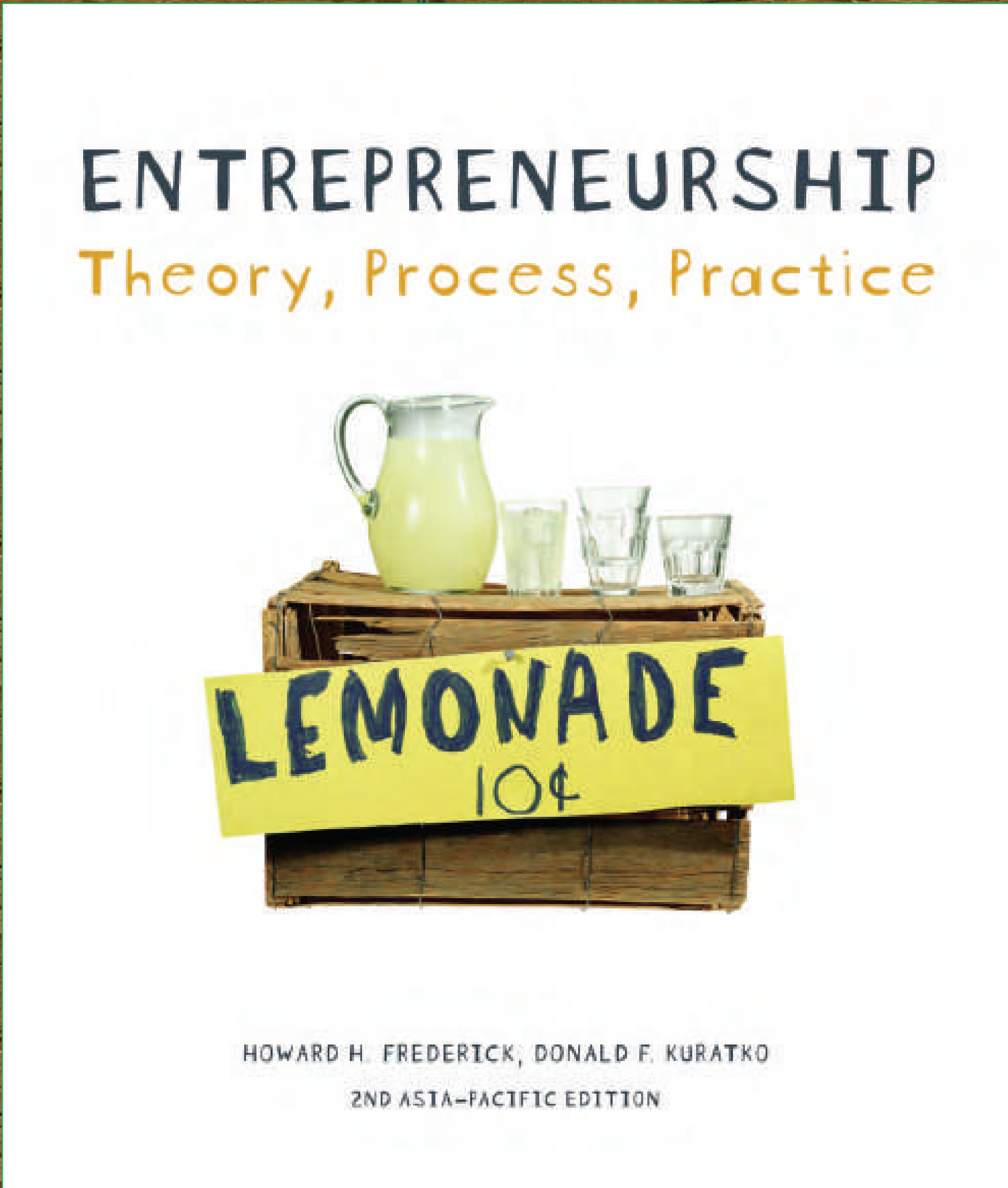
Entrepreneurship : theory, process, practice

Howard Frederick
Plymouth State University



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Entrepreneurship: Theory, process, practice

Second Edition

Authors Howard Frederick
Donald F. Kuratko
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In an era where balancing economic development with environmental protection has become an increasing priority, this second Asia–Pacific edition of ***Entrepreneurship: Theory, Process and Practice*** integrates theories of sustainable and environmental entrepreneurship. Alongside established topics ranging from planning and finance to cultural and legal issues, students will also learn entrepreneurial practices that integrate sustainability and lead to commercial and economic success.

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Foreword by Terri Irwin, environmental entrepreneur, Australia Zoo

Howard Frederick & Donald Kuratko,
Entrepreneurship Theory Process & Practice, 2nd Asia-Pacific edition (Melbourne: Cengage Learning, 2010)

"Entrepreneurship as if the planet mattered", this book's motto grabbed my attention. So many themes in the book resounded with my own experience as an entrepreneur.

One was about 'pathways to becoming an entrepreneur'. My own journey began when, at the age of five I decided I wanted to one day take over the family business. At six I opened my own bank account, at eight I learned to type, and at ten I used my savings to purchase a horse. By the time I was twelve I enrolled in summer classes at a business college so that when I turned fifteen I could start working full time. I purchased my first house at the age of 18 and did, in fact, take over the family business at 20, when I turned 22 I opened my own wildlife rehabilitation organisation, at 24 I started working evenings and weekends at an emergency veterinary hospital, and at 25 I paid off my house. It was when I was 27 that I met and married Steve and began my greatest adventure. I firmly believe that "luck" is merely the courage to seize opportunity.

The entrepreneurial family is another of the book's themes that has always been very much part of my life. When Steve and I married in 1992 we took over running the Irwin family's small wildlife park. Steve's parents, Bob and Lyn, retired and we began expanding what was a four acre Zoo with two full time staff into Australia Zoo. Seventeen years later we have a Zoo compromised of 1500 Acres, over 600 staff, and more than 1000 animals. We also now operate a wildlife hospital, travel agency, magazine, retail, wildlife documentary filming, more than 400000 acres of conservation properties, whale watching tours, international conservation programs and extensive research. I am also instilling that 'Enterprising Spirit' in my children, Bindi and Robert; I want them to grow up with the understanding that there is no such thing as failure, just varying degrees of success.

Another common interest that runs throughout the book is how entrepreneurs can protect the environment and promote biodiversity. It was shocking to read, for example, how throughout history entrepreneurs have continuously exploited and plundered the Earth's resources for commercial gain. One story in the book describes New Zealand entrepreneur Joseph Hatch, who committed virtual ecocide at the turn of the last century by rendering millions upon millions of Royal and King Penguins on Macquarie Island just because he spotted a 'market niche' for industrial oil. I was heartened to learn that many great names such as Baron Walter Rothschild and H.G Wells lined up against him in the first global campaign for environmental conservation.

While I am a business entrepreneur through and through, I am also a social entrepreneur and I like how the book incorporates both. The reason entrepreneurship seems so difficult to learn is because of one magical ingredient: passion. One cannot teach another how to be passionate. Like your personality, your level of passion is uniquely yours. I have never encountered anyone as passionate as Steve. In the spirit of entrepreneurship we launched a non-profit organisation called Wildlife Warriors. Currently, we are battling to save the Steve Irwin Wildlife Reserve and protect the pristine wilderness on the Wenlock River in Queensland's remote Cape York Peninsula. At threat are endangers plants and animals as well as the river with the highest biodiversity of freshwater fish in the country. We are determined to prevent strip mining from destroying this critically important rainforest region and instead continue environmentally sustainable management and employment.

Frederick & Kuratko's *Entrepreneurship Theory Process & Practice* is one of the best-written textbooks I have ever read, and is a must read because it makes a huge contribution to Australian and Asia-Pacific entrepreneurs who are concerned about how to address the environment, global warming and climate change. An entrepreneur often received her motivation simply from being in a hurry. It's a real desire to "do it now!" Bureaucracy and red tape simply do not fit into the plan. Especially important for myself and my staff are the chapters on entrepreneurial marketing, developing a sustainable business plan, performance measures, and of course family business.

This book is essential for social and business entrepreneurs in the Asia-Pacific. It is truly the 21st century's 'first' entrepreneurship text that goes beyond the industrial age and venture capital euphoria. No other book has come to grips so comprehensively with the dual crisis of climate change and economic collapse. I am happy that it is used in so many Australian and Asia-Pacific Universities.

FOREWORD

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Another common interest that runs throughout the book is how entrepreneurs can protect the environment and promote biodiversity. It was shocking to read, for example, how throughout history entrepreneurs have continuously exploited and plundered the Earth's resources for commercial gain. One story in the book [Chapter 4, p.134] describes New Zealand entrepreneur Joseph Hatch, who committed virtual ecocide at the turn of the 20th century by rendering millions upon millions of Royal and King Penguins on Macquarie Island just because he spotted a 'market niche' for industrial oil. I was heartened to learn that many great names such as Baron Walter Rothschild and H.G. Wells lined up against him in the first global campaign for environmental conservation.

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Terri Irwin

PREFACE

When the weather is hot across America, on sidewalks and under the shade trees you will see micro-businesses owned and operated by children selling ice-cold lemonade to their friends and neighbours. Many adults make a practice out of stopping whenever they see the 'Lemonade 5¢' sign (of course now it is 50 cents!) on a residential street. Typically, the kids have pulled together a supply of lemons, ice and clean water, a card table and tablecloth, and a sign advertising fresh cold lemonade.

Just Google or YouTube for 'lemonade stand' and you'll find dozens of interesting references. Start by looking at *Waldo's Last Stand* by the famous Little Rascals. Keep searching the Internet and you will find: how to start a lemonade stand, best lemonade stand competitions, learning business through lemonade stands, jokes about lemonade stands, financing a lemonade stand, lemonade stand business plans, and lemonade stand design considerations.

That is the America that the first author grew up in. Some bigger kids whispered the secrets of the lemonade stand to me. I learned the past participle of squeeze ('squozen'), then squeezed and squeezed, and the rest is history. Only as a professor do I understand what really happened when I was eight years old.

A friend's older brother, perhaps 13 at the time, explained the rules of the lemonade stand almost like movie script. Actually it was what we call today an 'expert script'. Just like in Kyosaki's and Lechter's famous book *Rich Dad Poor Dad – What the Rich Teach Their Kids About Money – That the Poor and Middle Class Do Not!*,[1] some people get exposed to these entrepreneurial scripts and others do not.

Just like the script of a play, the expert script defines who the actors and their roles are, their permitted interactions and dialogue, expected entry and exit points for the actors, appointed times when sales or service is expected, and what to do when the curtain goes down. The whole purpose of the play is to get gold coins into your cigar box.

The key lesson I took from this experience was that throughout my life I wanted to come in contact with as many expert scripts as I could through first-hand and learned experience. Becoming a real entrepreneur requires remembering the right expert script at the right time in the right place.[2] This book is filled with such scripts.

In my travels around the world, I see children and young people everywhere creatively starting value-producing enterprises, both business and social. Parents can greatly influence this. When a child expresses a desire for something, one father might say, 'We can't afford it'. But another father might say, 'Let's figure out how we can afford that'. One closes the door for opportunity. The other opens it. 'Merchant cultures' around the world give children their first taste of enterprise. Kids learn how to operate a cash box, keep inventory, process raw materials, and plan for growth. These are the little Bill Gates' of the world. Microsoft even offers lessons on 'Making money from lemons'.[3]

Different countries have different equivalents to the American lemonade. In Colombia, teenagers called 'Talkers' with multi-pocket vests stand on busy thoroughfares with different brands of phone cards and cellphones hanging out their pockets. Many people still cannot afford to own their own mobile phone. Conditions are rugged in Colombia, so different mobile networks may be needed. So they come to the 'Talker' for advice on the cheapest network to connect. Then they use his phone cards and phones – all for an obvious up-price.

There can even be a dark side to youth entrepreneurship. In New Zealand, I once was called by a frantic mother who said that her teenage son had just been expelled from school. I said, 'I'm sorry to hear this'. Then she said, '. . . for selling cigarettes by the piece'. I deeply expressed my regret that the child was selling cigarettes, but then I realised why she called the professor of entrepreneurship. Her real question was, 'What should she do with this stroppy and venturous child of hers who recognises opportunities (even bad ones!), knows how to maintain inventory, studies customer preferences, and keeps a cash box?' After all, she said, it was illegal for him to *buy* cigarettes, but not to *sell* them.

Another time on a tourist beach in Mexico, a beautiful young girl with straight-arrow back approached me in the wet sand balancing 10 trays on her head. Not only did I admire her posture, I especially loved what she was carrying – fruit pies. She had lemon meringue pie, apple pie, banana nut pie and several others all balanced on her head. She and her mother had obviously investigated consumer flavour preferences, modes of distribution, and freshness of inventory. To that she added the flourish of physicality to promoting the wares on her head. I was willing to pay a day's Mexican wage for some key lime pie.

The leitmotif of this book is personal enterprise wherever it exists, whenever it exists, and whatever it is – social, environmental, business, corporate; the list is endless. It is about the 'enterprising spirit' that everyone has at birth. That spirit of true creativity and inventiveness, of curiosity and derring-do, of calculated risk against great gain. True, this spirit can be beaten down for many reasons: by the parents, by the church or oppressive society, by the conformism of the school system, by crime or civil war, or by cultural proscriptions. But it is always there in every person, even later in life if only the right conditions should emerge.

Many people would agree that entrepreneurship may well be the most powerful economic and social force yet known to humankind. For hundreds of years, The Entrepreneurial Revolution captured the imagination and now permeates every aspect of society, culture, business and education. As exemplified by dynasty builders such as Richard Branson of Virgin Air, Bill Gates of Microsoft, Rupert Murdoch of News Corporation, or Tony Fernandes of Air Asia, the applications of creativity, risk taking, innovation, and passion can lead the way to economic development far greater than anyone could imagine. Just in the last few years, we can witness the immense impact of entrepreneurial companies such as Google and Facebook that have produced technological breakthroughs and become a part of our everyday lives.

Here we are in the Asia–Pacific region and a decade into the 21st century. Entrepreneurs' roles are changing as the Earth and the economy change. Today's entrepreneurs are faced with more complex challenges than ever before in the form of fuel-efficient technologies, social enterprise, new forms of finance, green consumer behaviour, and the march of technologies always cheaper and more powerful. The entrepreneurial drive and determination of the yet-to-be-discovered dynasty builders at every level of business and society will give us the most hope for the solutions to all of these challenges. The process of transforming creative ideas into commercially viable, socially just and environmentally sustainable enterprises continues to be a major force in today's world economy.

Of course, it is not just about youth and their lemonade stands. From artists to zoologists, the enterprising spirit can fill any person. Entrepreneurship as a field of study is not a required undergraduate course in great universities. Engineering students are taking courses and programs that set forth a basic framework for understanding the process of entrepreneurship. Think of some of the professions that are highly self-employed – artists, real-estate brokers, photographers, jewellers, musicians, designers, writers, financial advisors, management analysts, and interior designers. Beyond this, think of the creative and innovative people you know in civil society groups, NGOs, non-profits, community trusts, and social enterprises. Think of all the artists who survived the world of commerce without sacrificing their art.

Our motto for this 2nd Asia–Pacific edition was 'Entrepreneurship as if the planet mattered'. This textbook has been structured to illustrate the broadest variety of sustainable entrepreneurship in the Asia–Pacific in the 21st century in a manner as unique and creative as our region itself.

Our first attempt to do this won one of the Australian Awards for Excellence in Education Publishing. The judges said: '*Entrepreneurship* impressed us with its inclusion and incorporation of original research, varied approaches to the subject, suitability for both undergraduate and post-graduate students, clarity of writing, and pedagogic features designed to assist students and learners'. The book is used through Australia and New Zealand and is even beginning to enter the Southeast and East Asian markets through its translation into Mandarin under China Renmin University Press and Cengage Asia (2009).[4]

This is the first entrepreneurship textbook of the 21st century with people, planet and profits at its base. The new chapter sequence in *Entrepreneurship: Theory, Process, Practice*, 2nd Asia–Pacific edition, is systematically organised around the initiation, planning, growth, and development of new and emerging business and social ventures. The text has been streamlined to 16 chapters. The first eight chapters well serve an undergraduate course in 'Foundations of Innovation & Entrepreneurship'. The second eight chapters compose a course called 'New Venture Creation'. Or they can all be covered in a post-graduate MBA or executive course.

Text, cases, and exercises appear in *Entrepreneurship: Theory, Process, Practice*, 2nd Asia–Pacific edition to bring together in one place the most significant resources for exploring the development of new and emerging ventures and to present them in an exciting, organised, and challenging manner that relates to Earth's twin crises: economic and environmental.

Every chapter – from performance measures to marketing, from strategy to start-up, from ethics to family business – now includes in-depth information relating this topic to the book's main theme of people, planet and profit.

Of course, one thing has not changed: our focus on entrepreneurs in the Asia–Pacific region of the world.

We put together *Entrepreneurship: Theory, Process, Practice*, 2nd Asia–Pacific edition to compact and synthesise a large body of knowledge for the budding entrepreneur and enterprising spirit of all types. Our aims are to simplify, condense, organise and translate a vast and sometimes complex body of knowledge into a form useful for building commercially viable projects of all sorts.

We have taken ideas from multiple sources and repackaged them to make a new whole. As the American Historical Association says, textbooks are different from other scholarly writing in the 'form of attribution, and the permissible extent of dependence on prior scholarship'.[5] Within our organisation and accumulation of knowledge on Asia–Pacific entrepreneurship, we have cited more than 1000 authors in the field and aim to provide ready access to their works.

The most important addition to this 2nd Asia–Pacific edition is Chapter 3: The environment, the economy and entrepreneurship, which lays out the challenges that entrepreneurs will face over the next 50 years. Other new chapters include Chapter 4: Ethical, environmental and social entrepreneurship, Chapter 5: Innovation: The creative pursuit of ideas, Chapter 6: Pathways to entrepreneurial ventures, and Chapter 13: Strategic entrepreneurial growth.

The 16 chapters form four Parts to the book. Each contains four chapters that specifically address these pertinent concepts of entrepreneurship.

Part 1 (Chapters 1–4) is named 'The environment for entrepreneurship in the Asia–Pacific'. It introduces the entrepreneurial mind-set and examines entrepreneurship as evolution and revolution. This part reveals the evolving nature of entrepreneurship and its importance to the entire global economy, to civil society, and to the planet itself. Part 1 reviews the fundamentals of the environment of the economy and the economy of entrepreneurship. This includes the basics of climate change and climate-change economics as well as the emerging field of entrepreneurial ecology. Finally, we focus on social entrepreneurship and the ethical perspective that entrepreneurs need to take in developing a morally conscious approach to business, one that safeguards society and the planet.

Part 2 (Chapters 5–8) is named 'Initiating entrepreneurial ventures'. We begin with the pursuit of ideas and opportunity recognition by examining creativity for individuals and the concept of innovation. A new approach in this book is how we discuss the unique and culturally determined pathways that an entrepreneur might take to launch a new venture, whether starting a brand new venture, acquiring an existing firm, or expanding a social enterprise. We review business and environmental regulations, look at intellectual property, and compare legal forms of business organisation across our hemisphere. This part concludes with a thorough examination of the sources of capital, including social capital and natural capital, available to entrepreneurs.

Part 3 (Chapters 9–12) is entitled 'Developing the entrepreneurial plan'. This part includes the methods of assessing new ventures and business opportunities, as well as a discussion of the issues in marketing that affect the preparing, planning, and operating of entrepreneurial start-ups. The performance measures that all entrepreneurs need also are discussed. Finally, the development of a clear and comprehensive sustainable business plan is examined. Appendix 1: *Red River Optical: Affordable reading glasses for Vietnam*, contains a complete illustrative sustainable business plan of a for-profit enterprise in Vietnam.

