
   c. Turn down the job. School is hard enough without working, too. You do not want your grades to suffer.
4. You are offered a job as a survey-taker for a marketing firm. The job pays really well but will require you to talk to a great many people. What do you do?
   a. Take the job. You like people and this job will be a good way to practice getting to know what consumers want.
   b. Turn down the job. Just the thought of approaching strangers makes you queasy.
   c. Take the job so you can conduct some market research of your own by also asking the people you survey what they think about your business idea.
5. Your last job paid well and was interesting, but it required you to put in long hours and sometimes work on the weekends. What was your response?
   a. You put in the extra hours without complaint, but mainly because you felt that the rewards were worth it.
   b. You went a little overboard and worked yourself into a state of exhaustion; moderation is not your strong suit.
   c. You quit. You are strictly a nine-to-five person. Work is definitely not your life!
6. You are such a good guitar player that friends keep offering to pay for you to give them lessons. What is your response?
   a. You spend some money to run a six-week advertisement in the local paper, announcing that you are now available to teach at the same rate that established teachers in the area charge.
   b. You start teaching a few friends to see how it goes. You ask them what they are willing to pay and what they want to learn.
   c. You give a few friends some lessons but refuse to take any money.
7. Your best friend has started a business designing Web sites. He needs help because the business is really growing. He offers to make you a partner in the business even though you are computer-illiterate. What is your response?
   a. You jump in, figuring that you will learn the ropes soon enough.
   b. You ask your friend to keep the partnership offer open but first to recommend a class you can take to get your skills up to speed.
   c. You pass. You do not see how you can work in a business you know nothing about.

Analysis of the "Do You Have What It Takes?" Quiz

Scoring

1. a = 2	b = 1	c = 0
2. a = 2	b = 0	c = 1
3. a = 1	b = 2	c = 0
4. a = 1	b = 0	c = 2
5. a = 1	b = 2	c = 0
6. a = 2	b = 1	c = 0
7. a = 2	b = 1	c = 0

Exhibit 1-1 *"Do You Have What It Takes?" Quiz*

12 Points or More: You are a natural risk-taker and can handle a lot of stress. These are important characteristics for an entrepreneur to have to be successful. You are willing to work hard but have a tendency to throw caution to the wind a little too easily. Save yourself from that tendency by using cost/benefit analysis to carefully evaluate your business (and personal!) decisions. In your enthusiasm, do not forget to look at the opportunity costs of any decision you make.

6 to 12 Points: You strike an excellent balance between being a risk-taker and someone who carefully evaluates decisions. An entrepreneur needs to be both. You are also not overly motivated by the desire to make money. You understand that a successful business requires hard work and sacrifice before you can reap the rewards. To make sure that you are applying your natural drive and discipline to the best possible business opportunity, use the cost/benefit analysis to evaluate the different businesses you are interested in starting.

6 Points or Fewer: You are a little too cautious for an entrepreneur, but that will probably change as you learn more about how to run a business. You are concerned with financial security and may not be eager to put in the long hours required to get a business off the ground. This does not mean that you cannot succeed as an entrepreneur; just make sure that whatever business you decide to start is the business of your dreams, so that you will be motivated to make it a success. Use cost/benefit analysis to evaluate your business opportunities. Choose a business that you believe has the best shot at providing you with both the financial security and the motivation you require.

In addition to your paid professional advisors, such as attorneys and accountants, individual advisors or an advisory board can be the difference between success and failure. Even if you are forming a venture with a full slate of experienced technical and managerial professionals, the guidance of a carefully composed advisory board can provide valuable counsel and connections. Such a board might meet only once or twice a year to listen to your problems, share experiences, and help you avoid mistakes. During the times between meetings, advisors may also be able to offer substantial assistance.

Of course, taking advantage of available courses in entrepreneurship, whether brief workshops, individual college courses, an entrepreneurial certificate program, or a degree program, can offer considerable benefits. The opportunity to learn from the experiences of others and to systematically explore entrepreneurial options and build skills will be important. There are numerous Internet resources for nascent entrepreneurs, too.

A well-prepared entrepreneur is more likely to stay on the path to success.

Entrepreneurial Options

Entrepreneurship extends beyond the fast-growing technology enterprises that are most commonly associated with it. There are many variations on entrepreneurship, and the opportunities are innumerable. Entrepreneurship may include for-profit enterprises that support the missions of not-for-profit organizations, businesses designed for social impact, and ventures that are environmentally oriented.

Social entrepreneurship has multiple definitions and forms, but in general it is commonly thought of as a for-profit enterprise that has the dual goals of achieving profitability and attaining beneficial returns for society. Another view is that of taking an entrepreneurial perspective toward social problems.[5] Gregory Dees has created the following definition:

social entrepreneurship a for-profit enterprise with the dual goals of achieving profitability and attaining social returns.