Part 4 (Chapters 13–16) is called 'Growth strategies for entrepreneurial ventures'. The need for strategic planning, the challenge of managing entrepreneurial growth, and the global opportunities available to entrepreneurs are all discussed in this part. We conclude with a look at intrapreneurship, also called 'corporate entrepreneurship', which exists and can be cultivated in every large organisation. In an effort to make *Entrepreneurship: Theory, Process, Practice*, 2nd Asia–Pacific edition the most comprehensive text available in our region, located at the end of each chapter are a wealth of endnotes with the Asia–Pacific region especially in mind. The focus here is on the 'theoretical' component of entrepreneurship. These references have been carefully selected and updated to provide professors and students with a thorough background of the latest research that relates to the entrepreneurship material being presented. All URLs were current in May 2009.

'learnpreneurship.com'

Professor Frederick has developed an online environment called 'learnpreneurship.com' for students and professors using this book. Learnpreneurship.com™ uses a 'blended learning approach'. The website has links, videos, other cases and business plans, interactive exercises, video case-ettes, news feeds and simulations. It implements Professor Frederick's philosophy that 'Teaching is best done online and learning is best done in the classroom'.

This book and global warming

Global paper consumption is fast approaching an unsustainable million of tons per day.[6] Virtually every phase of the production of *Entrepreneurship: Theory, Process, Practice*, 2nd Asia–Pacific edition contributed to global warming, from harvesting trees to production of pulp and paper, transportation, waste management, and eventual disposal. The pulp, paper and publishing industries and readers themselves have significant impacts on people and communities all around the world. The authors are committed to preventing negative impacts of book publishing on natural forests, the global climate or the rights of forest-dependent communities. We are certainly not alone: one study shows more than 80 per cent of consumers are willing to pay more for books and magazines printed on recycled paper.[7]

Publishers increasingly realise that day-to-day operations inevitably have an impact on the environment and they are committing to minimising the potentially harmful effects of such activities. Such a sustainability policy for a book publisher would cover procurement, energy, water, waste management, and a plan for continuous improvement.

Solving these problems requires our readers to share this responsibility. The most effective way to reduce the negative impacts of this book is to use the knowledge in it very efficiently. In our teaching we are committed to a '3e' learning environment that supports (e)learning, (e)nvironmentally friendly strategies, and (e)xperiential assignments. Students in our classes submit their assignments online and they are graded via email using specialised marking software. Our students are familiarised in submitting assignments online, online filing systems, reuse of paper, electronic note taking, adjusting printing grayscale, recycling classroom waste material, use of electronic databases, and use of the library to avoid needless paper consumption. They are also offered the opportunity to consider planting trees to help offset their own book-reading footprint.

ENDNOTES

1 Robert Kiyosaki & Sharon L. Lechter, *Rich Dad Poor Dad – What the Rich Teach Their Kids About Money – That the Poor and Middle Class Do Not!*, Warner Business Books, 2000.

2 See for example Ronald K. Mitchell and Susan A. Chesteen, 'Enhancing entrepreneurial expertise: Experiential pedagogy and the new venture expert script', *Simulation & Gaming*, 26(3), September 1995: 288; Ronald K. Mitchell, Lowell Busenitz, Theresa Lant, Patricia P. Mcdougall, Eric A. Morse and Brock J. Smith, 'Toward a Theory of Entrepreneurial Cognition: Rethinking the People Side of Entrepreneurship Research', *Entrepreneurship: Theory & Practice*, 27(2), Winter 2002: 93; Ronald K. Mitchell, 'Oral history and expert scripts: demystifying the entrepreneurial experience', *International Journal of Entrepreneurial Behaviour & Research*, 3(2), 1997: 122–39; Douglas Hershey, Thomas Wilson and Jennifer Mitchell-Copeland, 'Conceptions of the psychological research process: Script variation as a function of training and experience', *Current Psychology*, 14(4), December 1996: 293–312.

3 Making money from lemons, www.microsoft.com/education/makingmoney.mspx#EIF. Another excellent source for kids is Arthur Bochner, *The New Totally Awesome Business Book for Kids*, Newmarket: 2007.

4 Mandarin edition by China Renmin University Press in December 2009. 霍华德•H•弗雷德里克 (Howard H. Frederick), Translator: 蒋春燕 (Jiang Chunyan), Title name: 创业学（亚太版）, Pub year: 2009 Place: 北京.

5 American Historical Association, 'Statement on standards of professional conduct', Approved by Professional Division, 9 December 2004 and adopted by Council, 6 January 2005 www.historians.org/PUBS/free/professionalstandards.cfm?pv=y.

6 The Environmental Paper Network, The State of the Paper Industry: Monitoring the Indicators of Environmental Performance, Environmental Paper Network, 2007: 65, www.greenpressinitiative.org/documents/StateOfPaperInd.pdf. See also Green Press Initiative, *Indonesia Under Pressure: Understanding the Social and Environmental Impacts of Printing in Asia*, Green Press Initiative; 'Reducing Climate Impacts: A Guide for the Book and Newspaper Industries', www.greenpressinitiative.org/documents/climateguide.pdf. See also the following websites: www.pulpmillwatch.org, www.greenpressinitiative.org, www.sustainprint.com.

7 Noelle Skodzinski, 'Consumers Will Spend More for Publications Using Recycled Paper', *Book Business*, February 2006: 20, www.greenpressinitiative.org/documents/ReaderSurveyResults.pdf.

RESOURCES GUIDE

FOR THE STUDENT

AS YOU READ THIS TEXT YOU WILL FIND A WEALTH OF FEATURES IN EVERY CHAPTER TO ENHANCE YOUR STUDY OF ENTREPRENEURSHIP AND HELP YOU UNDERSTAND ITS APPLICATIONS.

Chapter objectives are listed at the start of each chapter giving you a clear sense of what the chapter will cover.

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

When **key terms** are used in the text for the first time, they are bolded for easy identification and listed at the end of each chapter. This will help you identify key concepts throughout the text.

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

Glossary
A full list of key terms is also available in the glossary, which can be found at the back of the book.

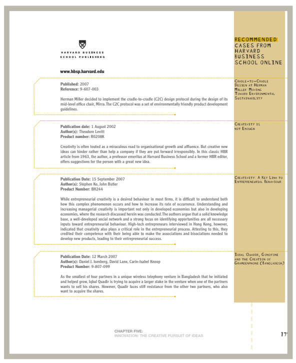
AT THE END OF EACH CHAPTER YOU'LL FIND SEVERAL TOOLS TO HELP YOU TO REVIEW THE CHAPTER AND KEY LEARNING CONCEPTS, BUT ALSO TO HELP EXTEND YOUR LEARNING.

The end of chapter **Summary** lists key points from the chapter, giving you a snapshot of the important concepts covered.

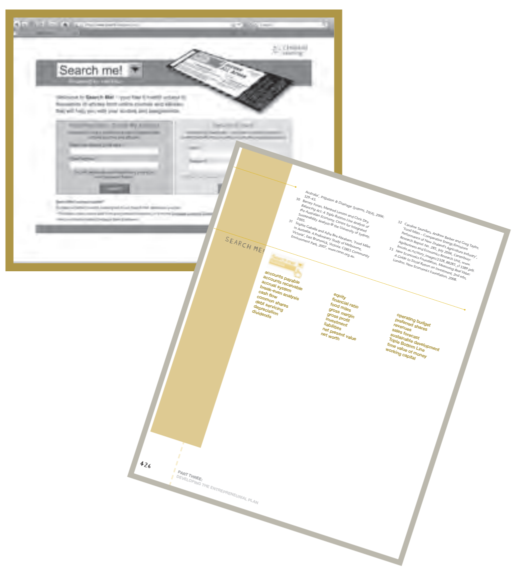
Experiential exercises emphasise learning by doing, giving you the opportunity to put your new skills into practice.

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

Case studies provide real-world examples to aid your understanding of entrepreneurship. They conclude with questions to test your knowledge and understanding of the material covered in the chapter.



A selection of **Harvard Business School case references** are listed at the end of each chapter to extend your reading and to help you pull together concepts from multiple chapters.



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ABOUT THE AUTHORS

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Professor Frederick learned business skills from his forestry family in the Pacific Northwest of the US. His grandfather ran a lumber mill and his father was a commercial lumberman. His mother was the ultimate creative industries entrepreneur, even running her own modelling agency. Frederick's PhD work focused on economic development in developing economies. His two Fulbrights (Mexico and Austria) were focused on civil society institutions such as libraries and the human rights movement. Before the fall of the Berlin Wall, Frederick was a research scholar in the German Democratic Republic where he studied business under communism. During the First Gulf War, he left academia for a time to direct PeaceNet, a partner network with EcoNet at the Institute for Global Communications (IGC) networks in San Francisco, where he was first sensitised to sustainability issues. He helped organise the first NGO Internet laboratory at the Earth Summit in 1992. In 1993 he was asked by Free State of Saxony (Germany) to take over a major commercial venture in eastern Germany. When that commercial venture failed during the dotcom bust, he looked for a green, entrepreneurial country to realise some more of his dreams, which he found in New Zealand. Today he helps his wife run a successful chocolate manufacturing company. For further information please visit Howard's teaching website www.learnpreneurship.com.

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IN REMEMBRANCE

DR RICHARD M. HODGETTS (1942–2001) On 17 November 2001, Dr Richard M. Hodgetts passed away after a three-and-a-half-year battle with bone marrow cancer. The field of management lost one of its most significant contributors.

Dr Hodgetts was a prolific author and a major contributor to the early editions of the original text. He authored or co-authored more than 45 college texts in numerous languages and published more than 125 articles in some of the world's most highly regarded research journals. He was also the founding editor of the *Journal of Leadership Studies* and served on a number of editorial boards.

Dr Hodgetts was an active Academy of Management member throughout his career: he served as program chair in 1991, chair of the Management History Division, editor of the New Time special issue of *Academy of Management Executive*, and on the Board of Governors from 1993 to 1996. For all of his dedicated service, he was inducted into the Academy Fellows. In 1999, Dr Hodgetts received the prestigious Distinguished Educator Award from the Academy of Management.

Besides his tremendous contributions to the knowledge base of management, Dr Hodgetts was a truly outstanding teacher. He won every Distinguished Teaching Award offered at both his first job of 10 years at the University of Nebraska and his home school for 25 years at Florida International University, including Faculty Member of the Year by the executive MBA students in the year of his passing. He literally developed thousands of students at all levels – undergraduate, MBA, executive development, and doctoraland – and millions across the world were influenced by his texts and innovative distance education materials and courses. Simply put, he was the ultimate educator.

Dr Hodgett's distinguished career as a scholar and educator was exemplified in his humour, his dedication to research, his genuine interest in his students, his compassion, and his true courage. Millions of students and practising leaders have been and will continue to be influenced by his teaching and publications. His legacy will live forever!

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It is often said that writing a book is like a long-term relationship with an obsessive partner. In your hands is the result of a five-year project. Throughout this time, my life went on: foreign residencies, student advisement, committees and conferences, even gardening and cooking. Throughout it all the book demanded constant attention. So in the first instance I need to thank the people that made it possible to focus on the book to the (near) exclusion of everything else. My wife, Dr Hanna Frederick, always gave me space even when she commanded me to cook her dinner. She has been a loving and supportive partner throughout this whole ordeal. Professor Pieter Nel helped move mountains so that I could concentrate on the task at hand. Professor Gael McDonald encouraged me constantly and gave me the opportunity to concentrate on the book.

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PART ONE: THE ENVIRONMENT FOR ENTREPRENEURSHIP IN THE ASIA-PACIFIC

CHAPTER

1

ENTREPRENEURSHIP: EVOLUTION AND REVOLUTION

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

Peter F. Drucker[1]

chapter objectives

- **01** To begin our exploration of entrepreneurship and the environment
- **02** To distinguish between business and social entrepreneurs
- **03** To distinguish between entrepreneurs and small-business owners
- **04** To explain the importance of entrepreneurs for economic growth
- **05** To examine the historical development of entrepreneurs and of entrepreneurship
- **06** To define and explore the major schools of entrepreneurial thought
- **07** To explain the process approaches to the study of entrepreneurship
- **08** To explore and debunk the myths of entrepreneurship
- **09** To highlight some of the latest trends in entrepreneurial research
- **10** To underscore the trends that are occurring in entrepreneurship education
- **11** To set forth a comprehensive definition of entrepreneurship.

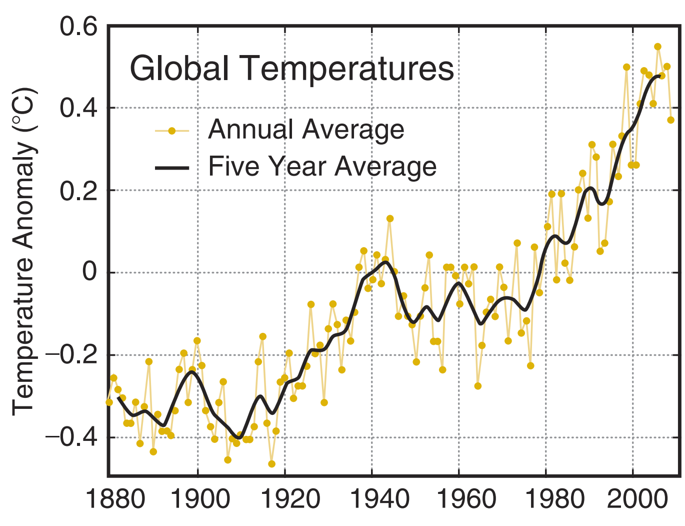
ENTREPRENEURS CHALLENGING THE UNKNOWN Human-induced climate change is one of the greatest challenges facing the human race in the 21st century.[2] Since the **Industrial Revolution** in the late 18th and early 19th centuries, many business entrepreneurs around the world have exploited the environment with impunity, without any thought of **sustainability**. Entrepreneurs were the first to see the possibility that coal and gas could fuel their dreams and innovations. Before they got started, the global average temperature was about 14 degrees Celsius and the Earth's atmosphere contained about 280 parts per million of carbon dioxide.

Once our entrepreneurial forefathers began to burn coal and gas to power their lives and realise their ambitions, the carbon dioxide in the atmosphere started to increase. By the time scientists started measuring it in the 1950s, it had already risen to 315 parts per million. Now it's at 380 and increasing two points per year. By adding enormous quantities of CO_2 and other **greenhouse gases** to the atmosphere over the last 150 years, humans have changed the world's climate and entrepreneurs must share the blame.

A few degrees of temperature increase may not sound much, but the extra heat that CO_2 in the atmosphere traps is enough to warm the planet considerably. That little bit per year has started melting almost every frozen part on Earth. It has already changed sea levels and seasons and been linked to more ferocious cyclones and unimaginable bushfires. Even modest temperature rises will affect hundreds of millions of people, particularly in the developing world.

It is no exaggeration to say that an entrepreneur (Henry Ford) played a major role in contributing to our current dilemma and an entrepreneur (perhaps one who commercialises hydrogen cars) can help ease the problem. So far only some European countries and Japan have begun to trim **carbon emissions**. US carbon emissions are extremely high while China and India are suddenly producing huge quantities of CO_2. China now contributes around 17 per cent of global CO_2 emissions, the US contributes around 16 per cent and the 27 states of the European

FIGURE 1.1: GLOBAL TEMPERATURES SINCE 1880



Source: http://en.wikipedia.org/wiki/File:Instrumental_Temperature_Record.png

Union contribute a further 12 per cent. Despite contributing only 1.1 per cent to global CO_2 emissions, Australia is the second highest per capita emitter.[3]

And it's not just large companies that are to blame. Small-scale entrepreneurs have made their contribution to the planetary crisis by helping to destroy areas of rainforest. This alone is a significant contributor to climate change since tropical forests sequester (take out and store) carbon from the atmosphere. In an attempt to better themselves by increasing their standards of living, entrepreneurial families as well as large companies have cleared vast stretches of rainforest, releasing megatons of CO_2 and it will take decades to restore these 'lungs of the Earth'.

Quantifying the human cost of all this damage is complex. Low-lying island nations are already vulnerable, as is a huge swathe of Bangladesh where millions live. Drought is becoming more prevalent, especially in Australia, thus complicating efforts to ensure clean water and agricultural irrigation. Warmer temperatures are increasing the occurrence of malaria.

There would seem to be only two solutions to our dilemma – mitigation or adaptation. **Mitigation** means managing the risks of climate change by reducing greenhouse gas emissions and there are considerable market opportunities in so doing. The other alternative is **adaptation** to climate change, which means adapting to changes in temperature, sea level, storm patterns and so forth. There are also considerable competitive and commercial advantages in this solution. Either way, entrepreneurs stand to gain.

How can we stop this environmental catastrophe? It's not rocket science. In fact, most of the technologies we need already exist, developed by entrepreneurs and inventors in the last quarter century. We need rapid, sustained, and dramatic cuts in CO_2 emissions in advanced countries, coupled with large-scale transfer of **clean energy technology** to China, India and the rest of the developing world. What we need is a commitment to take what we already know how to do and somehow spread it to every corner of every economy in the world.[4] Business as usual is dead and green growth is the answer to both our climate and economic problems. Again, who is best positioned to commercialise existing innovations and create new technologies? It's the entrepreneurs!

Why? Because entrepreneurs don't waste a good crisis. Capitalism is in crisis and natural resources are declining, yet we have an opportunity to rebuild the world in a way that carries on adding value and making wealth, but that actually has social and environmental solutions at its heart. It is entrepreneurs who recognise opportunities where others see chaos or confusion. They are the aggressive catalysts for change within the marketplace. They are the Olympic athletes challenging themselves to break new barriers, the long-distance runners dealing with the agony of the last few kilometres, the symphony orchestra conductors transforming different skills and sounds into a cohesive whole and top-gun pilots continually pushing the envelope of speed and daring.[5]

In the new world of climate change, they could well be the saviours of our planet. Entrepreneurs are the heroes of today's marketplace. They start companies and create jobs at a breathtaking pace. Entrepreneurship is a wellspring of economic growth, social renewal and personal development and history has repeatedly demonstrated that new entrepreneurial ventures are the way to bolster a flagging economy. Economic and planetary problems can only increase entrepreneurs' willingness to stop working for someone else and do something good for themselves and others by starting their own business.

Economies around the world have been repeatedly revitalised because of the efforts of entrepreneurs as it's the passion and drive of entrepreneurs that move the world of business forward. They challenge the unknown and continuously create the future. It is their savings, investment and innovation that lead to development. They are the ones who can alleviate poverty by contributing to **economic growth** and **job creation**. Terri Irwin, who wrote the book's Foreword, is evidence of that.

Long after we have forgotten about the economic crisis, we shall be living with the consequences of global warming. We need to innovate our way out of this crisis. Climate change is the great challenge of our time and the stakes could not be higher for entrepreneurs. There are huge rewards for those that embrace innovation to lead the transition to a low-carbon emission economy. Entrepreneurs must unleash a wave of creativity not seen since the Industrial Revolution. They must be at the forefront of the fight against climate change. 'We have to start thinking out of the box', says Rajendra Pachauri, Nobel Prize winner and chair of the Intergovernmental Panel on Climate Change. 'Entrepreneurs who respond to the challenge will reap commercial success – while businesses which fail to do so face oblivion.'[6]

Especially poor countries must harness entrepreneurship to the cause of broader prosperity, poverty reduction and the realisation of the **Millennium Development Goals (MDG)**. The MDGs are eight international development goals to which 192 United Nations member states have agreed to achieve by the year 2015. They include halving the proportion of people whose income is less than one dollar a day and reversing the loss of environmental resources. This means investing in entrepreneurs who can target the key causes of poverty, strengthen women's economic capacity, make it easier for young people to start enterprises and promote environmental entrepreneurship. The challenge is best explained by Ross Garnaut, Professor of Economics at the Australian National University and author of the *Garnaut Report on Climate Change* commissioned by the Australian government. He has challenged entrepreneurs to come up with solutions now: 'While an effective response to the challenge would play out over the many decades, it must take shape and be in place over the next few years. Without early and strong action, some time before 2020 we will realise we have indelibly surrendered to forces that have moved beyond our control.'[7]

CLIMATE INNOVATION ENTREPRENEURS

>>ENTREPRENEURIAL EDGE

It is blisteringly hot and the sunlight is bouncing off the sparkling blue water as Faroukh Mia picks up his mobile. He needs to know the latest prices for his main product line.

Faroukh is not, as you might imagine, a businessman sitting by a pool in Dubai. He is floating in a tiny fishing boat in the Bay of Bengal and he wants to know where to land his catch to secure the best price of the day.

Like millions of his countrymen in low-lying Bangladesh, Faroukh and his family are acutely at risk from rising sea levels. As such, they are often portrayed by the media as the helpless victims of impending climate disaster. But that misses half the story. They are also entrepreneurs, exploiting new technology sold to them by one of Bangladesh's most dynamic businesses.

Faroukh lives miles from the nearest mains power. His mobile, like the lights in his home and in his wife's sewing workshop, are charged by solar electricity, courtesy of a small photovoltaic (PV) panel attached to the roof of his house. It was sold to him by Grameen Shakti ('village energy'), an offshoot of the hugely successful Grameen Bank.

Thanks to a simple micro-credit system, even poor families like Faroukh's can afford the panels. Savings on the smoky, unreliable kerosene lanterns easily cover the monthly repayments. The solar lamps mean Faroukh's family can work into the evenings, more than doubling their income, while the phone plugs them into the wider economy in a way that would have been unimaginable ten years ago.

Many such 'climate entrepreneurs' are responding creatively to rising energy prices and the need to cut carbon emissions. Their ventures range from meeting the needs of the world's poorest to finding sustainable ways of indulging more luxurious appetites.

Source: Martin Wright, 'Climate Innovation Examples', *Financial Times*, 11 November 2008

BUSINESS AND SOCIAL ENTREPRENEURS ARE DIFFERENT

There are many kinds of entrepreneurs. The word 'preneur' is very flexible in the English language. A senior-preneur is someone who starts a business after the age of 55. A co-preneur is someone who works with the entrepreneur, such as the spouse, an accountant or a supplier. Biopreneurs work in biotechnology, biology and the environment. There are (believe it or not!) academic entrepreneurs such as your author. There are cross-cultural entrepreneurs, media-preneurs, end-poverty entrepreneurs, transparency-and-fairness entrepreneurs, social entrepreneurs, social-privatisation entrepreneurs, world-citizen entrepreneurs, intrapreneurs, knowledge-collaboration entrepreneurs, economics-of-abundance entrepreneurs and biodiversity entrepreneurs.[8] But for the present let's get three terms straight: business entrepreneur, social entrepreneur and small-business owner.

- **Business entrepreneurs** are driven by the profit motive. They seek growth and profits within the business world. They are constant innovators and always are trying to capture larger market shares in the competitive marketplace. They are pioneering individualists who create one venture after another and one innovation after another.
- **Social entrepreneurs** have many of the same personality characteristics as business entrepreneurs, but they are driven by a mission and seek to find innovative ways to solve problems that are not being or cannot be addressed by either the market or the public sector.[9]

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

The terms *entrepreneur* and *small-business* sometimes are used interchangeably, but they shouldn't be. Although some situations encompass both terms, it is important to note the differences.

- **Small-business owners** may once have captured an opportunity, but often then rest on their laurels. They may never grow large and they may prefer a more stable and less aggressive approach to running these businesses. They often like stable sales, profits and growth.

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

In this book, we concentrate on business *and* social entrepreneurs. Much of the content relates to the broadest range of sectors, from profit to non-profit and from government institutions to large businesses. But as far as small business is concerned, many of the particular points in this book may apply to both small-business owners and entrepreneurs. However, keep in mind that our focus is on the aspects of innovation and growth associated with business and social entrepreneurs, not with small-business managers.

ENTREPRENEURS HAVE A SPECIAL ENTERPRISING MIND-SET

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

The crew of the *Starship Enterprise* in the famous TV show *Star Trek* definitely had entrepreneurial qualities as the mission of the *Starship Enterprise* was 'to boldly go where no [one] has gone before'. Today, we still use the word **enterprise** (or enterprising) as an 'attitude to life, an attitude of exploring, of developing, of leading and of taking initiatives'. Enterprise – as in an *enterprising* individual – is the process of identifying, developing and bringing a vision to life, be it an innovative idea or simply a better way of doing something. Enterprise applies not only to business ventures, but also to political and social decisions.[10]

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

ENTREPRENEURSHIP IN THE ASIA–PACIFIC We do not focus on North Americans or Europeans, as most books do. Our perspective is an **Asia–Pacific** one. The region is hugely diverse – with the economic dynamism of Hong Kong, Taiwan and Singapore; the advanced technology in Japan and Korea; the natural resources of Australia; the human resources of China and Indonesia; and the agricultural productivity of New Zealand and the Philippines.

We use Asia–Pacific as a political and economic term to designate the economies on the edges of the greater Pacific Ocean. Specifically, in this book we include the following countries of the Asia–Pacific region: China, Japan, Australia, New Zealand, the Asian NICs (newly industrialised countries) of Singapore, South Korea, Taiwan and Hong Kong and the ASEAN (Association of Southeast Asian Nations) countries of Brunei, Indonesia, Malaysia, Philippines and Thailand as well as the island nations of Polynesia and Melanesia. We also include the South Asian sub-continent including India, Pakistan and Bangladesh. However, when we say an 'Asia–Pacific perspective on entrepreneurship', we mean a view of **free economies** in this region.

THE EVOLUTION OF THE 'UNDERTAKING' The word **entrepreneur** is derived from the French **entreprendre**, meaning 'to undertake'. We use the French word in English because unfortunately '**undertaker**' is already used by another profession (namely a mortician or funeral director)! Seriously though, in English and in most Romance languages the entrepreneur is someone who *undertakes* to organise, manage and assume the risks of a business. The definition is broadened so that today an entrepreneur is considered to be an innovator or developer who recognises and seizes opportunities; converts those opportunities into workable/marketable ideas; adds value through time, effort, money, or skills; assumes the risks of the competitive marketplace to implement these ideas; and realises the rewards from these efforts.[11]

Not all languages follow this 'undertaker model'. In Malay, *usahawan* means someone who does a commercial activity at some financial risk. In the Thai language, the word for entrepreneur is *pupagongan*, which means literally 'someone who assembles other people together'. In Indonesian, *wiraswasta* has the signification of 'courageous private sector'. In the Garinagala language of Australian Aborigines, they use *egargal* or 'story-teller' to mean entrepreneurs. The Māori language of the Polynesians of New Zealand has two words for entrepreneurship. *Ngira tuitui* means the 'needle that binds things together'. The other word that

Māori use for entrepreneurship is *tinihanga a Māui*, or the 'tricks of Māui'. Māui in Polynesian mythology is a demigod and cultural hero famous for his exploits and trickery. Māori admire his entrepreneurial spirit, heroism, altruism and brashness. Take the following story, for example:

> Every day Māui's brothers went fishing, but they always refused to take Māui with them because they were afraid of his magical tricks. One day, however, Māui hid in their canoe and revealed himself when they were far out to sea. Māui drew out his fishhook made from the magical jawbone of his grandmother, baited it with some blood from his nose, and then lowered it deep down in the ocean . . . Māui pulled the 'great fish' into the boat . . . and it miraculously turned itself into land that became the islands of New Zealand.[12]

However you say it, the entrepreneur is the aggressive catalyst for change in the world of business. They are independent thinkers who dare to be different in a background of common events. Research reveals that many entrepreneurs have certain characteristics in common, including the ability to consolidate resources, management skills, a desire for autonomy and risk taking. Other characteristics include brashness, competitiveness, goal-oriented behaviour, confidence, opportunistic behaviour, intuitiveness, pragmatism, the ability to learn from mistakes and the ability to employ human relations skills.[13]

Although no single definition of entrepreneur exists and no one profile can represent today's entrepreneur, research is providing an increasingly sharper focus on the subject. A brief review of the history of entrepreneurship illustrates this.

ENTREPRENEURSHIP THROUGH THE AGES

Throughout history there have been enterprising individuals who spotted and exploited smart opportunities. But as humans developed a sense of individualism, these 'dreamers who do', as innovation expert Gifford Pinchot famously called them, have often faced daunting, even life-threatening, challenges to realise their dreams.

In today's lingo we probably would say that a primitive hunter–gatherer with a new weapon was seeking *niche advantage in the wild marketplace*. As hunting technology developed some people started to accumulate a surplus and then turned from their struggle for mere survival to use their accumulated wealth and knowledge to start settled communities. Some clever ones must also have decided to lend their capital and knowledge to others for personal gain or the benefit of the clan, but in a collective society it was better to hide such individual gain.

Data from anthropology tell us that entrepreneurial wealth creation has existed for millennia. Excavated business tablets show that innovation and entrepreneurship were key aspects in civilisations that have long disappeared.[14] Ancient Assyrians carried out innovation transfer, had a corps of knowledge workers and developed business communication.[15] The Assyrians inherited a system of private enterprise from Sumer and Babylon. Wingham believes that entrepreneurship as we know it today developed in the 11th century BCE in ancient Phoenicia.[16] A sailing nation of merchants and traders, the Phoenicians peacefully connected a commercial empire that ranged from Syria in the east to Spain and even Ireland in the west. Phoenician traders were true entrepreneurs who took risks, explored the unknown and faced chaos on a daily basis. Certainly they returned profit to investors, merchants and themselves. This peaceful trading nation was swept aside for 2000 years by the bellicose and avaricious Persian Empire and with it the concept of the risk-taking 'undertaker'.

In Biblical times an enterprising individual with high ability and independence faced prejudices that societies had against **usury** (charging a fee for the use of money), which in the

Bible was viewed as a great crime. Ezekiel 18:13 says: 'He lends at usury and takes excessive interest. Will such a man live? He will not! Because he has done all these detestable things, he will surely be put to death and his blood will be on his own head'. Imagine looking for niche advantage in those times.

The Romans did permit usury, but, curiously, not by Romans themselves. Any business enterprise by a nobleman actually led to loss of prestige. Wealth accumulation was highly valued *as long as it did not involve a nobleman's participation in industry or commerce*.[17] In Rome there was no absence of wealth creation, only of commerce. Landholding and usury were the usual routes to wealth creation. 'Money poured in from booty, indemnities, provincial taxes, loans and miscellaneous extractions.'[18] Fortunately for some this aversion to commerce among the nobility left the way open for entrepreneurial freedmen, former slaves who were set up by their masters to run the businesses. Slavery may have been one of the few avenues to commercial advancement for people of the lower classes.

In ancient Rome, innovation and profit were completely disconnected. Certainly Romans made considerable advances in technology, but this was divorced from commerce. Pliny writes that one day an inventor came before Emperor Tiberius to show him his invention of an unbreakable glass window and to beseech him for an inventor's fee. Tiberius asked whether anyone else knew yet of the formula. The man assured him that the invention was absolutely secret, whereupon the emperor immediately cut his head off 'lest gold be reduced to the value of mud'. The sad lesson of this story is that the inventor had to turn to the emperor for a reward rather than to a venture capitalist for investment – nor could he protect his intellectual property![19]

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

In contrast, Islam promoted business entrepreneurship. It may have prohibited pork, alcohol, gambling, prostitution and usury, yet other than these activities Muslims were free to invest their money in any economic activity and produce, to trade and consume in whatever way they wished. Trade and commerce have always been a part of Islam. From pre-Islamic days the Holy City of Mecca has been the centre of commercial activities. There is no basic conflict between good business practice and profit making in Islam. One scholar of entrepreneurship from Turkey writes that in the spring of 595 CE businesswoman Lady Khadija had a dream telling her to hire Mohammed as her trade agent because of his honesty and stamina on the long camel routes. Indeed, writes Adas, had the Prophet Mohammed lived today 'on his business card it would have been written "exporter and importer"'.[20]

Meanwhile in Europe of the Middle Ages it was just the reverse. Great wealth and power came not from business acumen, but from military conquest. Innovations such as armour, the crossbow and gunpowder were needed for military campaigns, not retail shops. In King Arthur's Court boys learned warfare as the accepted means for accumulating wealth. Indeed, Mark Twain's *A Connecticut Yankee in King Arthur's Court* skewers the Roundtable when a Yankee entrepreneur is magically transported back to the past and sets up an enterprise academy.

But as Europe moved from a feudal economy to nascent capitalism, conditions finally began to change. Merchant entrepreneurs exploited technological advances in shipbuilding and built global trading networks and they used advanced weaponry to protect them. Forms of usury appeared, such as loans to rulers, leased monopolies, buying on credit, fixed exchange rates and so forth. Merchant entrepreneurs became major players in European politics and the owners of shipping fleets and banks produced descendants who, like the Medici, could become secular rulers or even popes.[21] By the late Middle Ages, the revival of towns saw tax-free zones and emancipated serfs leading to the growth of an entrepreneurial spirit.

Until the Industrial Revolution of the late 18th and early 19th centuries, in Europe at least an entrepreneur's life could lead to decapitation, death on the battlefield or appropriation by the emperor. Hardly a conducive environment!

As perilous as the profession may have been, the entrepreneurial spirit has driven many of humanity's achievements. Indeed, some say not much has really changed. Multinational corporations existed in Assyria. Ancient Greeks had brand-name competitions. Business travel was not unknown to Marco Polo. There were industry clusters in Phoenicia. Creative and innovative forms of free enterprise endured sometimes for centuries.[22]

Humanity's progress from caves to campuses has been explained in numerous ways, but central to virtually all of these explanations has been the role of the *agent of change*, the force that initiates and implements material progress. Today we recognise that the agent of change in human history has been and most likely will continue to be the entrepreneur.[23] **Rugged individualists**, those who cherish individual liberty and self-reliance, frequently found themselves opposed to authority and to controls over the individual. At the core of it was the mantra that entrepreneurs 'mind their own business' (as in take charge of or look after themselves).

Entrepreneurs today may well be the proto-typical **sovereign individuals**. In *The Sovereign Individual*, Davidson and Rees-Mogg see history as roughly 500-year cycles – from Athens's glory and decline (500 BCE), to the dawn of Christianity and the fall of Rome (500 CE), to feudalism's emergence (1000 CE) and its collapse around 1500. Each cycle sees the rigid grip of the governmental system ultimately breaking down and the (temporary) liberation of individuals from undesirable controls. The authors say that in the modern age citizens no longer need be beholden to a nation–state. Tomorrow's entrepreneurs will reside on the Internet and select where to reside and do business based on cost versus profit. They will comparison-shop for services (utilities, police protection, even currency) in a marketplace no longer dominated by state monopolies.[24]

EARLY DEFINITIONS OF ENTREPRENEURSHIP

The recognition of entrepreneurs as a class dates back to 18th-century France when economist Richard Cantillon associated entrepreneurs with 'risk-bearing' activity in the economy.[25] In England during the same period, the Industrial Revolution was growing and the entrepreneur played a visible role in risk taking and the transformation of resources.[26]

Economists have long claimed the word as their own. In fact, until the 1950s the majority of definitions and references to entrepreneurship had come from economists. For example, Cantillon (1725), renowned French economist Jean Baptiste Say (1803), and 20th-century economic genius Joseph Schumpeter (1934) all wrote about entrepreneurship and its impact on economic development.[27] Over the decades writers have continued to try to describe or define what entrepreneurship is all about. Here are some examples:

> Entrepreneurship . . . consists in doing things that are not generally done in the ordinary course of business routine; it is essentially a phenomenon that comes under the wider aspect of leadership.[28]

> Entrepreneurship, at least in all non-authoritarian societies, constitutes a bridge between society as a whole, especially the non-economic aspects of that society, and the profit-oriented institutions established to take advantage of its economic endowments and to satisfy, as best they can, its economic desires.[29]

> In . . . entrepreneurship, there is agreement that we are talking about a kind of behavior that includes: (1) initiative taking, (2) the organizing or reorganizing of social economic mechanisms to turn resources and situations to practical account, and (3) the acceptance of risk of failure.[30]

Significant writers have long argued and those disagreements often centre on whether or not an entrepreneur creates equilibrium or disequilibrium, must be risk-bearing, capital-owning, exceptional, a leader or just a combiner of factors and innovative or more alert than the general population.[31] After reviewing the evolution of entrepreneurship and examining its varying definitions, Ronstadt put together a summary description:

> Entrepreneurship is the dynamic process of creating incremental wealth. This wealth is created by individuals who assume the major risks in terms of equity, time, and/or career commitment of providing value for some product or service. The product or service itself may or may not be new or unique but value must somehow be infused by the entrepreneur by securing and allocating the necessary skills and resources.[32]

In the 20th century, the word has become closely linked with **free enterprise** and **capitalism**. Also, it was generally recognised that entrepreneurs serve as agents of change; provide creative, innovative ideas for business enterprises; and help businesses grow and become profitable.

Whatever the specific activity they engage in, entrepreneurs in the 21st century are considered the heroes of free enterprise. Many of them have used innovation and creativity to build multimillion-dollar enterprises from fledgling businesses – some in less than a decade. These individuals have created new products and services and have assumed the risks associated with these ventures. Many people now regard entrepreneurship as *pioneership* on the frontier of business.

In recognising the importance of the evolution of entrepreneurship into the 21st century we have developed an integrated definition that acknowledges the critical factors needed for this phenomenon:

> Entrepreneurship is a dynamic process of vision, change, and creation. It requires an application of energy and passion towards the creation and implementation of new ideas and creative solutions. Essential ingredients include the willingness to take calculated risks in terms of time, equity, or career; the ability to formulate an effective venture team; the creative skill to marshal needed resources; the fundamental skill of building a solid business plan; and, finally, the vision to recognise opportunity where others see chaos, contradiction, and confusion.

APPROACHES TO ENTREPRENEURSHIP

To understand the nature of entrepreneurship and better recognise its emerging importance it is important to consider some of its theory development. The research on entrepreneurship has grown dramatically over the years. As the field has developed, research methodology has progressed from empirical surveys of entrepreneurs to more contextual and process-oriented research. Theory development is what drives a field of study. Entrepreneurship theory has been developing for the last 35 years and it is apparent that the field is growing. We need to understand some of that development to better appreciate the discipline of entrepreneurship. The study of the basic theories in the field also helps to form a foundation upon which a student can build an understanding of the process and practice of entrepreneurship.

A *theory of entrepreneurship* is defined as a verifiable and logically coherent formulation of relationships or underlying principles that explain entrepreneurship. These principles predict entrepreneurial activity (for example, by characterising conditions that are likely to lead to new profit or social opportunities and the formation of new enterprises), or provide normative guidance (that is, prescribe the right action in particular circumstances).[33] As we are now in the new millennium it has become increasingly apparent that we need to have some cohesive theories or classifications to better understand this emerging field.