> Social entrepreneurs play the role of change agents in the social sector by:
>
> - adopting a mission to create and sustain social value (not just private value),
> - recognizing and relentlessly pursuing new opportunities to serve that mission,
> - engaging in a process of continuous innovation, adaptation, and learning,

[5] Gregory Dees, "The Meaning of 'Social Entrepreneurship,'" May 30, 2001, accessed July 9, 2013, http://www.fuqua.duke.edu/centers/case/documents/dees_SE.pdf.

- acting boldly without being limited by resources currently in hand, and
- exhibiting heightened accountability to the constituencies served and for the outcomes created.

In this view, social entrepreneurship is less about profit than it is about social impact.

social business a company created to achieve a social objective while generating a modest profit to expand its reach, improve the product or service, and subsidize the social mission.

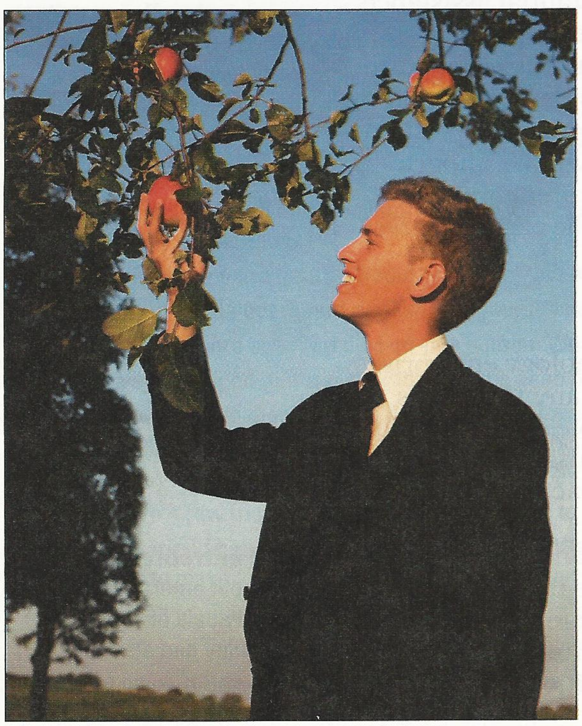
venture philanthropy a subset or segment of social entrepreneurship wherein financial and human capital is invested in not-for-profits by individuals and for-profit enterprises, with the intention of generating social rather than financial returns on their investments.

green entrepreneurship business activities that avoid harm to the environment or help to protect it in some way.

In addition to the broadly defined "social entrepreneurship," there is the more recent concept of the **social business**, "a non-loss, non-dividend company designed to address a social objective within the highly regulated marketplace of today. It is distinct from a non-profit because the business should seek to generate a modest profit but this will be used to expand the company's reach, improve the product or service or in other ways to subsidize the social mission."[6] In his book *Creating a World without Poverty—Social Business and the Future of Capitalism*, Mohammad Yunus suggests two kinds of social business:

- Type I provides a product and/or service with a particular environmental, social, or ethical purpose. Grameen Danone does this by providing food for the poor in Bangladesh.
- Type II is profit-oriented business with ownership consisting of underprivileged people who have the opportunity to benefit directly or indirectly.

In addition, **venture philanthropy** is a subset or segment of social entrepreneurship. Financial and human capital is invested in not-for-profits by individuals and for-profit enterprises with the intention of generating social rather than financial returns. In some cases, venture philanthropy may involve the investment of capital in the for-profit, commercial part of a not-for-profit. In others, it may mean investing in not-for-profits directly, to encourage entrepreneurial approaches to achieve social impact.



Organically grown produce
(Ulrich Willmunder/Shutterstock)

Green entrepreneurship is another form of social entrepreneurship and can be defined as: "Enterprise activities that avoid harm to the environment or help to protect the environment in some way."[7] TerraCycle is an excellent example of green entrepreneurship. According to the Corporation for Enterprise Development (CFED), green entrepreneurship can:

- create jobs and offer entrepreneurship opportunities,
- increase energy efficiency, thus conserving natural resources and saving money,
- decrease harm to workers' health,
- enable businesses to tap into new sources of local, state, and federal funding,
- take advantage of consumer preference for environmentally friendly goods, and
- preserve limited natural assets on which businesses and communities depend for business and quality of life.

Each of these alternative approaches offers opportunities for innovation and growth for the right entrepreneur.

[6] Muhammad Yunus, *Creating a World without Poverty: Social Business and the Future of Capitalism*, New York: PublicAffairs, 2009, p. 320.

[7] "Green Entrepreneurship," *Corporation for Enterprise Development: Effective State Policy and Practice*, Volume 5, Number 2, April 2004, http://www.cfed.org.

How Do Entrepreneurs Find Opportunities to Start New Businesses?

In the twentieth century, Joseph Schumpeter expanded on Say's definition of entrepreneurship by adding that entrepreneurs create value "by exploiting an invention or, more generally, an untried technological possibility for producing a new commodity or producing an old one in a new way, by opening up a new source of supply of materials or a new outlet for products, by reorganizing an industry and so on."[8] This view emphasizes innovation as the key to entrepreneurship. Management expert Peter Drucker simplified this view to the essential core of creating a new business, taking on risk, and persevering in light of uncertainty.[9]

Learning Objective 3
Find and evaluate opportunities to start your own business.

Schumpeter's definition describes five basic ways that entrepreneurs find opportunities to create new businesses:

1. Using a new technology to produce a new product
2. Using an existing technology to produce a new product
3. Using an existing technology to produce an old product in a new way
4. Finding a new supply of resources (that might enable the entrepreneur to produce a product more economically)
5. Developing a new market for an existing product

Entrepreneurs Creatively Exploit Changes in Our World

Today's economists and business experts have defined entrepreneurship even more specifically. Drucker pointed out that, for a business to be considered entrepreneurial, it should exploit changes in the world. This is in alignment with Schumpeter's definition of entrepreneurship but explicitly takes it a step further—to take advantage of circumstances. These changes can be technological, like the explosion in computer technology that led Bill Gates and Paul Allen to start Microsoft, or cultural, like the collapse of Communism, which led to a great many new business opportunities in Eastern Europe. Babson professor Daniel Isenberg narrows the definition of entrepreneurship to "the contrarian creation and capture of extraordinary value."[10]

Nothing changes faster than technology. Not so many years ago, there were no bar codes and no electronic scanners, hardly anyone used e-mail, and "smart phones" didn't exist. Today, even the smallest of organizations needs to use current technologies to be competitive. Sharp entrepreneurs increase their efficiency by taking advantage of the latest breakthroughs in business equipment. To learn about what's new in technology, read current business and trade magazines and visit such Web sites as:

- TechCrunch, *http://www.techcrunch.com*.
- Start-up Digest, *http://www.start-updigest.com*.

Peter Drucker defined an entrepreneur as someone who "always searches for change, responds to it, and exploits it as an opportunity." Entrepreneurs are always on the lookout for ways to create businesses from the opportunity of change.

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[8]Joseph A. Schumpeter, *Capitalism, Socialism and Democracy*, New York: Harper & Row, 1942.

[9]Peter Drucker, *Innovation and Entrepreneurship: Practice and Principles*, New York: Harper Collins, 1985.

[10]Daniel Isenberg, *Worthless, Impossible and Stupid: How Contrarian Entrepreneurs Create and Capture Extraordinary Value*, Cambridge, Massachusetts: Harvard Business Press, 2013.

How Do Entrepreneurs Create Business Ideas?

1. ***They listen.*** By listening to others, entrepreneurs get ideas about improving a business or creating a new one. Create one business idea by listening. Describe how you got the idea.
2. ***They observe.*** By constantly keeping their eyes and ears open, entrepreneurs get ideas about how to help society, about what kind of businesses they could start, and about what consumers need. Create a business idea by observing. Describe how you got the idea.
3. ***They analyze.*** When entrepreneurs analyze a problem, they think about what product or service could solve it. Create a business idea by thinking up a solution to a problem. Describe how you arrived at the idea.

Where Others See Problems, Entrepreneurs Recognize Opportunities

Here is a simple working description of an entrepreneur that captures the essentials: An entrepreneur recognizes opportunities where other people see only problems or the status quo.

Many famous companies were started because an entrepreneur turned a problem into a successful business. An entrepreneur recognized that the problem was actually an opportunity. Where there are dissatisfied consumers, there are likely opportunities for entrepreneurs.

Anita Roddick was an excellent example of an entrepreneur who started off as a dissatisfied consumer. She started The Body Shop International because she was tired of paying for unnecessary perfume and fancy packaging when she bought makeup, and she thought other women might feel the same way.

Train Your Mind to Recognize Business Opportunities

An important step in becoming an entrepreneur is to train your mind to recognize business opportunities. A further step is to let your creativity fly. Consider developing your entrepreneurial instincts by asking yourself:

- What frustrates me the most when I try to buy something?
- What product or service would really make my life better?
- What makes me annoyed or angry?
- What product or service would take away my aggravation?

BizFacts

Entrepreneurship has proven to be an effective way for minorities and women to enter the business world.

- More than 6.1 million businesses were minority-owned in 2007, and they generated $871 billion in revenues.
- There were more than 12.4 million non-farm businesses owned by women (or co-owned equally with men), accounting for 45.4 percent of all U.S. companies.

Source: U.S. Small Business Administration, accessed June 29, 2013, http://www.sba.gov.

Entrepreneurs Use Their Imaginations

Businesses are also formed when entrepreneurs not only fume about products or services that annoy them but fantasize about products or services they would like to have in their lives. Jump-start your imagination by asking yourself such questions as:

- What is the one thing I would like to have more than anything else?
- What would it look like? What would it taste like?
- What would it do?
- What innovative product or service idea have I been mulling over in my mind?
- What problem have I encountered in everyday life and thought: "There has to be a better way to do this?"

Consider posing these questions to friends and family members as well. You might hear about an opportunity you had not yet recognized.

An Idea Is Not Necessarily an Opportunity

Not every business idea you may have or invention you may explore is an opportunity. In fact, most ideas are not viable business possibilities. An *opportunity* has a unique characteristic that distinguishes it from an ordinary idea. An opportunity is *an idea that is based on what consumers need or want and are willing to buy sufficiently often at a high enough price to sustain a business*. A successful business sells products or services that customers need, at prices they are willing to pay. Many a small business has failed because the entrepreneur did not understand this. It is critical that an idea has "legs" for it to succeed.