In the study of contemporary entrepreneurship, one concept recurs: Entrepreneurship is interdisciplinary. As such, it contains various approaches that can increase one's understanding of the field.[34] Thus we need to recognise the diversity of theories as an emergence of entrepreneurial understanding. One way to examine these theories is with a *schools of thought* approach that divides entrepreneurship into specific activities. These activities may be within a macro view or a micro view, yet all address the conceptual nature of entrepreneurship.

The schools of entrepreneurial thought

A **school of thought** is a body of belief, literature or theory that is accepted as authoritative by some group of scholars or writers. In this section we will highlight the ideas emanating from the macro (meaning 'wide-scale' perspective) and micro (meaning 'small-scale') views of entrepreneurial thought. We will further break down these two major views into seven distinct schools of thought (see Figure 1.2). Although this presentation does not purport to be all-inclusive, neither does it claim to limit the schools to these seven, for a movement may develop for unification or expansion. Whatever the future holds, however, it is important to become familiar with these conceptual ideas on entrepreneurship to avoid the semantic warfare that has plagued general management thought for so many years.[35]

The macro view

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

FIGURE 1.2: ENTREPRENEURIAL SCHOOLS OF THOUGHT

- The **social and cultural school of thought**: This school of thought deals with external factors and surrounding conditions and influences that affect a potential entrepreneur's lifestyle. These can be either positive or negative forces in the moulding of entrepreneurial desires. The focus is on institutions, values and mores that, grouped together, form a socio–political environmental framework that strongly influences the development of entrepreneurs.[36] For example, if a middle manager experiences the freedom and support to develop ideas, initiate contracts, or create and institute new methods, the work environment will serve to promote that person's desire to pursue an entrepreneurial career. Another environmental factor that often affects the potential development of entrepreneurs is their social group. The atmosphere of friends and relatives can influence the desire to become an entrepreneur.
- The **financial/capital school of thought**: This school of thought is based on the capital-seeking process. The search for seed and growth capital is the entire focus of this entrepreneurial emphasis. Certain literature is devoted specifically to this process, whereas other sources tend to treat it as but one segment of the entrepreneurial process.[37] In any case, the venture capital process is vital to an entrepreneur's development. This school of thought views the entire entrepreneurial venture from a financial management standpoint. Decisions involving finances occur at every major point in the venture process.
- The **displacement school of thought**: This school of thought focuses on group phenomena. It holds that the group affects or eliminates certain factors that project the individual into an entrepreneurial venture. As Ronstadt has noted, individuals will not pursue a venture unless they are prevented or displaced from doing other activities.[38] (See also Chapter 4 on *social marginality*.) Three major types of displacement illustrate this school of thought:
    - *Political displacement*: This is caused by factors ranging from an entire political regime that rejects free enterprise (international environment) to governmental regulations and policies that limit or redirect certain industries.
    - *Cultural displacement*: This deals with social groups precluded from professional fields. Ethnic background, religion, race and sex are examples of factors that figure in the minority experience. Increasingly this experience will turn various individuals from standard business professions and towards entrepreneurial ventures.
    - *Economic displacement*: This is concerned with the economic variations of recession and depression. Job loss, capital shrinkage or simply bad times can create the foundation for entrepreneurial pursuits, just as it can affect venture development and reduction.

    These examples of displacement illustrate the external forces that can influence the development of entrepreneurship. Cultural awareness, knowledge of political and public policy and economic indoctrination will aid and improve entrepreneurial understanding under the displacement school of thought. The broader the educational base in economics and political science, the stronger the entrepreneurial understanding.
- The **ecological school of entrepreneurial thought.** This school of thought comes from the growing perception of the natural world and our relationship to it as entrepreneurs. It is based on the idea that everything is related with everything everywhere. The systems which uphold life on our planet can no longer endure the rhythm of wanton exploitation and consumption that entrepreneurs have subjected them to. This school of thought is based on the fields of *green economics* and *ecological economics*. It is

defined by its focus on intergenerational equity, irreversibility of environmental change, uncertainty of long-term outcomes, and sustainable development. Entrepreneurial entrepreneurship looks at the metabolism of new venture creation; that is, the study of the flows of energy and materials that enter and exit entrepreneurial businesses.

The micro view

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

- The **entrepreneurial trait school of thought**: Many researchers and writers have been interested in identifying traits common to successful entrepreneurs.[39] This approach is grounded in the study of successful people who tend to exhibit similar characteristics that, if copied, would increase success opportunities for the emulators. For example, achievement, creativity, determination and technical knowledge are four factors that *usually* are exhibited by successful entrepreneurs. Family development and educational attainment are also examined. Certain researchers have argued against educational development of entrepreneurs because they believe it inhibits the creative and challenging nature of entrepreneurship.[40] Other authors, however, contend that new programs and new educational developments are increasing because they have been found to aid in entrepreneurial development.[41] The family development idea focuses on nurturing and support that exist within the home atmosphere of an entrepreneurial family. This reasoning promotes the belief that certain traits established and supported early in life will lead eventually to entrepreneurial success.
- The **venture opportunity school of thought**: This school of thought focuses on the opportunity aspect of venture development. The search for idea sources, the development of concepts and the implementation of venture opportunities are the important interest areas for this school. Creativity and market awareness are viewed as essential. Additionally, according to this school of thought, developing the right idea at the right time for the right market niche is the key to entrepreneurial success.

  Another development from this school of thought is the previously described *corridor principle*. New pathways or opportunities will arise that lead entrepreneurs in different directions. The ability to recognise these opportunities when they arise and to implement the necessary steps for action is a key factor. The maxim that *preparation meeting opportunity equals luck* underlies this corridor principle. Proponents of this school of thought believe that proper preparation in the interdisciplinary business segments will enhance the ability to recognise venture opportunities.
- The **strategic formulation school of thought**: George Steiner has stated that 'strategic planning is inextricably interwoven into the entire fabric of management; it is not something separate and distinct from the process of management'.[42] The strategic formulation approach to entrepreneurial theory emphasises the planning process in successful venture development.[43]

  One way to view strategic formulation is as a leveraging of unique elements.[44] Unique markets, unique people, unique products, or unique resources are identified, used, or constructed into effective venture formations. The interdisciplinary aspects of strategic adaptation become apparent in the characteristic elements listed here with their corresponding strategies:

– *Unique markets:* Mountain versus **mountain gap strategies**, which refers to identifying major market segments as well as interstice (in-between) markets that arise from larger markets.
– *Unique people:* **Great chef strategies**, which refers to the skills or special talents of one or more individuals around whom the venture is built.
– *Unique products:* **Better widget strategies**, which refers to innovations that encompass new or existing markets.
– *Unique resources:* **Water well strategies**, which refers to the ability to gather or harness special resources (land, labour, capital, raw materials) over the long term.

Without question, the strategic formulation school encompasses a breadth of managerial capability that requires an interdisciplinary approach.[45]

OUR ENTREPRENEURIAL ECONOMY

Entrepreneurship is the symbol of business tenacity and **achievement**. Entrepreneurs are the pioneers of today's business successes. Their sense of opportunity, their drive to innovate and their capacity for accomplishment have become the standard by which free enterprise is now measured. This standard is taking hold within free and open economies throughout the world.

In the new millennium the entrepreneurial spirit is more alive than ever before. Today's current younger generation has sometimes been referred to as **Generation X** because they feel 'X-ed' out of traditional opportunities. Yet throughout the world, young entrepreneurs have become known as **Generation E** for entrepreneurship. And not just in Europe and North America. The poor, whether in Thailand or Australia, can and do get richer through enterprise. With their peers around the world, these young people are now part of one of the most entrepreneurial generations since the Industrial Revolution.[46]

Entrepreneurs will continue to be critical contributors to economic growth through their leadership, management, innovation, research and development effectiveness, job creation, competitiveness, productivity and formation of new industry. Entrepreneurship is the answer to the current financial crisis.

To understand the nature of entrepreneurship, it is important to understand the two perspectives in which entrepreneurial firms operate. The first perspective is statistical, providing actual aggregate numbers to emphasise the importance of small firms in our economy. The second perspective examines some of the trends in entrepreneurial research and education so as to reflect the emerging importance of entrepreneurship in academic developments.

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

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

As we can see, entrepreneurship is not just a developed-world phenomenon. The poor in the developing countries can and do get richer through enterprise. Former UN Secretary

General Kofi Annan has said 'entrepreneurs have the power to create the greatest change for their own countries'.[47]

Predominance of new ventures in the economy

The last 15 years have witnessed the powerful emergence of entrepreneurial activity throughout the world and increasingly new and small firms rather than large ones are the major providers of job-creation engines.

Millions upon millions of people are engaged in entrepreneurial endeavours around the globe. In 2009 the Global Entrepreneurship Monitor, the premier benchmarking project, estimated that around the world about one in 11 adults is either starting a new business or managing a young business of which they are the owner. In poorer countries about 40 per cent of young people aged 18–34 are starting a business (compared to 15 per cent in richer countries).

Our region has some of the highest and lowest rates of **start-up** activity in the world. Compare the sluggish 2.2 per cent rate of Japan to the red-hot start-up rate of 39.2 per cent in the Philippines or 28.4 per cent in Thailand. New Zealand for years has had the highest rate of early-stage entrepreneurship in the so-called 'developed' world. China and Australia consistently have distinguished themselves in their entrepreneurial capacity (see Table 1.1).

TABLE 1.1: ENTREPRENEURSHIP MEASURES, 2008

COUNTRY	START-UP RATE	COUNTRY	START-UP RATE
Philippines	39.2	Malaysia	11.1
Thailand	28.4	Hong Kong	10.0
China	24.6	Korea	10.0
Indonesia	19.3	United States	9.6
New Zealand	17.5	Singapore	4.9
Australia	13.4	Japan	2.2
India	11.8		

TABLE 1.2: HIGH-GROWTH ENTREPRENEURS IN THE ASIA–PACIFIC, 2008

COUNTRY	% OF ALL ENTREPRENEURS
Hong Kong	21.4%
Singapore	20.4%
China	18.7%
United States	14.5%
Japan	11.4%
New Zealand	10.2%
Australia	8.0%
Thailand	4.4%
India	3.0%

Source: Global Entrepreneurship Monitor, 2008

All of above available on the Global Entrepreneurship Monitor site at www.gemconsortium.org. For India, Japan, US and Korea, *Global Entrepreneurship Monitor 2008: National & Regional Summaries* , Boston: Babson College, 2009. For Hong Kong and Thailand, *Global Entrepreneurship Monitor 2007: National & Regional Summaries*, Boston: Babson College, 2009. For Singapore, Poh-Kam Wong, Lena Lee, Yuen-Ping Ho, *Global Entrepreneurship Monitor: 2006 Singapore Report*, National University of Singapore, 2007. For Philippines, Imelda J. Madarang, Cielito F. Habito and the Philippine Center for Entrepreneurship, *Global Entrepreneurship Monitor: Philippine Report 2006-2007*, Philippine Center for Entrepreneurship, 2007. For New Zealand, material with permission from Howard H. Frederick, *Global Entrepreneurship Monitor Aotearoa New Zealand 2005*, Auckland: New Zealand Centre for Innovation & Entrepreneurship, 2006. For Australia, Hindle, Kevin, Hancock, Gary and Klyver, Kim, 'Entrepreneurial capacity in Australia in 2006: A Summary of Salient Data from the 2006 GEM Australia National Adult Population Survey', *Australian Graduate School of Entrepreneurship Research Report Series*, 4(6), Melbourne: Swinburne University of Technology, ISSN 1448-7128, 2007

High growth versus lifestyle

Studies show that relatively few early-stage entrepreneurial firms contribute a disproportionate share of all new jobs created by new firms.[48] The truth is that most entrepreneurs are lifestylers and expect either no or only limited medium-term growth potential as measured by job-creation expectations. Only 8 per cent of all start-up attempts expected to create 20 or more jobs, while only 3 per cent of all start-up attempts expected 50 or more jobs. As a proportion of all entrepreneurs, they are most prevalent in Hong Kong and Singapore, followed by China. India and Thailand have the lowest proportion of entrepreneurs who expect to grow their venture (see Table 1.2).

Though they may be the backbone of an economy, most entrepreneurs only want to achieve modest goals. They fund their lifestyles and families, but do not actively contribute to the growth of the dynamic economy. Many may never achieve anything new nor create any wealth; they merely optimise supply and demand in established markets and add nothing of value. The ability to identify a good potential opportunity does not automatically guarantee a successful business, let alone a value-creating business. They are more interested in the 'three Bs' (boat, beach house and BMW).

THE TROUBLE WITH LIFESTYLE ENTREPRENEURS

>>ENTREPRENEURIAL EDGE

Anyone who wants to schedule a meeting with the founders of Burke Publishing had better be flexible. The textbook publishing company is run by Rory and Sandra Burke, a husband-and-wife team who operate the business from a 35-foot sailboat, the *Pacific Voyager,* in the coastal waters off New Zealand. Their floating headquarters has on occasion anchored miles beyond cellphone or email range. It's a fabulous lifestyle, but one that severely limits their company's growth potential.

To really ramp up sales, Rory says, they'd need to dry-dock the boat, move to a land-based office and start hiring employees. And to the Burkes, that sounds like a lousy trade-off. 'We're lifestyle entrepreneurs', Rory says. 'We try to strike the balance between income, possessions, the time we work, and where we work'. If that means Burke Publishing remains the same size, that's okay with them . . .

When New Zealanders do talk about celebrating business success, they often use a phrase drawn from agriculture: 'tall poppy syndrome'. When farmers raise poppies, they routinely lop off the tops of any that are growing too fast, in an attempt to maintain uniformity. In New Zealand, the thinking goes, those who appear too successful feel pressure to cloak their wealth. 'If people make it, they don't let anyone know they've made it', says Jana Matthews, a Colorado-based entrepreneurial leadership expert who puts together workshops that teach growth strategies to New Zealand businesses.

Americans' willingness to fail is another quality that the growth-minded New Zealanders admire from afar. While a stint at a failed start-up can be a badge of honour on an American résumé, New Zealanders remain fearful of the stigma of having a business falter. This attitude partly explains the country's lack of serial entrepreneurs. Having risked everything and succeeded once, why take that risk again?

One final difference between American entrepreneurs and New Zealanders is that Americans have a passion to keep expanding their businesses, no matter how large they get. Successful New Zealanders prefer to stand pat. 'We despise the growth mania that we hear Americans talk about, the compulsion to get more customers', says Howard Frederick, who tracks the country's small businesses at Unitec New Zealand, another Auckland university. 'Here it's '"More customers? That's a bother"'.

Bottom line: New Zealand company builders like the Burkes have trouble getting off their boat to rev up sales and American entrepreneurs have trouble getting out of the office and onto a boat in the first place. It seems each culture could take some lessons from the other.

Source: Extract from 'Entrepreneurial edge: The trouble with life style entrepreneurs', July 2005, from *Inc: The magazine for growing companies* by Daniel McGinn. Copyright 2005 by Mansueto Ventures LLC. Reproduced with permission of Mansueto Ventures LLC.

Entrepreneurship and national culture

As we begin our examination of entrepreneurship in Asia–Pacific, let's keep three principles in mind:

- a certain portion of the adult population can be classified as entrepreneurs
- we can measure that proportion
- a country, a culture or even an ethnic group can be rated higher or lower in entrepreneurial activity than another.

Cultural and social norms can encourage or discourage entrepreneurs. The literature of the impact of both **national culture** and ethnicity on entrepreneurship and economic development has long focused on characteristics that might promote or inhibit entrepreneurship. Many of these works have focused on the supposed unique 'ideal type' of entrepreneurship from the perspectives of sociology, economics, political science, management and journalism.[49] For example, Lam and Paltiel argue that Confucianism is correlated with economic development and entrepreneurship in Taiwan and Japan.[50] Other literature describes cultural characteristics that explain why Singapore might lack a spirit of entrepreneurship.[51] One interesting study focuses on why Māori New Zealanders are more entrepreneurial than European New Zealanders.[52]

One dominant school of thought examines the relationship of culture and personality traits.[53] For example, Cowling found that gender and education variables varied in the strength of explaining entrepreneurship across countries.[54] Frederick believes that New Zealand entrepreneurs are lifestylers and do not feel an urgency to succeed; nor are they ego-driven.[55]

Well known is Hofstede's argument that cultural dimensions such as **power distance**, **uncertainty avoidance**, **individualism/collectivism** and masculinity/femininity affect national wealth and economic growth.[56] Morris and Davis showed that entrepreneurship declines the more collectivism is emphasised.[57] Trompenaars showed how different cultures respond to different management approaches and how organisations have different meanings to different cultures.[58] Many authors reinforce the view that characteristics such as these comprise the salient dimensions of culture insofar as entrepreneurship is concerned.[59] In this tradition, Lee and Peterson, drawing as well upon Lumpkin and Dees,[60] propose that *a society's propensity to generate autonomous, risk-taking, innovative, competitively aggressive and proactive entrepreneurs and firms depends on its cultural characteristics*.[61] Countries with these specific cultural tendencies will engender a strong *entrepreneurial orientation*, hence higher total entrepreneurial activity. Lee and Peterson posit that:

> [Entrepreneurial] cultures are less tolerant of power distance, willing to accept living with uncertainty, are more individualistic, masculine, achievement oriented, and universalistic. In contrast, societies that express concern about class structure, commitment to the hierarchy, job security, consensus decision making, and entitlement thinking will likely readily accept power distance, have a strong uncertainly avoidance, be more collective, feminine, ascription oriented, and particularistic.

Lee and Peterson put these into six cultural dimensions:

- uncertainty avoidance – degree to which a culture or ethnic group accepts uncertainty or is willing to take risks
- power distance – degree to which a culture or ethnic group tolerates hierarchical or unequal relationships
- **materialism** – degree of stress placed on materialism and wealth rather than on harmony and relationships

- **individualism** – degree of emphasis placed on individual accomplishment rather than collectivism or group accomplishment
- achievement – how power and status are achieved, either earned through competition and hard work or ascribed by birthright, age or gender
- behaviour regulation – degree to which a culture or ethnic group applies norms universally to all or whether certain individuals enjoy special rights or privileges because of their status.[62]

Specifically, 'ideal type' entrepreneurs would: generally accept uncertainty and risk, not tolerate unequal relationships, stress materialism and wealth, emphasise individual accomplishment, believe that power and status are earned through competition and hard work and believe that a code of laws exists equally for all.