In addition, according to Jeffry Timmons, "An opportunity has the qualities of being attractive, durable, and timely and is anchored in a product or service which creates or adds value for its buyer or end user."[11]

Timmons's definition of a business opportunity includes these four characteristics:

1. It is attractive to customers because it creates or adds value for its customers.
2. It will work in the business environment.
3. It can be executed in a defined window of opportunity.
4. It can be implemented with the right team to make it durable.

The window of opportunity is the length of time available to get the business idea to market before the market either diminishes due to lessening demand or is dominated by a competitor. You might have a great idea, but if other entrepreneurs have it too, and have already brought it to the marketplace, that window of opportunity is probably closed.

Remember, not every idea is an opportunity. For an idea to be a genuine opportunity, it must lead to the development of a product or service that is of value to the consumer and is profitable for the business.

Larry Lilac/Alamy

[11] Jeffry Timmons, *New Venture Creation: Entrepreneurship for the 21st Century*, 5th ed., New York: Irwin/McGraw-Hill, 1999, p. 7.

Entrepreneurial Wisdom . . .

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

- ***Strengths***—All the capabilities and positive points the entrepreneur has, from experience to contacts. These are internal to the organization.
- ***Weaknesses***—All of the negatives the entrepreneur faces, such as lack of capital or training or failure to set up a workable accounting system. These are internal to the organization.
- ***Opportunities***—Any positive external event or circumstance (including lucky breaks) that can help the entrepreneur get ahead of the competition.
- ***Threats***—Any external factor, event, or circumstance that can harm the business, such as competitors, legal issues, or declining economies.

SWOT analysis consideration of the internal strengths and weaknesses of an organization and the external opportunities and threats which it may face.

Opportunity Is Situational

A problem is one example of an opportunity that entrepreneurs need to be able to recognize. A changing situation or a trend is another. Opportunity is *situational*, meaning it is dependent on variable circumstances. There are no rules about when or where an opportunity might appear. Change and flux create opportunities.

Think about recent changes in computer technology. In the early 1990s, the conventional wisdom was that only the biggest telecommunications companies were in a position to exploit the Internet and all the opportunities it had to offer. How could entrepreneurs compete with established, resource-laden companies? The opposite has been true, however. Entrepreneurs penetrated and, indeed, have dominated the market for Internet-based services. Think of Facebook, Google, and Foursquare. Each was an entrepreneurial venture that left industry giants scrambling to catch up.

It can take a huge corporation (think dinosaur) multiple years to develop and implement a new business strategy, while entrepreneurs can be nimble and enter and exit the market like roadrunners. Successful entrepreneurs can "turn on a dime rather than a dollar bill."

The Five Roots of Opportunity in the Marketplace

Entrepreneurs can exploit "five roots of opportunity."[12] Notice how similar these are to Schumpeter's definition of entrepreneurship.

1. **Problems** your business can solve
2. **Changes** in laws, situations, or trends
3. **Inventions** of new products or services
4. **Competitive advantage** in price, location, quality, reputation, reliability, speed, or other attributes of importance to customers
5. **Technological advances** that entrepreneurs take from the laboratory to the marketplace

Integrating Internal and External Opportunities

It is helpful not only to be aware of the five roots of opportunity in the marketplace but to think also about how we perceive opportunities ourselves. Opportunities fall into two classes: internal and external. An internal opportunity is one that comes from inside you—from a personal hobby,

[12] Adapted from John Clow (ed.), *Master Curriculum Guide: Economics and Entrepreneurship*, New York: Joint Council on Economic Education, 1991.

Russell Simmons
(© Everett Collection
Inc/Alamy)

Step into the Shoes . . .

Russell Simmons Makes Rap Happen

In the late 1970s, Russell Simmons was promoting rap concerts at the City University of New York. At the time, rap was considered a passing fad, but Simmons really loved it. Even though most record executives thought rap would be over in a year or two, Simmons truly believed it was a business opportunity. He formed Def Jam Records with fellow student Rick Rubin for $5,000. Within a year, they produced hit records by Run DMC and LL Cool J, and Simmons went on to become a multimedia mogul.

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

Simmons loved rap and hoped that other people would, too. That was the internal factor—he had the passion to sustain himself as he worked 24/7 to make his dream come true. As it turned out, music fans were a little bored with rock at that time and looking for a fresh sound. Rap filled the bill. This was an external opportunity that happened to coincide with Simmons's internal commitment.

interest, or even a passion—or inside your organization. These can come in the form of the resolution of a problem, such as creating a viable product from scrap material, or the potential for a new product line.

An external opportunity, in contrast, is generated by an outside circumstance. External opportunities are conditions you notice that make you say to yourself, "Hey! I could start a great business from that!" For example, you see that people in your neighborhood are complaining about the lack of available day care, so you start a day care center after confirming the market need. But what if you find out very quickly that two-year-olds get on your nerves? That can be a major drawback for external opportunities. Your idea may fill a market need, but you may not have the skills or interest to make it a successful business.

The best business opportunities usually combine both internal and external factors. Ideally, a business that you are passionate about will fill a sustainable need in the marketplace.

Establishing Strategies

Business success hinges on the creation and application of profitable strategies to the work at hand. A **strategy** is a plan for how a business intends to go about its own performance and outdo that of its competition. Michael Porter created a "strategy framework" that delineates cost leadership and differentiation as low-cost and product-uniqueness strategies.[13] It also layers in the concept of focus strategies, which work in narrow market segments rather than broad ones. The illustration in Figure 1-1 shows how each of Porter's Generic Strategies relates to the other.

strategy a plan for how an organization or individual plans to proceed with business operations and outperform that of its competitors.

A firm using a product-uniqueness strategy bases its competitive advantage on its ability to differentiate the firm's products and/or services from others in its competitive market space. Such factors as quality, availability, customer service, and the like are critical to differentiation, as will be discussed in greater detail in the marketing chapters of this text.

If you choose to emphasize a low-cost approach, you will be using a "cost-leadership" strategy. This means that you are finding ways to reduce

[13] Michael Porter, *Competitive Strategy: Techniques for Analyzing Industries and Competitors*, New York: Free Press, 1998.

Figure 1-1 *Porter's Generic Strategies*

Scope of Target Market	Strategic Advantage	
	Product Uniqueness	**Low Cost**
Industry-Wide (Broad)	Differentiation Strategy	Cost Leadership Strategy
Market Segment (Narrow)	Focus Strategy (Differentiation)	Focus Strategy (Low Cost)

Source: Adapted from Michael Porter, *Competitive Strategy: Techniques for Analyzing Industries and Competitors* (Free Press, 1998).

the costs of operations and management sufficiently to be able to undercut the pricing of your competition and to sustain that price advantage.

Another component of the Porter framework is that of a focus strategy. This line of attack narrows in and creates a laserlike focus on a particular market segment or group. Rather than strategically targeting an entire industry, you locate a niche or subset of the customer base and focus your marketing efforts on it. If you can find a sufficiently large niche to sustain your business, you can set the company apart from the competition and maintain the advantage. A focus strategy can work with differentiation and cost leadership.

Paths to Small Business Ownership

Not all business owners start their ventures from the ground up. Although the emphasis of this book is on starting and growing your own enterprise, the paths to business ownership are varied. You could buy an existing company, secure franchise rights, license or purchase critical technology or methods, inherit a company, or be hired as a manager.[14] There are pros and cons to each approach, and it will be worthwhile to give thought to each option. Note the possibilities in **Exhibit 1-2**.

Securing Franchise Rights

franchise is a legal and commercial relationship between the owner of a trademark, service mark, trade name or advertising symbol and an individual or group seeking to use that identification in a business.

"A **franchise** is a legal and commercial relationship between the owner of a trademark, service mark, trade name or advertising symbol and an individual or group seeking to use that identification in a business."[15] For many people who want to own and operate a business, it is worthwhile to consider franchising as a path to business ownership. (See Chapter 2 for a discussion of franchising as an entrepreneurial opportunity.)

Buying an Existing Business

acquisition a business purchase.

The purchase of a business, or **acquisition**, can be a good way to jump-start entry into small business ownership. There is both an art and a science to buying an existing business.

The challenge is to do a complete, in-depth analysis of the opportunity, just as you would for a start-up, with the added dimension of taking into account an existing history, whether for better or worse. Be wary of owners whose businesses seem to be too good to be true or who are overly eager to sell. Be thorough, whether you are buying an entire firm, a customer list, or some or all assets and especially if you are taking on some or all debt. Done well, buying a business can be the starting point for success.

[14] Jerome A. Katz and Richard P. Green, *Entrepreneurial Small Business*, New York: McGraw-Hill/Irwin, 2008.

[15] U.S. Small Business Administration Workshop, "Is Franchising for Me?" accessed December 2007, http://www.sba.gov/idc/groups/public/documents/sba_homepage/serv_sbp_isfforme.pdf.

Exhibit 1-2 *Selected Business Entry Options*

Business Aspects	Start a Business	Buy an Existing Business	Secure a Franchise or License	License Technology
Customers	None	Established	None—but may have name recognition	None
Location	Needed	In place	Assistance possible	Needed
Management Control	Owner	Owner	Owner within terms of license	Owner within terms of license
Operational Control	Owner	Owner	Owner within terms of license	Owner
Marketing	Needed	In place (+/−)	Assistance possible. Rules absolutely.	Needed
Reputation	None	In place (+/−)	Should be. If not, why license?	Possible
Royalties/Fees	Not usual	Maybe	Ongoing	Likely
Financing	Needed	Prior owner may provide	Assistance possible	Needed
Disclosures	None	Buyer beware	UFOC and contracts	Agreement

Done poorly, buying a business can be more challenging and problematic than starting a new venture. (See Chapter 3 for a more in-depth discussion.)