But as we look around the world, entrepreneurial cultures sometimes do not fit this ideal type. One obvious example is called 'collective entrepreneurship'. There is a body of literature[63] that identifies *individual entrepreneurship* as only one culturally determined variant. As Morris et al. state: 'The role of individuals versus groups or collectives in facilitating entrepreneurship in organisations may . . . be culture-bound'.[64]

Entrepreneurship need not be carried out by 'rugged pioneer' self-maximising ideal-type entrepreneurs; it can often be carried out collectively. Entrepreneurial collectives are communities that share the risks and rewards associated with the discovery and exploitation of new businesses. Schumpeter himself recognised the rise of collective entrepreneurship: [. . .the] entrepreneurial function need not to be embodied in [. . .] a single physical person. Every social environment has its own ways of filling the entrepreneurial function [. . .it] may be and often is filled co-operatively'.[65] One oft-cited advocate of collective entrepreneurship, former US Secretary of Labour Robert Reich, said: 'We must begin to celebrate collective entrepreneurship, endeavours in which the whole of the effort is greater than the sum of individual contributions. We need to honour our teams more, our aggressive leaders and maverick geniuses less'.[66]

In an individualistic environment, people are motivated by self-interest and achievement of personal goals. They are hesitant to contribute to collective action unless their own efforts are recognised, preferring instead to benefit from the efforts of others. Collectivists believe that they are an indispensable part of the group and will readily contribute without concern for advantage being taken of them, or for whether others are doing their part. They feel personally responsible for the group product and are oriented towards sharing group rewards. This may especially be true of Asian entrepreneurs. Contrary to the 'ideal-type' conceptualisation of the entrepreneur as a self-made person whose entrepreneurial behaviour is supported by specific religious and cultural values, entrepreneurs in Asia are often culturally more inclined to operate along collective forms of business. Cooperation rather than competition is one of the key factors that explain Asian entrepreneurship. Rutten examines this phenomenon in small-scale rural industrialists in India, Chinese and Malay owners of combine harvesters and workshops for agricultural machinery in Malaysia and Muslim owners of small and medium-scale iron foundries in Indonesia.[67]

The age of the gazelles

New and smaller firms create the most jobs. The vast majority of these job-creating companies are fast-growing businesses. David Birch of Cognetics, Inc., has named these firms **gazelles**. A gazelle, by Birch's definition, is a business establishment with at least 20 per cent sales growth every year (for five years), starting with a base of at least $100 000. Despite the continual downsizing in major corporations during the 1990s the gazelles produced millions of jobs. Their extraordinary performance and contribution warrants recognition.[68] Gazelles are leaders in innovation. New and smaller firms are responsible for a high proportion of the innovations right throughout the economy. However, there are number of myths about the gazelles:

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

How can you tell a gazelle when you see one?

- **Growth rate**. They will definitely come from companies that have a growth rate higher than 25 per cent yearly. As they say, a rising tide floats all boats and there will many, many companies in the category.
- **Scalability**. If a company can scale, it means it can produce its products for ever-increasing margins (that is, the 1000th widget costs less to make than the 10th).
- **Competitive advantage**. The company will have ‘unfair’ competitive advantage and will own its own proprietary intellectual property (that is, patents). It will be able to stop other entrants from feasting on the buffet. Gazelles will be able easily to differentiate their offerings to their competitors.
- **Look for the 10x rule**. The gazelle has to offer a solution that is 10x faster, 10x better, 10x more secure, 10x cheaper, etc.[69]

Trends in entrepreneurship research

As we continue our study of entrepreneurship, it is important to note the research and educational developments that have occurred over the past few years. The major themes that characterise recent research about entrepreneurs and new-venture creation can be summarised as follows:

- Social entrepreneurship has emerged with unprecedented strength among the new generation of entrepreneurs.[70]
- Entrepreneurial cognition (examining the great variety among types of entrepreneurs and the methods they have used to achieve success) is a wave of research on the psychological aspects of the entrepreneurial process.[71]
- Women and minority entrepreneurs have emerged in unprecedented numbers. They appear to face obstacles and difficulties different from those that other entrepreneurs face.[72]

- The global entrepreneurial movement is increasing, judging by the enormous growth of interest in entrepreneurship around the world in the past few years.[73]
- Family businesses have become a stronger focus of research. The economic and social contributions of entrepreneurs with family businesses have been shown to make immensely disproportionate contributions to job creation, innovation and economic renewal.[74]
- Venture financing, including both venture capital and angel-capital financing as well as other innovative financing techniques, emerged in the 1990s with unprecedented strength, fuelling entrepreneurship in the 21st century.[75]
- **Intrapreneurship** (entrepreneurial actions within large organisations) and the need for entrepreneurial cultures have gained much attention during the past few years.[76]
- The boundaries of entrepreneurship as a field are permeable and cross-disciplinary, but there is a growing culture and knowledge base within the field.[77]
- Entrepreneurs are masters at 'know-who', meaning access to networks and processing information. In chaotic markets, entrepreneurs somehow become alert and develop knowledge by making information investments that others do not.[78]
- The risks and trade-offs of an entrepreneurial career – particularly its demanding and stressful nature – have been a subject of keen research interest relevant to would-be and practising entrepreneurs alike.[79]
- The entrepreneurial spirit is universal among the free economies, judging by the enormous growth of interest in entrepreneurship around the world in the past few years.[80]
- Nonetheless, since entrepreneurship is an 'emerging' field, it has a reputation for 'accumulative fragmentalism'.[81]

Trends in entrepreneurship education

Entrepreneurship education is one of the fastest growing disciplines in the world today. The growth and development in curricula and programs devoted to raising the level of enterprise and new venture creation has been remarkable. American research shows that students – be they in art or architecture, sport or health – who have had just one course in entrepreneurship or personal enterprise are more likely to be self-employed, to start successful businesses and to launch social enterprises.[82] Evidence suggests that many of the best ideas in business plan competitions come from non-business majors. Many of the strongest contributors are non-business students and some of the most innovative entrepreneurial initiatives do not involve business schools.[83]

The trend towards **proprietorship** and **self-employment** is impressive. While we do not have comparable figures for the Asia–Pacific countries, in the US accurate figures of self-employment among the various job categories have been kept.[84] Table 1.3 shows the percentage of self-employment of many favoured new-millennium professions.

Graduates from the performing arts are remarkably high in self-employment rates. From farmers and animal trainers to coaches and fashion designers, many of today's professions are highly self-employed.

The field of entrepreneurship education has accelerated in the last two decades.[85] The trend towards university-wide entrepreneurship education is strong and gaining momentum.[86] Kuratko believes that entrepreneurship is the future of business schools and that entrepreneurship faculty are beginning to move into leadership roles.[87] There's an interesting dialectic in the business education field between control and creativity/compliance and innovation, which are conflicting approaches that might be classified as divergent thought-systems.[88] There is an

TABLE 1.3: PROFESSIONS, PERCENTAGE OF SELF-EMPLOYED OVER 20 PER CENT

Farmers	80%	Management analysts	30%
Artists	62%	Actors, producers and directors	28%
Real estate brokers	61%	Veterinarians	28%
Animal trainers	57%	Lawyers	27%
Construction managers	57%	Interior designers	26%
Photographers	51%	Fashion designers	25%
Property and real estate	51%	Graphic artists	25%
Musicians and singers	48%	Optometrists	25%
Food service managers	45%	Podiatrists	24%
Sales worker supervisors	37%	Small engine mechanics	23%
Psychologists	34%	Interpreters and translators	22%
Dentists	33%	Architects/landscape architects	20%
Designers	33%	Athletes, coaches, umpires	20%
Writers and authors	33%	Funeral directors	20%
Carpenters	32%	Television and video camera operators and editors	20%
Appraisers and assessors	30%		

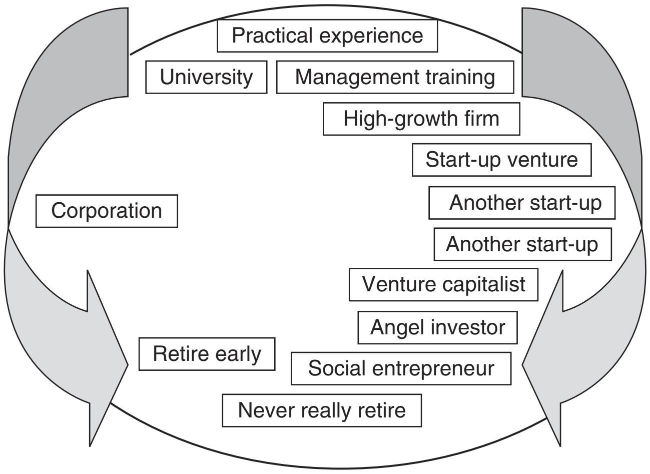
ideological chasm between the compliance-oriented management disciplines, such as finance and accounting, and the entrepreneurship teachers, who value creativity and innovation. Most students in a business school environment are interested only in compliance; they want to be told how to be good managers and what canon they must follow. A smaller proportion are interested in innovation, breaking out of existing norms and creating something of lasting value.

In fact, Australian entrepreneurship professor Kevin Hindle believes that entrepreneurship education is located in the wrong building! It is fundamentally at odds with the orientation of the typical university-based business school, both in terms of the way material is taught and in the way that it is evaluated.[89] The new field would need to extend beyond the boundaries of schools of management or engineering, perhaps even beyond universities.[90] Legendary entrepreneurship educator David Birch believes that 'business schools teach you exactly the opposite of entrepreneurship . . . Basically, business schools teach you to work for somebody'.[91] Hindle even questions whether entrepreneurship should be taught in the business school. He says that entrepreneurship belongs 'wherever you want to put it so long as the key condition of imaginative transcendence of the immediately vocational is met. You teach it wherever the right mind-set prevails'.

Has entrepreneurship education truly arrived? We can measure this by looking at the usual milestones of a discipline. According to Kuratko, entrepreneurship education is one of the fastest-growing academic disciplines of all time.[92] It is now estimated that the number of schools teaching a new venture creation or similar course has grown from about 20 only two decades ago to more than 2000 in the US alone.[93]

The academic literature in the fields of enterprise and entrepreneurship is vast and deep with at least 45 dedicated refereed academic journals. There are now respected conferences on how to teach entrepreneurship. In 1970 there was one textbook, now there are dozens. However, you are holding in your hands the first entrepreneurship textbook of a new type. The others have yet to come to grips with climate change and the environment, let alone the role of entrepreneurs in the global economic crisis. The entrepreneurship education movement is growing so fast that it is now expanding outside the business school. Hundreds of campuses are launching new kinds

FIGURE 1.3: THE CIRCLE OF LIFE: WHICH WAY FOR YOU?



of 'e-ships': engineering entrepreneurship, nursing entrepreneurship, music entrepreneurship, nutrition entrepreneurship, even statistics entrepreneurship.

KEY CONCEPTS

Before concluding our discussion of the nature of entrepreneurship, we need to put into perspective two key concepts: entrepreneurship and the entrepreneur.

Entrepreneurship

Entrepreneurship is a dynamic process of vision, change and creation that requires an application of energy and passion towards the creation and implementation of new ideas and creative solutions. This process of innovation and new-venture creation is accomplished through four major dimensions – individual, organisational, social and cultural, and process – and is aided by collaborative networks in government, education and institutions. All of the macro and micro positions of entrepreneurial thought must be considered while recognising and seizing opportunities that can be converted into marketable ideas capable of competing for implementation in today's economy.[94]

Entrepreneur

As we demonstrated earlier in the chapter, the entrepreneur is an innovator or developer who recognises and seizes opportunities; converts those opportunities into workable/marketable ideas; adds value through time, effort, money, or skills; and assumes the risks of the competitive marketplace to implement these ideas. The entrepreneur, a catalyst for economic change, uses purposeful searching, careful planning and sound judgement when carrying out the entrepreneurial process. The entrepreneur – uniquely optimistic and committed – works creatively to establish new resources or endow old ones with a new capacity, all for the purpose of creating wealth.

SUMMARY

This chapter examined the evolution of entrepreneurship, providing a foundation for further study of this dynamic and developing discipline. By exploring the early economic definitions as well as select contemporary ones, the chapter presented a historical picture of how entrepreneurship has been viewed. Contemporary research is broadening the horizon for studying entrepreneurship and is providing a better focus on the what, how and why behind this discipline.

The approaches to entrepreneurship were examined from two different perspectives: schools of thought and process. Six selected schools of thought were presented.

This chapter then attempted to provide a broad perspective on the entrepreneurial revolution that is occurring throughout the US and the world. The chapter discussed important statistics that support our entrepreneurial economy. A description of gazelles (business establishments with at least 20 per cent sales growth every year, starting from a base of $100 000) and their impact on the economy was presented.

The chapter concluded with definitions of two key concepts: entrepreneurship and the entrepreneur.

KEY TERMS & CONCEPTS

achievement
adaptation to climate change
Asia–Pacific
better widget strategies
business entrepreneurs
capitalism
carbon emissions
clean energy technology
collectivism
corridor principle
displacement school of thought
ecological school of entrepreneurial thought
economic growth
enterprise
entreprendre
entrepreneur
entrepreneurial assessment approach
entrepreneurial management
entrepreneurial trait school of thought
entrepreneurship
entrepreneurship education
external locus of control
financial capital school of thought
free economies
free enterprise
Generation E
Generation X
great chef strategies
greenhouse gases
individualism
Industrial Revolution
integrative approach
internal locus of control
job creation
macro view of entrepreneurship
materialism
micro view of entrepreneurship
mitigation
mountain gap strategies
national culture
power distance
proprietorship
rugged individualists
school of thought
self-employment
small-business owners
social and cultural school of thought
social entrepreneurs
sole proprietor of the rest of their life
sovereign individuals
start-up
strategic formulation school of thought
sustainability
uncertainty avoidance
undertaker
usury
venture opportunity school of thought

REVIEW & DISCUSSION QUESTIONS

1. What is the potential role for entrepreneurs in the era of climate change?
2. What is the difference between social entrepreneurs and business entrepreneurs?
3. What is the difference between entrepreneurs and small-business managers?
4. Is there a distinction between ‘enterprising’ and ‘entrepreneurial’ in your language? If so, what is it?
5. What are the areas of the Asia–Pacific that we cover in this book?
6. Briefly describe what is meant by the term ‘entrepreneurship’.
7. Why do we use the French word instead of an English equivalent?
8. When was the word ‘entrepreneur’ first used in economic literature?
9. Describe the predominance of new ventures in the economy.
10. Identify some of the innovative products and investment opportunities for the new millennium.
11. What is the difference between entrepreneurship and enterprise?

12 How were entrepreneurs historically viewed? What challenges did they face throughout history?
13 Which countries are highest and which are lowest in Asia–Pacific in terms of their start-up rates?
14 What indispensable contributions do entrepreneurs make to the economy?
15 What are the six cultural dimensions that we use to describe national culture and entrepreneurship?
16 What are some of the latest trends in entrepreneurship research?
17 What are some of the latest trends in entrepreneurship education?
18 What are the professions that have the highest proportion of self-employed people?

EXPERIENTIAL EXERCISE: UNDERSTANDING YOUR BELIEFS ABOUT SUCCESSFUL ENTREPRENEURS

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

1 Successful entrepreneurs are often methodical and analytical individuals who carefully plan out what they are going to do and then do it.
2 The most successful entrepreneurs are born with special characteristics such as high achievement drive and a winning personality and these traits serve them well in their entrepreneurial endeavours.
3 Many of the characteristics needed for successful entrepreneurship can be learned through study and experience.
4 The most successful entrepreneurs are those who invent a unique product or service.
5 Highly successful entrepreneurs tend to have very little formal schooling.
6 Most successful entrepreneurs admit that dropping out of school was the best thing they ever did.
7 Because they are unique and individualistic in their approach to business, most successful entrepreneurs find it hard to socialise with others; they just do not fit in.
8 Research shows that although it is important to have adequate financing before beginning an entrepreneurial venture, it is often more important to have managerial competence and proper planning.
9 Successful entrepreneurship is more a matter of preparation and desire than luck.
10 Most successful entrepreneurs do well in their first venture, which encourages them to continue; failures tend to come later on as the enterprise grows.

Put your answers on Table 1.5 in this way:

- enter answers to numbers 1, 3, 8 and 9 just as they appear
- then subtract the answers to 2, 4, 5, 6, 7 and 10 from 11 before entering them here.

Thus, if you gave an answer of 8 to number 1, put an 8 before number 1 here. However, if you gave an answer of 7 to number 2 here, place a 4 before number 2 here. Then add both columns of answers and enter your total in the space provided.

TABLE 1.5: SCORING BLOCK

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

INTERPRETATION

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

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

EXPERIENTIAL EXERCISE: ARE YOU A HIGH ACHIEVER?

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

1 An instructor in one of your classes has asked you to vote on three grading options. Which of these options would you choose?
   a Study the course material, take the exams and receive the grade I earn
   b Roll a dice and get an A if I roll an odd number and a D if I roll an even number
   c Show up for all class lectures, turn in a short term paper and get a C.
2 How would you describe yourself as a risk taker?
   a High
   b Moderate
   c Low.
3 You have just been asked by your boss to take on a new project in addition to the many tasks you are already doing. What would you tell your boss?
   a Since I'm already snowed under, I can't handle any more.
   b Sure, I'm happy to help out; give it to me.
   c Let me look over my current workload and get back to you tomorrow about whether I can take on any more work.
4 Which one of these people would you most like to be?
   a Steve Jobs, founder of Apple Computers
   b Donald Trump of 'Apprentice' TV show fame
   c Rupert Murdoch, CEO of News Corporation.
5 Which one of these games would you most like to play?
   a Monopoly
   b Bingo
   c Roulette.
6 You have decided to become more physically active. Which one of these approaches has the greatest attraction for you?
   a Join a neighbourhood sports team
   b Work out on my own
   c Join a local health club.
7 With which one of these groups would you most enjoy playing poker?
   a Friends
   b High-stake players
   c Individuals who can challenge me.

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8 Which one of these persons would you most like to be?

a A detective solving a crime

b A politician giving a victory statement

c A millionaire sailing on their yacht.

9 Which one of these activities would you prefer to do on an evening off?

a Visit a friend

b Work on a hobby

c Watch television.

10 Which one of these occupations has the greatest career appeal for you?

a Computer salesperson

b Corporate accountant

c Criminal lawyer.

SCORING

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

SCORING KEY

	a	b	c
1	10	0	2
2	2	10	2
3	6	2	10
4	7	10	5
5	10	0	0
6	2	10	6
7	4	2	10
8	10	7	4
9	4	10	4
10	10	5	10
Totals			

ADD THE FOUR TOTALS TOGETHER TO GET THE GRAND TOTAL ____________

HIGH ACHIEVERS	76–100
MODERATE ACHIEVERS	50–75
LOW ACHIVERS	LESS THAN 50

INTERPRETATION OF EACH QUESTION

1 High achievers take personal responsibility for their actions. They do not like to rely on luck. The third option (c) assumes the class time saved by not having to study for exams will be used to study for other classes; otherwise the answer would be a zero.

2 High achievers are moderate risk takers in important situations.

3 High achievers like to study a situation before committing themselves to a course of action.

4 Jobs is a high-achieving individual but is more interested in design and engineering than in goal accomplishment. Trump is an extremely high-achieving salesperson/executive. Murdoch is more driven by the need for power than the need to achieve.

5 Monopoly allows the high achiever to use their skills. Bingo and roulette depend on luck.

6 The high achiever would work out on their own. The second-best choice is to join a health club, which allows less individual freedom but gives the chance to get feedback and guidance from individuals who understand how to work out effectively.

7 High achievers like challenges but not high risks. If you are a very good poker player and you chose (b), you then can raise your score on this question from 2 to 10.

8 Because high achievers like to accomplish goals, the detective would have the greatest appeal for them. The politician is more interested in power and the millionaire is simply enjoying life.

9 High achievers like to do constructive things that help them improve themselves, so working on a hobby would be their first choice.

10 The computer salesperson and the criminal lawyer have a much higher need to achieve than does the corporate accountant.

CASE 1.1: PAUL CAVE

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

Using creative thought and determination, Paul Cave, founder and chairman of BridgeClimb, has created a $50 million dollar business in just a few years, effectively monopolising an internationally famous Australian icon brand he doesn't own, capitalising on huge advertising he doesn't pay for and sending a personally delivered word-of-mouth recommendation through one million customer heroes to arguably 100 million prospects around the world. And this is just the beginning. Paul Cave made no fewer than 52 presentations in the late 1990s in an attempt to raise $12 million to fund a business that would enable millions of people to climb the Sydney Harbour Bridge. The predominantly merchant banking targets thought it was a fascinating opportunity, but not for their money. In the end, it was another entrepreneur, Brett Blundy, who Cave says 'put money into this within 60 seconds of my telling him about it and became my first major shareholder'. Analytical minds struggle where there is no precedent to rely upon. Clearly Blundy, like Cave, searches for opportunities where there is no precedent.

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

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

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

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

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

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

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

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

The advice that Paul Cave offers budding entrepreneurs is deceptively simple when one considers the depths to which he has gone to implement his formula.

Be clear about what it is and don't stray from that course. Keep driving in pursuit of that goal. He admits that BridgeClimb having the Sydney Harbour Bridge is 'a dream come true' and his international team is working on other icon bridges around the world.

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

Source: John Lyons, 'Marketing without Money', 2003.

QUESTIONS

1 What was the opportunity that Cave saw that allowed him to market someone else's product without any money?

2 Cave gives meaning to the I Ching's hexagram 'in adversity, it furthers one to be persevering'. Give your own interpretations to this. What does Cave mean about enabling the customers to become heroes?

3 What entrepreneurial traits did Cave exhibit in starting this business?

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Will the New Competitive Landscape Cause Your Firm's Decline? It Depends on Your Mind-Set

Publication Date: 15 July 2008
Author(s): Somnath Lahiri, Liliana Perez-Nordtvedt, Robert W. Renn
Product Number: 9-BH2-84

A view of the new competitive landscape shows globalisation, rapid technological change and hyper-competition as conduits leading to either organisational decline or organisational growth. In this article we explain how managers can use four mind-sets to convert potential threats posed by these environmental challenges into pathways of prosperity instead of pathways of decline. A global mind-set, or the ability to view the world using a broad perspective, converts globalisation threats into growth opportunities by thinking beyond geographic boundaries, valuing integration across borders and appreciating regional and cultural diversity. An innovation mind-set, meaning a mental framework that fosters development and implementation of new ideas, transforms rapid technological change threats into opportunities by valuing constant generation of new ideas and business models, realising sources of new ideas and stressing next practices rather than best practices. A virtual mind-set, or the ability of managers to hand over their firms' activities to external providers, turns hyper-competition into prospects for growth by facilitating flexibility and responsiveness. Finally, a collaboration mind-set, meaning a willingness to engage in business partnerships, converts all three challenges into opportunities by allowing firms to form successful partnerships that can lead to synergy by combining business complementarities.

From Regional Star to Global Leader

Publication Date: 1 January 2009
Author(s): Nitin Nohria, Katherine Tsang, Mansour Javidan, James Champy
Product Number: R0901A

Yang Jianguo was recently promoted from country manager for China to global head of product development at a staid French perfume maker. He was chosen for his technical smarts and his knowledge of emerging markets is a critical avenue for growth, given that sales in the company's core markets have stalled. Eager to succeed in his new role in Paris, Jianguo has lots of fresh ideas, but they seem to be falling on deaf ears. Members of the executive team, for their part, find Jianguo to be largely indifferent to their input. Can Jianguo adjust to this new culture? And can he succeed without sacrificing his identity? Three experts comment on this fictional case study in R0901A and R0901Z. Katherine Tsang, the CEO of Standard Chartered Bank in Shanghai, explains the cultural differences between China and France and recommends that Jianguo push his thinking beyond the Chinese market. She also suggests that the company give all its executive team members multicultural training so they have the tools to understand one another and work together effectively. Mansour Javidan, the dean of research and a professor at Thunderbird School of Global Management, acknowledges that Jianguo's transition would be easier if he had the full support of the CEO, Alain Deronde. But since that isn't forthcoming, he advises Jianguo to work with Alain to develop targets for growth in emerging and traditional markets and a plan for building an infrastructure to achieve those goals. James Champy, the chairman of consulting for Perot Systems, is surprised that a family business would choose an 'outsider' for this important post, but he recognises it as a wise strategic move. He says that Jianguo needs a coach and should focus on learning the home market first, before trying to make inroads further afield.

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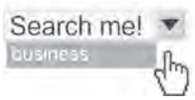


adaptation to climate change
carbon emissions
economic growth
entrepreneurship
free economies
free enterprise
Generation X
greenhouse gases
self-employment
small businesses owners
social entrepreneurs
start-up
sustainability

2 THE ENTREPRENEURIAL MIND-SET

For all we know about balance sheets, income statements, and cash flow accounting; for all of our understanding about marketing strategies, tactics, and techniques; and for everything we have learned about management principles and practices, there remains something essential, yet mysterious, at the core of entrepreneurship. It is so mysterious that we cannot see it or touch it; yet we feel it and know it exists. It cannot be mined, manufactured, or bought; yet it can be discovered. Its source is invisible; yet its results are tangible and measurable. This mysterious core is so powerful that it can make the remarkable appear ordinary, so contagious that it can spread like wildfire from one to another and so persuasive that it can transform doubt and uncertainty into conviction. This mysterious core is PASSION!

Ray Smilor, *Daring Visionaries*

chapter objectives

- **01** To look around the world to see how many entrepreneurs there are
- **02** To identify and discuss the most commonly cited characteristics found in successful entrepreneurs
- **03** To discuss the 'dark side' of entrepreneurship
- **04** To identify and describe the different types of risk entrepreneurs face
- **05** To identify the major causes of stress for these individuals and the ways they can handle stress
- **06** To examine entrepreneurial motivation
- **07** To present the major sources of information useful in profiling the entrepreneurial mind-set.

THE ENTREPRENEURIAL MIND-SET

Why do people become entrepreneurs? There are so many reasons. Most entrepreneurs have a strong desire to be independent, which frequently leads to a decision to leave their present employer. They may see limited opportunities for advancement or they may become bored with the same work every day. Ultimately, they want to be their own bosses, what we call sole proprietors of the rest of their lives. The second most important reason to become an entrepreneur is to make more money. Wealth creation is an essential motivation for many. Entrepreneurs believe it is better to invest in themselves than to park their earnings in a low-interest savings account. Job satisfaction, achievement, opportunity and money are the primary motivations for people to launch their own venture.

Another less opportunistic reason comes out of necessity. The decision to start one's own business comes from some kind of disruption. One person in a two-person family is transferred and the other becomes the 'trailing spouse'. A job is made redundant. Needs are not being met. Around the world, economic dislocation and even civil war contribute to this *creative disruption*.

Another characteristic that we frequently observe is that the entrepreneur is the oldest child in the family or the only child. Perhaps this contributes to self-confidence and self-esteem. One common attribute is that entrepreneurs frequently know another entrepreneur in their family or in their parents' circle of friends.[1] Parental and peer group influences have an impact on one's choice to become self-employed.

Sometimes entrepreneurs emerge from deprived or marginal classes of society. We often see the most entrepreneurial people as women, youth, Indigenous people and immigrants; for example, female Indian immigrants in London, overseas Chinese living in Singapore, gay entrepreneurs in Sydney or San Francisco, Palestinian entrepreneurs in the Gulf, or even enterprising religious minorities such as Sikhs in Australia.

Look around the world. In 2008 the Global Entrepreneurship Monitor surveyed 43 countries with a total population of two billion people. In that slice of the world there were 133 million entrepreneurs, about 10.5 per cent of the world's population (see Table 2.1). On average, the highest rate of entrepreneurship is in the thirties and forties age brackets. Figure 2.1 shows the statistics for the top 10, middle 10 and bottom 10 countries in the Global Entrepreneurship Monitor 2008 survey. The 25–34 year old age group has the highest proportion of entrepreneurs followed by the 35–44 age group. It is interesting to note that in the top (mostly Latin American) countries there are more *senior-preneurs* (aged 55–64) in the population than in the peak youth rates of least entrepreneurial (mostly European) countries. The bottom line is that there are millions upon millions of people around the world starting businesses.

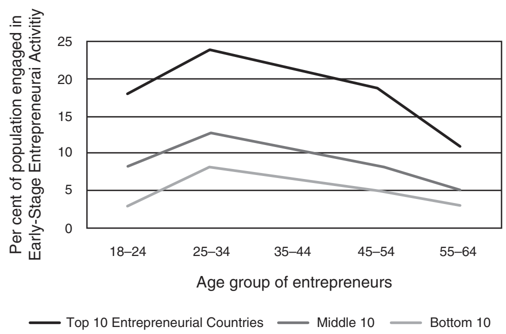
In our region, as many as 45 per cent of all entrepreneurs are 18–34 years old. China and Thailand lead this league, but New Zealand and Australia have about one-third of all entrepreneurs in this age group (see Table 2.2).

TABLE 2.1: ENTREPRENEURS AROUND THE WORLD

	Age	% Entrepreneurs	Total entrepreneurs
Youngsters	18–24	9.0	114 326 064
Young Adults	25–34	14.0	177 364 509
Lower mid-age	35–44	11.7	148 405 531
Upper mid-age	45–54	9.6	121 925 543
Seniors	55–64	5.8	73 631 032
Entire population	18–64	10.5	133 286 350

Source: Global Entrepreneurship Monitor, 2008

FIGURE 2.1: ENTREPRENEURS BY AGE GROUP, 2008



Source: Global Entrepreneurship Monitor, 2008

TABLE 2.2: YOUTH ENTREPRENEURS IN SELECTED COUNTRIES, 2005

COUNTRY	% OF ENTREPRENEURS WHO ARE 18–34
China	45.8
Thailand	44.1
Singapore	40.7
New Zealand	39.0
Australia	35.3
United Kingdom	32.8
United States	31.1

Source: Global Entrepreneurship Monitor, 2005

Every person has the potential and free choice to pursue a career as an entrepreneur. However, exactly what motivates individuals to make a choice for entrepreneurship has not been identified as one single event, characteristic, or trait. As demonstrated in Chapter 1, researchers are continually striving to learn more about the entire entrepreneurial process to better understand the driving forces within entrepreneurs.[2]

This chapter is devoted to a more psychological look at entrepreneurs; it describes the most common characteristics associated with successful entrepreneurs as well as elements associated with the 'dark side' of entrepreneurship. In this manner we can become more acquainted with the complete perspective involved with **entrepreneurial behaviour** that is involved with the **entrepreneurial mind-set** an individual exhibits. Although certainly not an exact science, examining this mind-set provides an interesting look at the entrepreneurial potential within every individual.[3] We believe that every individual can become the sole proprietor of their destiny at some point in their lives.

Who are entrepreneurs?

Frank Carney, the founder of Pizza Hut, Inc., once described entrepreneurs as the cornerstone of the enterprise system, the self-renewing agents for the economic environment. Entrepreneurs – normally defined as *risk takers* in new-venture creations – are optimistic, hard-driving, committed individuals who derive great satisfaction from being independent. Starting a new business requires more than just an idea; it requires a special person who uses sound judgement and planning along with managed risk taking to ensure the success of their own business.

Bolton and Thompson define an entrepreneur as 'a person who habitually creates and innovates to build something of recognised value around perceived opportunities'. A *person* also can be a group of people as it is possible to describe teams and even organisations as entrepreneurial. The word 'person' emphasises that a personality rather than a system is involved. *Habitualness* is an important characteristic of entrepreneurs that distinguishes them from business owner–managers or people who build a business simply to achieve a comfortable lifestyle. True entrepreneurs just cannot stop being entrepreneurs.[4]

Entrepreneurs are driven by an intense commitment and determined perseverance and they work very hard. They are optimists who see the cup as half full rather than half empty. They strive for integrity. They burn with the competitive desire to excel. They use failure as a tool for learning. They have enough confidence in themselves to believe they personally can make a major difference in the final outcome of their ventures.[5]

The substantial failure rate of new ventures attests to the difficulty of entrepreneurship. Inexperience and incompetent management are the main reasons for failure. But what are the factors for success? Do they apply to all components of entrepreneurship? Do they apply differently to social and business entrepreneurs? These are some of the issues we shall explore in this chapter.

Common characteristics associated with entrepreneurs

A review of the literature related to entrepreneurial characteristics reveals the existence of a large number of factors that can be consolidated into a much smaller set of profile dimensions. For example, the following is one list of common characteristics that has been identified:

- total commitment, determination and perseverance
- drive to achieve and grow
- opportunity orientation and goal orientation
- taking initiative and personal responsibility
- persistent problem solving
- realism and a sense of humour
- seeking and using feedback
- internal locus of control
- calculated risk taking and risk seeking
- low need for status and power
- integrity and reliability.

Stevenson and Gumpert have presented an outline of the entrepreneurial organisation that reveals such characteristics as imagination, flexibility and willingness to accept risks.[6] Gartner examined the literature and found a diversity of reported characteristics.[7] Hornaday examined various research sources and formulated a list of 42 characteristics often attributed to entrepreneurs (see Table 2.3).

In the simplest of theoretical forms of studying entrepreneurship, entrepreneurs cause entrepreneurship. That is, the simple formula

$$\textit{Entrepreneurship} = f\,(\textit{entrepreneur})$$

states that entrepreneurship is a function of the entrepreneur. Thus, the continuous examination of entrepreneurial characteristics aids the evolving understanding of entrepreneurship. One author provides the follow description:

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

Everyone has dreams. We all dream while asleep, even if we don't remember dreaming. Entrepreneurs' dreams are different. Their dreams are not limited to dreams about fantasy islands or fast cars. Theirs are about business.[8]

Entrepreneurship also has been characterised as the interaction of the following skills: inner control, planning and goal setting, risk taking, innovation, reality perception, use of feedback, decision making, human relations and independence. In addition, many people believe that successful entrepreneurs are individuals who are not afraid to fail.

Research continues to expand our understanding of **entrepreneurial cognition**.[9] Here we are looking at how entrepreneurs perceive, recognise, conceive, judge, sense, reason, remember and imagine. New characteristics are continually being added to this ever-growing list. At this point, however, let us examine some of the most often cited entrepreneurial characteristics.

TABLE 2.3: CHARACTERISTICS OFTEN ATTRIBUTED TO ENTREPRENEURS

1	Confidence	22	Responsibility
2	Perseverance, determination	23	Foresight
3	Energy, diligence	24	Accuracy, thoroughness
4	Resourcefulness	25	Cooperativeness
5	Ability to take calculated risks	26	Profit orientation
6	Dynamism, leadership	27	Ability to learn from mistakes
7	Optimism	28	Sense of power
8	Need to achieve	29	Pleasant personality
9	Versatility; knowledge of product, market, machinery, technology	30	Egotism
10	Creativity	31	Courage
11	Ability to influence others	32	Imagination
12	Ability to get along well with people	33	Perceptiveness
13	Initiative	34	Toleration for ambiguity
14	Flexibility	35	Aggressiveness
15	Intelligence	36	Capacity for enjoyment
16	Orientation to clear goals	37	Efficacy
17	Positive response to challenges	38	Commitment
18	Independence	39	Ability to trust workers
19	Responsiveness to suggestions and criticism	40	Sensitivity to others
20	Time competence, efficiency	41	Honesty, integrity
21	Ability to make decisions quickly	42	Maturity, balance

Source: John A. Hornaday, 'Research about Living Entrepreneurs', in C. Kent, D.L. Sexton and K.H. Vesper (eds), *Encyclopedia of Entrepreneurship*, Prentice-Hall, Englewood Cliffs, NJ, 1982, 26–7. © Adapted by permission of Prentice Hall, Englewood Cliffs, NJ

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Although this list admittedly is incomplete, it does provide important insights into the entrepreneurial mind-set.

Commitment, determination and perseverance

More than any other factor, total dedication to success and focus on advantage can overcome obstacles and setbacks. Sheer determination – what we call 'bloodymindedness' in Australia – and a stubborn, unwavering commitment to succeed often win out against odds that many people would consider insurmountable. They also can compensate for personal shortcomings. Often entrepreneurs with a high-potential venture and a plan that includes venture capital financing can expect investors to measure their commitment in several ways. Examples include a willingness to mortgage their house, take a cut in pay, sacrifice family time and reduce their standard of living.

Drive to achieve

Entrepreneurs are self-starters who appear to others to be internally driven by a strong desire to compete, to excel against self-imposed standards and to pursue and attain challenging goals. This **drive to achieve** has been well documented in the entrepreneurial literature beginning with David McClelland's pioneering work on motivation in the 1950s and 1960s.[10] McClelland suggested that the key to entrepreneurial behaviour lies in the drive to excel, to achieve a goal in relation to a set of standards. High achievers take calculated risks. They examine a situation, determine how to increase the odds of winning and then push ahead. A high-risk decision for the average businessperson is often perceived as a moderate risk decision for the well-prepared high achiever.

Opportunity orientation

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

Initiative and responsibility

Entrepreneurs are independent and highly self-reliant. Most researchers agree that effective entrepreneurs actively seek and take the initiative. They willingly put themselves in situations where they are personally responsible for the success or failure of the operation. They like to take the initiative in solving a problem or in filling a vacuum where no leadership exists. They also like situations where their personal impact on problems can be measured. This is the action-oriented nature of the entrepreneur expressing itself.

Persistent problem solving

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

Seeking feedback

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

Internal locus of control

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

Tolerance for ambiguity

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

Calculated risk taking

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

Integrity and reliability

Integrity and reliability are the glue and fibre that bind successful personal and business relationships and make them endure. Investors, partners, customers and creditors alike value these attributes highly. Integrity and reliability help build and sustain trust and confidence. Small-business entrepreneurs, in particular, find these two characteristics crucial to success.

Tolerance for failure

Entrepreneurs use failure as a learning experience and generally have a high **tolerance for failure**. The iterative, trial-and-error nature of becoming a successful entrepreneur makes serious setbacks and disappointments an integral part of the learning process. The most effective entrepreneurs are realistic enough to expect such difficulties. Furthermore, they do not become disappointed, discouraged, or depressed by a setback or failure. In adverse and difficult times, they look for opportunity. Many of them believe they learn more from their early failures than from their early successes. Entrepreneurs differentiate between noble failure and stupid failure.[11]

High energy level

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

Creativity and innovativeness

Creativity was once regarded as an exclusively inherited trait. Looking around the world we see that cultures differ very much in terms of creativity and innovation. Some, like Singapore, are known less for their innovation than for their industriousness. Others, like New Zealand, have a very strong streak of innovation running throughout the popular culture. It appears likely that creativity is less a genetic trait than a cultural characteristic – one that can be learned (Chapter 5 provides a comprehensive examination of this critical characteristic). Creativity is a process marked by 'fluency, flexibility and ability to make unusual associations'.[12] New ventures often have a collective creativity that emerges from the joint efforts of the founders and personnel and produces unique goods and services.

Vision

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

Self-confidence and optimism

Although entrepreneurs often face major obstacles, their belief in their ability seldom wavers. During these down periods they maintain their confidence and let those around them know it. This helps the others sustain their own optimism and creates the level of self-confidence necessary for efficient group effort. Many entrepreneurs are egocentric. They want to be recognised.[13]

Independence

The desire for independence is a driving force behind contemporary entrepreneurs. A frustration with rigid bureaucratic systems, coupled with a sincere commitment to make a difference, adds up to an independent personality trying to accomplish tasks their own way. This is not to say entrepreneurs must make *all* the decisions; however, they do want the authority to make the important ones.