Licensing Technology

One way to potentially shorten the product-development cycle and to access innovative technology is to identify and *license* that technology—that is, to enter into a contract to use it without purchasing the rights to own it. Whether you acquire such rights through a university, state economic development office, federal agency such as NASA, or an individual scientist/inventor, you can create a business based on technology transfer. Or, you may find that it makes more sense to purchase the rights outright, or over time.

The MBA team of Bruce Black and Matt Ferris, from the University of Georgia, developed a business plan that garnered numerous competitive awards for the KidSmart Vocal Smoke Detector, someone else's creation that they arranged to bring to market. The product is now available in major retail stores and on the Internet, through Signal One, the successor company.

Before securing franchise rights, purchasing a business, or licensing technology, be certain to do your research thoroughly to understand what you are and are not buying, and what your ongoing obligations—financial, operational, legal, and reporting—will be. Because these transactions are complex and can have significant financial and personal implications, it is important to invest in qualified legal and financial counsel before signing any agreements of this kind.

Do Not Take Unfair Advantage of Someone Else's Creativity

You would be upset if someone made money from your invention or artistic creation, so resist the urge to base your business on someone else's creative work. Be sure that any business you start respects the intellectual property of others.

- Do not sell counterfeit knockoffs of popular brands.
- Do not take graphics, music, or content from the Web without permission and/or payment.
- Always know the source of the goods you buy from suppliers to avoid the risk of receiving stolen property.

The Many Faces of Entrepreneurship

Entrepreneurs are as diverse as the composition of the economy. They are of all ethnicities, races, and religions and come from every socioeconomic status. They enter into self-employment for a wide range of reasons and choose to continue as entrepreneurs or return to outside employment for just as many. There are women and minority entrepreneurs and young entrepreneurs in record numbers. Continuing an American tradition, there are also refugee and immigrant entrepreneurs.

This diverse and ever-changing pool of entrepreneurs does not produce a single path to entrepreneurial success. Rather, the types of businesses formed reflect the diversity of the founders. In addition to full-time ventures founded to maximize growth and wealth, some are started as part-time and microenterprises, "gazelles," artisanal and opportunistic businesses, and others.

Gazelles

A classic entrepreneurial story is that of a pair of inventors who develop a new, innovative technology or product in a garage, basement, or dormitory; lift themselves up by their bootstraps into a wildly successful business venture in virtually no time; take the company public; and become incredibly wealthy in the process. This stereotype describes the founders of a high-potential venture with the potential to become a **gazelle**, a company that achieves an annual growth rate of 20 percent or greater, typically measured by the growth of sales revenue.

gazelle a company that achieves an annual growth rate of 20 percent or greater, typically measured by the increase of sales revenue.

Gazelles tend to be the exception rather than the rule for entrepreneurial enterprises but are a significant type of firm. Gazelles are financed by a combination of found resources with significant outside assistance. They rely heavily on external financial support and counsel.

Microenterprises

Most businesses are founded as **microenterprises**, which are defined as businesses with five or fewer employees, initial capitalization requirements of less than $50,000, and the habitual operational involvement of the owner. In fact, more than 60 percent of all U.S. firms have four or fewer employees, according to the U.S. Small Business Administration.[16] The Association for Enterprise Opportunity (AEO) estimates that the more than 25.1 million microenterprises in the United States account for 88.2 percent of all businesses and 22 percent of all private employment.[17]

microenterprise a firm with five or fewer employees, initial capitalization requirements of under $50,000, and the regular operational involvement of the owner.

Microenterprises are founded for a variety of reasons and are often more fluid than other types of businesses. These firms may be founded to provide only part-time employment for their owners. They may not be intended as long-term enterprises and may not have the goal of growing larger. They may be planned as only temporary ventures to provide income during periods of unemployment or to supplement household finances for a particular purpose. **Lifestyle businesses** are microenterprises that permit their owners to follow a desired pattern of living, such as supporting college costs or taking vacations. On the other hand, a microenterprise could make the difference between a family living in poverty and achieving economic stability.

lifestyle business a microenterprise that permits its owners to follow a desired pattern of living, such as supporting college costs or taking vacations.

Mainstream Small Firms

These constitute the bulk of the small businesses in the public perception, in the press, and in community visibility. They provide, or have the

[16]U.S. Small Business Administration, Office of Advocacy, 2013.

[17]Association for Enterprise Opportunity, accessed June 30, 2013, http://www.microenterpriseworks.org.

potential to provide, substantial profits to their owners. Mainstream small firms can be operated by founder-entrepreneurs, subsequent generations of family members, successor owners, or franchisees. They create many of the jobs included in statistics from the U.S. Small Business Administration and employ the majority of American workers. Unlike many micro-enterprises, they are established with continuity and permanent wealth building in mind and are more often registered with local, state, and federal agencies.

Making the Business Work Personally and Professionally

What makes a business work is not only profitability and cash flow, although they are necessary. Each entrepreneur has his own goals and objectives for the business. As an entrepreneur, it will be up to you to determine how you want your business to be and to make it happen.