Team-building

The desire for recognition and autonomy does not preclude the entrepreneur's desire to build a strong entrepreneurial team. Successful entrepreneurs need to have highly qualified, well-motivated teams that help handle the venture's growth and development. In fact, although the entrepreneur may have the clearest vision of where the firm is (or should be) headed, the personnel are often more qualified to handle day-to-day implementation challenges.[14]

THE ENTREPRENEURIAL JOURNEY

As we discussed in Chapter 1, the prevalent view in the literature is that entrepreneurs create ventures. Although that is a true statement, its narrow framing neglects the complete process of entrepreneurship and much of the reality regarding how ventures and entrepreneurs come into being. Researchers point out that – similar to a painting that emerges based on the individual interacting with, feeling and agonising over his or her creations – a venture is not simply produced by an entrepreneur. Entrepreneurs do not pre-exist; they emerge as a function of the novel, idiosyncratic and experiential nature of the venture-creation process. Venture creation is a lived experience that, as it unfolds, forms the entrepreneur. In fact, the creation of a sustainable enterprise involves three parallel, interactive phenomena: emergence of the opportunity, emergence of the venture and emergence of the entrepreneur. None are predetermined or fixed – they define and are defined by one another.[15] Thus, this perspective on the entrepreneur has gained new momentum in the entrepreneurship research of the 21st century.

This experiential view of the entrepreneur captures the emergent and temporal nature of entrepreneurship. It moves us past a more static 'snapshot' approach and encourages consideration of a dynamic, socially situated process that involves numerous actors and events. It allows for the fact that the many activities addressed as a venture unfolds are experienced by different actors in different ways.[16] Moreover, it acknowledges that venture creation transcends rational thought processes to include emotions, impulses, and physiological responses as individuals react to a diverse, multifaceted, and imposing array of activities, events and developments. This perspective is consistent with recent research interest in a situated view of entrepreneurial action.[17] However, we must be aware that this psychological aspect of entrepreneurship presents a dark side as well.

THE DARK SIDE OF ENTREPRENEURSHIP

Do entrepreneurs suffer more from mental disorders? After all, it takes a little bit of madness to start a business and, just as surely, a business can drive one a little bit mad. A great deal of literature is devoted to extolling the rewards, successes and achievements of entrepreneurs. However, there is also a **dark side of entrepreneurship** (see also Chapter 4 on criminal entrepreneurs). In examining this dual-edged approach to the entrepreneurial personality, Kets de Vries has acknowledged the existence of certain negative factors that may envelop entrepreneurs and dominate their behaviour.[18] Among entrepreneurs there are those who have failed and were exposed as well as those who have destroyed something that was important to others. For some it was an error of judgement – we call them *failed entrepreneurs*. But some entrepreneurs exhibit criminal behaviour. It is no accident that many people associate the word 'entrepreneur' with rogues and wheeler-dealers. In *Entrepreneurs*, Bolton and Thompson even have an entire chapter entitled 'Entrepreneurs in the shadows'. They examine:

- opportunist entrepreneurs who either adopt a flawed strategy or fail to deliver
- inventors who become failed entrepreneurs as they lack key project championing capabilities
- empire-builders who grow too quickly and lose control – sometimes involving a creative cover-up strategy
- entrepreneurs who make mistakes, or whose business fails, but who determinedly make a comeback
- entrepreneurs who attract controversy
- dishonest entrepreneurs.[19]

>>ENTREPRENEURSHIP IN PRACTICE

CHILDHOOD SHAPES THE FUTURE WHIZ-KIDS

They are hugely optimistic, full of energy and extremely exciting to be around. But they are also stubborn, single-minded and selfish. And they absolutely hate holidays.

Welcome to the fascinating world inside the mind of the entrepreneur, where risk is irrelevant, speed is vital – and failure is not an option.

In a bid to find out what makes them tick, a team of psychologists and business experts spent a day putting a group of entrepreneurs through a series of psychological tests for a new BBC2 series called *Mind of a Millionaire*. What they found was rather surprising.

Adrian Atkinson, business psychologist with the consultancy Human Factor International and one of the program's experts, says: 'Entrepreneurs are different from the rest of us. They don't behave rationally in the way other people do. They're willing to risk everything to start a business. They pursue opportunities without regard for resources, preferring to create the opportunity and then find the money later.

'They believe that everything that happens, whether good or bad, is due to their actions.'

The result, he says, is great for the economy, which thrives on constant innovation and change, but not so good for dinner-party conversation.

'You wouldn't want to get stuck in a lift with an entrepreneur because most of them are not tremendously enjoyable companions', he says. 'They have this amazing focus and single-mindedness and they don't need relationships with other people. They just talk about business all the time.'

Atkinson says entrepreneurs can be divided into three distinct types: (1) Social entrepreneurs, such as Paul Harrod, whose company provides employment for the homeless. These entrepreneurs are driven by the desire to improve society; (2) Theme entrepreneurs, such as Anita Roddick, who start businesses within a particular defined area; and (3) Serial entrepreneurs, such as Richard Branson, who look for opportunities to create wealth anywhere and will often set up one company after another in quick succession.

All three types are, however, motivated by one of three factors – revenge, status or power. And the roots of that stem overwhelmingly from their childhood experiences.

Atkinson explains: 'Revenge entrepreneurs are driven to put right a social injustice to their family or to themselves, which they experienced as a child.

'Status entrepreneurs are driven to create a situation where they are highly respected by the people they think matter. Something in their childhood has made them feel excluded and they are determined to show the world that they fit in.

'Power entrepreneurs are driven by the desire to show people they can do whatever they want to do. What drives all of them is the desire to create wealth to appease their feelings of insecurity. It is not about money, it is about providing security from slipping back into their previous existence'.

René Carayul, a business adviser and another member of the program's team of experts, says one of the most fascinating characteristics of entrepreneurs is their absolute refusal to acknowledge failure.

He says: 'They don't do failure, they redefine it. Failure for them is a learning experience that will enable them to be even better. If they fall over, they just come straight back up again. I have never met such a bunch of optimistic people. Everything is an opportunity, the glass isn't half full, it's spilling over'.

Carayul says there are several things traditional businesspeople can learn from the way entrepreneurs work. He says: 'Number one, making mistakes is okay. It's a necessary part of learning. Number two, speed is the key competitive advantage when you're in business now – it's not who does it better, it's who gets there first. Time used to be the enemy. It's now an assassin. And number three, play to your strengths'.

Sadly, for the rest of us, however, Carayul thinks that ultimately entrepreneurs are born, not made. He says: 'If you don't have that drive, that energy, that focus, then you can't make a chicken salad out of chicken s**t, no matter how you try'.

Source: Rachel Bridge, *Sunday Times*, 5 October 2003, from http://business.timesonline.co.uk/tol/business/article1166132.ece

Entrepreneurs face a number of different types of risk. These can be grouped into four basic areas: (1) financial risk, (2) career risk, (3) family and social risk and (4) psychic risk.[20]

Financial risk

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

Career risk

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

Family and social risk

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

Psychic risk

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

STRESS AND THE ENTREPRENEUR

Some of the most common entrepreneurial goals are independence, wealth and work satisfaction. Research studies of entrepreneurs show that those who achieve these goals often pay a high price.[21] A majority of entrepreneurs surveyed had back problems, indigestion, insomnia, or headaches. To achieve their goals, however, these entrepreneurs were willing to tolerate these effects of stress. The rewards justified the costs.

What is entrepreneurial stress?

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

Lacking the depth of resources, entrepreneurs must bear the cost of their mistakes while playing a multitude of roles, such as salesperson, recruiter, spokesperson and negotiator. These simultaneous demands can lead to role overload. Owning and operating a business require a large commitment of time and energy, often, as noted previously, at the expense of family and social activities. Finally, entrepreneurs are often working alone or with a small number of employees and therefore lack the support from colleagues that may be available to managers in a large corporation.[22]

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

- chronic and severe sense of time urgency. For instance, Type A people become particularly frustrated in traffic jams
- constant involvement in multiple projects subject to deadlines. Type A people take delight in the feeling of being swamped with work
- neglect of all aspects of life except work. Workaholics live to work rather than work to live
- a tendency to take on excessive responsibility, combined with the feeling that 'only I am capable of taking care of this matter'
- explosiveness of speech and a tendency to speak faster than most people. Type A people are thus prone to ranting and swearing when upset. A widespread belief in the stress literature is that Type A behaviour is related to coronary heart disease and that stress is a contributor to heart disease.[23]

Thus, to better understand stress, entrepreneurs need to be aware of their particular personality as well as the roles and operating environments that differentiate their business pursuits.[24]

Sources of stress

Boyd and Gumpert have identified four causes of entrepreneurial stress.[25]

- **Loneliness:** Although entrepreneurs are usually surrounded by others – employees, customers, accountants and lawyers – they are isolated from persons in whom they can confide. Long hours at work prevent them from seeking the comfort and counsel of friends and family members. Moreover, they tend not to participate in social activities unless they provide a business benefit. A sense of loneliness can set in because of inner feelings of isolation.
- **Immersion in business:** One of the ironies of entrepreneurship is that successful entrepreneurs make enough money to partake of a variety of leisure activities, but they cannot take that exotic cruise, fishing trip, or skiing vacation because their business will not allow their absence. Most entrepreneurs are married to their business. They work long hours, leaving little time for civic organisations, recreation, or further education.
- **People problems:** Entrepreneurs must depend on and work with partners, employees, customers, bankers and professionals. Most experience frustration, disappointment and aggravation in their experiences with these people. Successful entrepreneurs are to some extent perfectionists and know how they want things done. Often they spend a great deal of time trying to get lackadaisical employees to meet their performance standards and, frequently, because of irreconcilable conflict, many partnerships are dissolved.

- **Need to achieve:** Achievement brings satisfaction. During the Boyd and Gumpert study, however, it became clear that a fine line exists between attempting to achieve too much and failing to achieve enough. More often than not, the entrepreneur was trying to accomplish too much. Many are never satisfied with their work no matter how well it is done. They seem to recognise the dangers (for example, to their health) of unbridled ambition, but they have a difficult time tempering their achievement need. They seem to believe that if they stop or slow down a competitor is going to come from behind and destroy everything they have worked so hard to build.

THE ENTREPRENEURIAL EGO In addition to the challenges of risk and stress, the entrepreneur also may experience the negative effects of having an ego, especially in countries that value modesty and circumspection. In other words certain characteristics that usually propel entrepreneurs into success also can be exhibited to their extreme. We examine four of these characteristics that may hold destructive implications for entrepreneurs.[26]

An overbearing need for control

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

Sense of distrust

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

Overriding desire for success

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

Unrealistic optimism

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

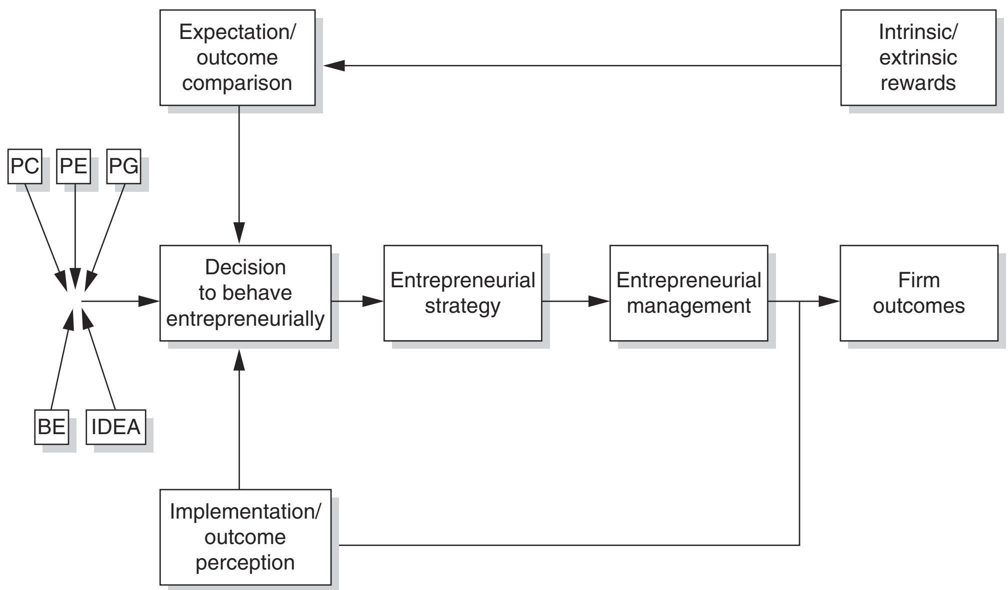
However, when taken to its extreme, this optimistic attitude can lead to a fantasy approach to the business. A self-deceptive state may arise in which entrepreneurs ignore trends, facts and reports and delude themselves into thinking everything will turn out fine. This type of behaviour can lead to an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

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

ENTREPRENEURIAL MOTIVATION

Examining why people start businesses and how they differ from those who do not (or those who start unsuccessful businesses) may help explain how the motivation that entrepreneurs exhibit during start-up is linked to the sustaining behaviour exhibited later. Herron and Sapienza stated: 'Because motivation plays an important part in the creation of new organisations, theories of organisation creation that fail to address this notion are incomplete.'[27] One researcher – in his review of achievement motivation and the entrepreneur – said: 'It remains worthwhile to carefully study the role of the individual, including his or her psychological profile. Individuals are, after all, the energisers of the entrepreneurial process.'[28]

FIGURE 2.2: **A MODEL OF ENTREPRENEURIAL MOTIVATION**



PC = personal characteristics
PE = personal environment
PG = personal goals
BE = business environment

Source: Douglas W. Naffziger, Jeffrey S. Hornsby and Donald F. Kuratko, 'A Proposed Research Model of Entrepreneurial Motivation', *Entrepreneurship Theory and Practice*, Spring 1994: 33

Thus, although research on the psychological characteristics of entrepreneurs has not provided an agreed-on 'profile' of an entrepreneur, it is still important to recognise the contribution of psychological factors to the entrepreneurial process.[29] In fact, the quest for new-venture creation as well as the willingness to *sustain* that venture is directly related to an entrepreneur's motivation.[30] A research study examined the importance of satisfaction to an entrepreneur's willingness to remain with the venture. Particular goals, attitudes and backgrounds were all important determinants of an entrepreneur's eventual satisfaction.[31] In that vein, one research approach examines the motivational process an entrepreneur experiences.[32] Figure 2.2 illustrates the key elements of this approach.

ENTREPRENEURIAL FEAR 101

>>ENTREPRENEURSHIP IN PRACTICE

The fear an entrepreneur experiences has its own taste, its own smell and its own gut-wrenching pain. And it does not go away as long as the person remains an entrepreneur. It becomes an education that entrepreneurs experience – Entrepreneurial Fear 101. Although the course is very exclusive, admission is automatic; permission is neither needed nor sought, and tenure is indefinite. The fear entrepreneurs experience cannot be expected, cannot be escaped and cannot be prepared against. Because most entrepreneurs do not admit they have experienced this entrepreneurial fear, it remains a deep, dark secret. And because it is not talked about, most entrepreneurs feel they are the only ones who have ever experienced it.

According to Wilson Harrell, an entrepreneur from Jacksonville, Florida, this entrepreneurial fear is much different from simple fear. Fear is usually accidental, unexpected and short lived, such as the sudden rush of adrenaline experienced when you almost get hit by a bus, he explains. On the other hand, entrepreneurial fear is self-inflicted. It is a private world where no sleep occurs and wide-awakening nightmares filled with monsters constantly try to destroy every morsel of the entrepreneur's being.

What causes this fear? Well, it is not the money, for any entrepreneur will explain that money is just a bonus of the accomplishment and losing money is one of the risks taken. Fear of failure has a lot to do with it. Entrepreneurs do not want to become just another businessperson and pass into oblivion without leaving their mark. What induces this complex fear has yet to be determined.

For Harrell, the fear came while starting his own food brokerage business to sell products on military bases in Europe. Harrell was appointed a representative of Kraft Food Company and did so well increasing its sales that he sold himself out of a job. Because he had made his job look so easy, it was suggested to Kraft's management team that its own salespeople could do the work better and cheaper.

So what did Harrell do? Because losing the Kraft account would put him out of business, he put everything on the line and proposed that if Kraft kept brokering through his company and took over the brokering in Germany, then Harrell would help it take over the food industry everywhere. After Harrell experienced 30 days of immeasurable terror, Kraft made the decision to trust Harrell and continue brokering through his company. Although he later sold his business, 30 years later the company still represents Kraft, Inc., not only in Europe but also in the Far East and many other countries. The company has grown into the largest military-representative organisation in the field and was sold in 1985 for more than $40 million.

What is the secret to entrepreneurship, given such fear? It's reward. No matter what pain is experienced through the fear, the elation felt from success subsides it. That high, along with fear, is an emotion reserved for entrepreneurs and becomes food for spirit. Addictive? It is more like a roller-coaster ride. In the beginning, imagine pulling yourself up the incline very slowly, making any tough decisions with a growing sense of excitement and foreboding. Then when you hit the top, for a brief moment it is frightening and the anticipation accelerates before you feel no more feelings of control. As you go screaming into the unknown, fear takes over. At first, all you feel is fear; then, suddenly, the ride is over, the fear is gone, but the exhilaration remains. What is next for the entrepreneur? He or she buys another ticket.

So what is the key ingredient for entrepreneurial success? According to Wilson Harrell, it is the ability to handle fear. For he believes it is the lonely entrepreneur living with his or her personal fear who breathes life and excitement into an otherwise dull and mundane world.

Source: Extracts from 'Entrepreneurial terror', Feb. 1987, from *Inc: The magazine for growing companies* by Wilson Harrell. Copyright 1987 by Mansueto Ventures LLC in the format textbook via Copyright Clearance Centre.

The decision to behave entrepreneurially is the result of the interaction of several factors. One set of factors includes the individual's personal characteristics (PC), the individual's personal environment (PE), the relevant business environment (BE), the individual's personal goal set (PG) and the existence of a viable business idea.[33] In addition, the individual compares his or her perception of the probable outcomes with the personal expectations he or she has in mind. Next, an individual looks at the relationship between the entrepreneurial behaviour he or she would implement and the expected outcomes.

According to the model, the entrepreneur's expectations are finally compared with the actual or perceived firm outcomes. Future entrepreneurial behaviour is based on the results of all of these comparisons. When outcomes meet or exceed expectations, the entrepreneurial behaviour is positively reinforced and the individual is motivated to continue to behave entrepreneurially – either within the current venture or possibly through the initiation of additional ventures, depending on the existing entrepreneurial goal. When outcomes fail to meet expectations, the entrepreneur's motivation will be lower and will have a corresponding impact on the decision to continue to act entrepreneurially. These perceptions also affect succeeding strategies, strategy implementation and management of the firm.[34]

THE MIND-SET OF SOCIAL AND ENVIRONMENTAL ENTREPRENEURS

Most countries – particularly in Asia – have a long history of social entrepreneurship, ranging from credit unions and cooperatives to a whole host of new, innovative programs with goals ranging from fighting poverty and urban decay to funding for the arts and climate change. In Chapter 1 we explained the difference between business entrepreneurs and social entrepreneurs and in Chapter 4 we will discuss social entrepreneurs in more detail. But for now let's just define them as 'people with the mission to create and sustain social value'.