A Business Must Make a Profit to Stay in Business

No matter how big or small, a business must make a **profit**—that is, show a positive gain from operations after all expenses are subtracted. Most businesses lose money initially because entrepreneurs have to spend money to set up operations and advertise to attract customers. If the business cannot make a profit and generate cash, eventually the entrepreneur will be unable to pay the bills and will have to close.

profit amount of money remaining after all costs are deducted from the income of a business.

Closing a business is nothing to be ashamed of, if you operate ethically and learn from the experience. In fact, many successful entrepreneurs open and close more than one business during their lives. If your venture is not making a profit after you have gotten it up and running, that is a signal you may be in the wrong business. Closing it may be the best decision.

An entrepreneur may change businesses many times over a lifetime in response to changing competition and consumer needs.

Profit Is the Sign That the Entrepreneur Is Adding Value

Learning Objective 4

Explain how profit works as a signal to the entrepreneur.

Profit is the sign that an entrepreneur has added value to the resources he or she is using. Debbi Fields added value to scarce resources by creating something that people were willing to buy for a price that gave her a profit. In contrast, not making a profit is a sign that the entrepreneur is not using resources well and is not adding value to them.

Profit Results from the Entrepreneur's Choices

An entrepreneur's choices directly affect how much profit the business makes. For example, suppose, like Debbi Fields, you have a business selling homemade cookies. You might decide one week to buy margarine instead of butter because it is cheaper, even though the cookies may not taste as good made with margarine. This type of choice is called a **trade-off**. You are giving up one thing (taste) for another (money).

trade-off the act of giving up one thing for another.

If your customers do not notice the change and continue to buy your cookies, you have made a good choice. You have conserved a resource (money) and increased your profit by lowering your costs. The increase in profit confirms that you have made the right choice.

If your customers notice the change and stop buying your cookies, your profit will decrease. The decrease in profit signals that you have made a bad choice. Next week you should probably go back to butter. The profit signal taught you that your customers were dissatisfied and the trade-off was not worth it. Every choice an entrepreneur makes is a trade-off.

Seven Rules for Building a Successful Business

Russell Simmons and Rick Rubin were successful in creating Def Jam because they instinctively applied the seven basic rules of building a successful business:

1. ***Recognize an opportunity.*** Simmons believed that rap music was an untapped business opportunity.
2. ***Evaluate it with critical thinking.*** He tested his idea by promoting concerts and observing consumer reaction.
3. ***Build a team.*** Simmons formed a partnership with Rubin.
4. ***Write.*** Simmons and Rubin created a realistic business plan.
5. ***Gather resources.*** Simmons and Rubin pooled their $5,000.
6. ***Decide ownership.*** Simmons and Rubin formed a legal partnership.
7. ***Create wealth.***

The Team Approach

While most businesses do not hire employees, successful entrepreneurial ventures grow well beyond their initial founder. Some have multiple co-founders while others grow their teams along with their businesses. The team approach can make or break a business. For example, alone, neither Simmons nor Rubin had enough skills or money to launch a record label, but together they were able to do it. Their business was also helped by the fact that each knew different artists and had different contacts in the recording industry.

Potential team members are all around you. Some might be in your immediate circles of friends and family members who have skills, equipment, or contacts that would make them valuable business partners. At the same time, you may reach across the globe to find other team members. Perhaps you very much want to start a Web site design business, because you know of companies in your community that want to put up Web sites.

Entrepreneurial Wisdom . . .

Build Your Brain

Becoming a successful entrepreneur is all about making connections, those "Aha!" moments when you realize what your business opportunity is or when you figure out how to do something better than the competition. Research indicates that mental exercise will help your brain become better at making such connections. Even the most erudite scientists recognize the value of activities that encourage brain cells to make new connections. Robotics engineer Hugo de Garis, who has worked on such projects as building an artificial brain for an artificial cat, plays classical piano every day before he sits down at the computer. "This helps to build my own brain," he told *The New York Times*.[18] Arnold Scheibel, head of the University of California–Los Angeles Brain Research Institute, suggests the following brain-builders:

- Solving puzzles
- Playing a musical instrument
- Fixing something; learn to repair cars or electrical equipment
- Creating art, writing poetry, painting, or sculpting
- Dancing
- Making friends with people who like to have interesting conversations

[18] Nicholas D. Kristof, "Robokitty," *The New York Times*, August 1, 1999.

You are a graphic artist, but you do not know how to use Web site development programs. If you have a friend who has that knowledge, you might start a business together. Or maybe you would like to start a DJ venture, but you only have one turntable or laptop computer. If you form the business with a friend, you can pool equipment. (When forming a business team, organize the enterprise so that everyone involved shares in the ownership and profits. People work better when they are working for themselves.) Just be careful of jumping into business relationships with undue haste.

Now carry this idea a step further. Everyone you meet is a potential contact for your business, just as you may be a valuable contact for theirs. Thinking this way will encourage you to *network*, or exchange valuable information and contacts with other businesspeople. Keep your business cards with you at all times and truly view every individual you encounter as an opportunity for your business. Remember, though, that networking is a two-way street. See how you can help those that you meet rather than always focusing on how they can help you. The results can be nothing short of amazing.

Chapter Summary

Now that you have studied this chapter, you can do the following:

1. Explain what entrepreneurs do.
   - Entrepreneurs start their own businesses and work for themselves.
   - Entrepreneurs recognize opportunities to start businesses that other people may not have noticed.
   - Entrepreneurs shift economic resources from an area of lower productivity into an area of higher productivity and greater yield. By doing this, they add value to scarce resources.
2. Describe how free-enterprise economies work and how entrepreneurs fit into them.
   - The free-enterprise system is based on voluntary exchange. Voluntary exchange is a trade between two parties who agree to trade money for a product or service. Both parties agree to the trade because each benefits from the exchange.
   - The free-enterprise system encourages entrepreneurs who use resources efficiently to satisfy consumer needs by rewarding them with profit.
3. Find and evaluate opportunities to start your own business.
   - The five roots of opportunity are:
     i. problems that your business can solve;
     ii. changes in laws, situations, or trends;
     iii. inventions of totally new products or services;
     iv. competition (if you can find a way to beat the competition on price, location, quality, reputation, reliability, or speed, you can create a very successful business with an existing product or service); and
     v. technological advances (scientists may invent new technology, but entrepreneurs figure out how to sell it).
4. Explain how profit works as a signal to the entrepreneur.
   - Profit is the sign that an entrepreneur has added value to the scarce resources he or she is using.
   - Not making a profit is a sign that the entrepreneur is not using resources well and is not adding value to them.

5. A business opportunity is an idea plus these three characteristics:
   - It is attractive to customers.
   - It will work in your business environment.
   - It can be executed in the defined window of opportunity.
6. Use cost/benefit analysis to make decisions.
   - Cost/benefit analysis is the process of comparing costs and benefits in order to make a good decision.
   - Cost/benefit analysis can be inaccurate without including opportunity cost. This is the cost of missing your next-best investment.
7. Use SWOT analysis to evaluate a business opportunity.
   - Strengths: all of the capabilities and positive points that the entrepreneur has, from experience to contacts. These are internal to the organization.
   - Weaknesses: all of the negatives the entrepreneur faces, such as lack of capital or training or failure to set up a workable accounting system. These are internal to the organization.
   - Opportunities: any positive external events or circumstances (including lucky breaks) that can help the entrepreneur get ahead of the competition.
   - Threats: any external factors, events, or circumstances that can harm the business, such as competitors, legal issues, or declining economies.

Key Terms

acquisition, 20
capital, 5
capitalism, 5
commission, 7
cost/benefit analysis, 10
dividend, 7
entrepreneur, 3
franchise, 20
free-enterprise system, 4
gazelle, 22
green entrepreneurship, 14
lifestyle business, 22
mentor, 11
microenterprise, 22
opportunity cost, 11
product, 3
profit, 23
salary, 7
service, 3
social business, 14
social entrepreneurship, 13
strategy, 19
SWOT analysis, 18
trade-off, 23
venture philanthropy, 14
voluntary exchange, 5
wage, 7

Entrepreneurship Portfolio

Critical Thinking Exercises

1-1. What would be the best thing about owning your own business? What would be the worst?

1-2. Identify three nonfinancial benefits of entrepreneurship that might be important to you. Write a paragraph about each.

1-3. If you were to start a business, what would be your opportunity cost? In other words, what is the next-best use of your time? How much money could you make working at a job, instead? The answer to this last question will give you a rough idea of how to value your time when you start a business and figure out how much to pay yourself.

1-4. Describe an idea that you have for a business. Explain how it could satisfy a consumer need.

1-5. Explain how a business opportunity differs from a business idea.

1-6. Give an example of a change that has occurred or is about to occur in your area/neighborhood. Discuss business opportunities this change might create.

1-7. List five business opportunities in your environment and the need(s) each would satisfy. Note whether the opportunity you describe is internal, external, or a mix.

Key Concepts Questions

1-8. Define small business.

1-9. Explain how profit works as a signal to the entrepreneur.

1-10. Do you agree that it will probably take about three months for your business to start earning a profit? Why or why not? If not, how long do you expect it to take and why?

1-11. Describe three things you have learned about capitalism.

1-12. Visit the U.S. Small Business Administration Web site (http://www.sba.gov). Find and read one of the articles on starting a business and write a brief summary of the key information (200 words or fewer). Remember to create a proper citation for the article.

Application Exercises

1-13. Have a conversation with a friend or relative. Ask this person to tell you about which things he or she finds frustrating in the area/neighborhood. Write down these comments.

Step 1: Generate at least three business opportunities from this conversation.

Step 2: Use the checklists below to evaluate your three business ideas as opportunities.

Step 3: Choose the best of the business opportunities and write a SWOT analysis for it.

Step 4: Create a cost/benefit analysis for starting this business. Use the analysis to explain why you would or would not actually start it.