Do social entrepreneurs have a different mind-set from business entrepreneurs? Bornstein believes that social entrepreneurs do the same things as business entrepreneurs and have the same skills and temperament.[35] But there are some differences. Social entrepreneurs are generally thought to be driven, motivated and focused individuals who are motivated by a desire to make a real social change. In the UK, for example, Global Entrepreneurship Monitor found that women and people from ethnic minorities are more likely to become social than business entrepreneurs. Social entrepreneurs also tend to be more educated and financially better off. They are not as positive and confident as mainstream entrepreneurs. They are more likely to fear failure than their business counterparts and are more likely to say that lack of finance will stop them.[36]

Or is it that they are perhaps a bit more unreasonable than business entrepreneurs in the sense that playwright George Bernard Shaw alluded to when he said: 'The reasonable man adapts himself to the world, the unreasonable one persists in trying to adapt the world to himself. Therefore all progress depends on the unreasonable man'. As many say, our future may depend on entrepreneurs of all types, but especially on social entrepreneurs.[37] Famous social entrepreneur Bill Drayton said:

> The core [of the social entrepreneur] is personality, a temperament that simply can't stop. Social entrepreneurs are not happy until their ideas have changed the whole society. That's very different from almost everyone else. Scholars and artists come to rest when they've expressed an idea. Managers, when they solve a problem for their company, complete their goal. If a professional is able to serve a client, that is satisfying. None of

> that satisfies a social entrepreneur. The entrepreneur simply knows in a very deep way that, 'I have got to change the whole society'. People with this temperament are looking for the idea that's important enough, new enough, and ripe enough. When they find it, they will persist because they cannot rest until they have gone all the way and seen the idea change society.[38]

Research is scarce in this field, but it seems that social entrepreneurs are motivated more by virtuous entrepreneurial behaviour to achieve a social mission, by a coherent unity of purpose and action in the face of moral complexity, by the ability to recognise social value-creating opportunities, and by key decision-making characteristics of innovativeness, pro-activeness and risk taking.[39] Yes, both business and social entrepreneurs have a mission and values. But for social entrepreneurs, the social mission is central. For business entrepreneurs, return on investment and profit are central. Both wish to create superior value, but that value is very different.[40] Social enterprises are fundamentally different from commercial ones. They sometimes have a spiritual or virtue dimension, something very often missing from commercial enterprises.

One interesting study clearly distinguishes the personality of social entrepreneurs and business entrepreneurs as being different in one important aspect – gap filling. Kalish argues that there are two psychologically distinct orientations to spotting a **market niche** (gap) and filling it.[41]

- The business entrepreneur finds 'structural holes' between similar (homophilous) groups of people. For example, they may spot market niches between connected categories of people such as between manufacturers, who produce products and services that should find a market, and customers, who are actively seeking those products but do not know where to find them. Business entrepreneurs actively position themselves to plug the structural hole. Normally they do not introduce their contacts to each other because they desire the positional power inherent in plugging the gap for their own increased personal gain.
- Social entrepreneurs, like business entrepreneurs, like to span structural holes between groups. But the difference is that they do this between competing (heterophyllous), conflicting or even warring groups of people. They sometimes do this despite the potential personal cost involved and despite the fact that the groups may view each others as incompatible and in conflict. The psychological profile of social entrepreneurs suggests that they do not see others in terms of interacting categories (for example, producers and customers), but rather as real individuals. Compared with business entrepreneurs, social entrepreneurs view themselves as 'embedded in the larger context and may, therefore, be more similar to the non-partisan and the mediator'.[42] They value the unity of the whole of society and attempt to link others to the benefit of society.

Sustainability entrepreneurs operate in a slightly different context.[43] They seek to combine the environmental, economic and social components of sustainability in a holistic manner. They are said to have a different organising logic from more conventional entrepreneurs.[44] Market creation is more difficult for them because the financial community is not mature enough to understand their innovations. They also face confusion in the marketplace because they may operate their businesses in ways that run counter to popular perceptions of entrepreneurial behaviour (for example, donations to environmental causes, employee-friendly working conditions, an interest in wider social issues than bottom-line profits and a concern for the longer-term implications of their business activities).[45]

Recent research confirms the *gap spanning* aspect discussed above and shows that sustainability entrepreneurs do have the distinct ability to achieve outcomes that benefit society and ecosystems.[46] But environmental entrepreneurs go beyond gap filling and become catalysts for change toward larger-scale socioeconomic structural transformations.

SOURCES OF RESEARCH ON ENTREPRENEURS The best source of information about the entrepreneurial mind-set is direct observation of practising entrepreneurs. Through the use of interviews, surveys and case studies, the experiences of individual entrepreneurs can be related. Analysis of these experiences can provide insights into the traits, characteristics and personalities of individual entrepreneurs and leads to the discovery of commonalities that help explain the perspective. At the end of this chapter you'll find an exciting experiential exercise called 'Interviewing an entrepreneur'.

Another big source is publications, research-based as well as popular.[47] The following are among the more important of these publications:

- **Technical and professional journals**: These are refereed journals that contain articles dealing with research – methodology, results and application of results – that is well designed and tightly structured. The academic literature in the fields of enterprise and entrepreneurship is vast and deep, with almost a hundred dedicated refereed academic journals. Assuming four issues per year of eight articles, that means that there are about 3000 new articles coming out annually. This does not include the mainstream management journals that are devoting more issues (some special issues) to entrepreneurship. Nor does it count the thousands of conference papers presented each year. The literature has long reached the point where it would be impossible for any individual to read all refereed journal articles. Use the electronic library databases to access these invaluable resources.
- **Textbooks on entrepreneurship**: These texts typically address the operation of small firms and non-profit organisations. Sections or chapters are frequently devoted to research on entrepreneurs. Examples include *Launching New Ventures: An Entrepreneurial Approach*; *Entrepreneurship: A Process Perspective*; *Entrepreneurship and Small Business: A Pacific Rim Perspective*; and *New Venture Creation: Entrepreneurship for the 21st Century*.[48]
- **Books about entrepreneurship**: Most of these books are written as practitioners' how-to guides. Some deal with the problems facing the individual who starts a business; others deal with a specific aspect of the subject. Examples include *Startup*, *In the Owner's Chair*, *Rethinking Marketing: The Entrepreneurial Imperative, Nuts: Southwest Airlines' Crazy Recipe for Business and Personal Success* and *The Breakthrough Company*.[49]
- **Biographies or autobiographies of successful, failed and dishonest entrepreneurs**: Examples include *Business at the Speed of Thought* and *Radicals and Visionaries*.[50]
- **Compendia about entrepreneurs**: These are collections that deal with several selected individuals or that present statistical information or overviews of perceived general trends. Examples include *The Entrepreneurs*,[51] which is a compendium of information about selected living entrepreneurs; *The Venture Café*,[52] which examines strategies and stories from high-tech start-ups; and the yearly national and global reports of the *Global Entrepreneurship Monitor*.[53]
- **News periodicals**: Many newspapers and news periodicals run stories on entrepreneurs either regularly or periodically. Examples include *Fast Company* (US), 'Entrepreneur' special supplement to *The Australian* (Australia), *BRW* (Australia), *Unlimited* (New

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Zealand), *Ideolog* (New Zealand), *Entrepreneur* (US), *Economist* (UK), *Business Week* (US), *Fortune* (US), *Forbes* (US) and the *Wall Street Journal* (US).

- **Venture periodicals**: A growing number of new magazines are concerned specifically with new-business ventures. Most, if not all, of each issue's contents are related to entrepreneurship. Examples include *Entrepreneurship*, *Fortune Small Business*, *Inc*. and *Family Business*.
- **Newsletters**: Several newsletters are devoted exclusively to entrepreneurship, such as those from the National Dialogue on Entrepreneurship and the Kauffman Foundation.
- **Proceedings of conferences**: Publications relating to annual or periodic conferences deal at least in part with entrepreneurship. Examples include *Proceedings of the Academy of Management*, *Proceedings of the International Council for Small Business*, *Proceedings of the US Association for Small Business and Entrepreneurship, Frontiers in Entrepreneurship Research* (proceedings of the Babson College Annual Entrepreneurship Conference) and *Regional Frontiers of Entrepreneurship Research* (proceedings of the annual Australian Graduate School of Entrepreneurship Conference).
- **Internet**: Simply entering into a search engine the topic 'successful entrepreneurs' produces about 500 000 potential sources at this time. Many countries have stories on their successful entrepreneurs. Try, for example, searching for 'successful entrepreneurs Malaysia' and you will find 19 600 hits. Set up an RSS feed on Yahoo news with the keywords 'entrepreneur' and 'Australia' and you will receive in real time all mentions of the two words throughout the media.

The second major source of information about the entrepreneurial mind-set is direct observation of practising entrepreneurs. The experiences of individual entrepreneurs can be related through the use of interviews, surveys and case studies. Have a look at the Harvard cases at the end of each chapter in this book. Analysis of these experiences can provide insights into the traits, characteristics and personalities of individual entrepreneurs and leads to the discovery of commonalities that help explain the mind-set.

The final source of entrepreneurial information is speeches and presentations (including seminars) by practising entrepreneurs. This source may not be as in-depth as the others, but it provides an opportunity to learn about the entrepreneurial mind-set. Entrepreneur-in-residence programs at various universities illustrate the added value oral presentations may have in educating people about entrepreneurship.

SUMMARY

We started out by looking at the sheer numbers and proportions of entrepreneurs around the world and we saw that the largest cohort of entrepreneurs is in the 25–44 age group.

In attempting to explain the entrepreneurial mind-set within individuals, this chapter presented the most common characteristics exhibited by successful entrepreneurs.

Several studies have been conducted to determine the personal qualities and traits of successful entrepreneurs. Some of these were examined in the chapter: commitment, determination and perseverance; drive to achieve; opportunity orientation; initiative and responsibility; persistent problem solving; seeking feedback; internal locus of control; tolerance for ambiguity; calculated risk taking; integrity and reliability; tolerance for failure; high energy level; creativity and innovativeness; vision; independence; self-confidence and optimism; and team building.

Next, a review of the dark side of entrepreneurship revealed certain negative factors that can arise when entrepreneurs overextend their characteristics. Finally, a motivational model of entrepreneurship was discussed.

The chapter introduced a model of entrepreneurial motivation. Recognising the contribution of psychological factors to the process of entrepreneurship, this model demonstrated the importance of entrepreneurs' perceived expectations and actual outcomes in their motivation to start and sustain a venture.

Finally we looked at the phenomenon of social and environmental entrepreneurs and whether their mind-set differs from business entrepreneurs.

KEY TERMS & CONCEPTS

calculated risk taking
career risk
dark side of entrepreneurship
delegating
drive to achieve
entrepreneurial behaviour
entrepreneurial mind-set
entrepreneurial motivation
external optimism
family and social risk
financial risk
immersion in business
loneliness
need for control
need to achieve
networking
opportunity orientation
psychic risk
risk
stress
tolerance for ambiguity
tolerance for failure
virtuous entrepreneurial behaviour
vision

REVIEW & DISCUSSION QUESTIONS

1 What do we see when we look around the world at entrepreneurs? Who are they and how many are there?
2 Some of the characteristics attributed to entrepreneurs include persistent problem solving, continuous seeking of feedback and internal locus of control. What does this mean?
3 Which of the characteristics in Table 2.3 do you have?
4 How do the following traits relate to entrepreneurs: desire to achieve, opportunity orientation, initiative and responsibility?
5 Entrepreneurs have a tolerance for ambiguity, are calculated risk takers and have a high regard for integrity and reliability. What does this mean?
6 Is it true that most successful entrepreneurs have failed at some point in their business careers? Explain.
7 In what way is vision important to an entrepreneur? Self-confidence? Independence?
8 Entrepreneurship has a dark side. What is meant by this statement?
9 What are the four specific areas of risk that entrepreneurs face? Describe each.
10 What are four causes of stress among entrepreneurs? How can an entrepreneur deal with each of them?
11 Describe the factors associated with the entrepreneurial ego.
12 What is the concept of entrepreneurial motivation?
13 How does the model depicted in Figure 2.2 illustrate an entrepreneur's motivation?
14 What are the differences in mind-set between social and business entrepreneurs?
15 How are environmental entrepreneurs different from others?
16 Identify and describe the three major sources of information that supply data related to the entrepreneurial mind-set.

EXPERIENTIAL EXERCISE: ENTREPRENEURIAL SELF-ASSESSMENT

Are you the entrepreneurial type? Go to www.bdc.ca/en/home.htm and follow the links to Tools/Entrepreneurial Self-Assessment and complete the questionnaire. Your overall score describes your profile compared to other entrepreneurs.

TIPS ON HOW TO CONDUCT THE INTERVIEW

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

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

THE ENTREPRENEUR BEFORE STARTING THE VENTURE

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

THE ENTREPRENEUR AT THE TIME HE/SHE STARTED THE VENTURE

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

THE ENTREPRENEUR AS SHE/HE GREW THE VENTURE

- How have your goals and values changed since starting the venture?
- Did your risk orientation change as the venture grew?
- Did your need for control change as the venture grew?
- Did the typical work week change as the venture grew (in terms of how much time the venture required and in terms of how you allocated your time)?
- Did you make assumptions when you first started out that subsequently proved to be wrong? What sorts of insights were gained?
- What key mistakes did you make along the way? What were some of the key lessons learned (their greatest moment and their worst moment)?

- Were there some critical points in the development of the venture when the venture almost failed, or when you found yourself at a critical crossroads in terms of some vital decision or issue that had to be addressed in a certain way or the venture would have failed?

THE ENTREPRENEUR TODAY AND TOMORROW

- What would you do differently if you had it all to do over again?
- What key personal characteristics do you see in yourself that were especially critical for achieving success with this particular venture?
- What are your plans for the future in terms of the venture?
- What is your exit strategy or do you not have one?
- What advice, based on your own experience, do you have for a student interested in starting a venture today?

Source: Michael Morris, 'The Business Model, Marketing Inventions, the Entrepreneurial Audit and the Interview of an Entrepreneur as Learning Vehicles', presentation at 'Experiential Classroom: Lifelong Learning for Entrepreneurship Education Professions', Syracuse University: September 2004. For further information on this yearly program, see http://entrepreneurship.okstate.edu/classroom

EXPERIENTIAL EXERCISE: RECOGNISE YOURSELF?

Which of these categories do you fit into? *Business Week* once segmented entrepreneurs into various groups. What does psychographic research say about you?

You know you're perfectly sane. But that doesn't mean you can't be pigeonholed by your attitudes, foibles and neuroses. It's a science known as psychographics and people who study small businesses say it brings a sense of order to a diverse group. One problem: Psychographic definitions can get pretty diverse, too, depending on the focus. Here are some samples:

SELF IMAGE (WARRILLOW & CO.)

- Mountain Climbers (10 per cent of entrepreneurs): Insatiable appetite for achievement. Live for fast growth. Win awards and media coverage. Demand excellence.
- Freedom Fighters (30 per cent of entrepreneurs): Value independence above all. Started own company to 'call the shots'. Want to build a successful business and still have a life.
- Craftspeople (60 per cent of entrepreneurs): Don't think of themselves as small-business owners. Defined by profession (jeweller, plumber, caterer) and value mastery of craft.

WORK HABIT (PITNEY BOWES/YANKELOVICH)

- Idealists (24 per cent of entrepreneurs): Passionate about an idea they want to bring to life, but dislike details of running a business and finance. Seek work–life balance.
- Optimisers (21 per cent of entrepreneurs): Enjoy their work. Seek efficiency. Savvy on finance and tech. Focus on profits, not size. Confident, happy with work–life balance.
- Hard workers (20 per cent of entrepreneurs): Growth, growth, growth – whatever it takes. Want a bigger company with growth in revenue, staff. They sweat all the details.
- Jugglers (20 per cent of entrepreneurs): Worriers and control freaks. Pressed for time. Proud of ability to juggle. Want to grow to 'promised land' where worries are over.
- Sustainers (15 per cent of entrepreneurs): Just trying to make a living. Want comfort, stability and to keep things the way they are. Good work–home balance. Not into technology.

BY OBJECTIVE (WUNERMAN/CATO/JOHNSON)

- Success (20 per cent of entrepreneurs): Optimists who want to win. They value quick growth, money and material possessions. They want control and status.
- Big Idea (16 per cent of entrepreneurs): Risk-taking mavericks who seek social validation and creative fulfilment. Informal, intuitive, value self-satisfaction.

- Person (23 per cent of entrepreneurs): Want to create a good place to work and do business. Integrate work, home, community. Value emotional support, loyalty, respect.
- Security (10 per cent of entrepreneurs): The goal: Less stress, more leisure time. Value integrity. Cautious but optimistic.
- Survival (31 per cent of entrepreneurs): Pessimists. Feel put upon; just want to stay in business.

Source: 'Recognise Yourself? See What Psychographics Says about You', *Business Week*, 23 April 2001

CASE 2.1: JANE'S EVALUATION

Paul Medwick is a commercial banker. In the past month, he has received loan applications from three entrepreneurs. All three have fledgling businesses with strong potential. However, Paul believes it is important to look at more than just the business itself; the individual also needs close scrutiny. The three entrepreneurs are: (1) Robin Wood, owner of a small delicatessen located in the heart of a thriving business district; (2) Richard Trumpe, owner of a 10-minute oil-change-and-lube operation; and (3) Phil Hartack, owner of a bookshop that specialises in best sellers and cook books. Paul has had the bank's outside consultant, Professor Jane Jackson, interview each of the three entrepreneurs. Jane has done a lot of work with entrepreneurs and after a couple hours of discussion usually can evaluate a person's entrepreneurial qualities. In the past, Jane has recommended 87 people for loans, and only two of these ventures have failed. This success rate is much higher than that for commercial loans in general. Following is Jane's evaluation of the three people she interviewed.

CHARACTERISTIC	ROBIN WOOD	RICHARD TRUMPE	PHIL HARTACK
Perseverance	H	M	M
Drive to achieve	M	H	M
Initiative	M	H	M
Persistent problem solving	M	M	H
Tolerance for ambiguity	L	M	H
Integrity and reliability	H	M	H
Tolerance for failure	H	H	H
Creativity and innovativeness	M	H	M
Self-confidence	H	H	H
Independence	H	H	H

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

Questions

1. Which of the three applicants do you think comes closest to having the mind-set of an ideal entrepreneur? Why?
2. To which applicant would you recommend that the bank lend money? (Assume that each has asked for a loan of $50 000.) Defend your answer.
3. Can these three entrepreneurs do anything to improve their entrepreneurial profile and their chances for success? Be specific in your answer.

CASE 2.2: TO STAY OR TO GO?

Mary Gunther has been a sales representative for a large computer firm in Australia for seven years. She took the job following her graduation from a large university, where she majored in computer science. Recently, Mary has been thinking about leaving the company and starting her own business. Her knowledge of the computer field would put her in an ideal position to be a computer consultant.

Mary understands computer hardware and software, is knowledgeable about the strong and weak points of all the latest market offerings, and has a solid understanding of how to implement a computer system throughout an organisation. Mary believes that many medium-sized firms around the country would like to introduce computer technology but do not know how to do so. The large manufacturers, such as the one for which she works, are more interested in selling hardware than in helping their clients develop a fully integrated, company-wide computer system. Small consulting firms have to be brought in to do this. Mary feels that, as a consultant, she not only would be able to evaluate a computer's effectiveness, but she also would know how to set up the machines to provide maximum benefit to the company.

If she were to leave the computer firm tomorrow Mary estimates that she could line up 10 clients immediately. This would provide her with sufficient income for six months. During this period she is sure that she would have little difficulty getting more clients. Six of these 10 firms are located on the East Coast, two of them are in Victoria, and the remaining two are in Western Australia. Mary estimates that it would take about two weeks to install a system and have it working and it would probably take another two days to correct any problems that occur later. These problems would be handled during a follow-up visit, usually 10 to 14 days after the initial installation and set-up.

The idea of starting her own venture appeals to Mary. However, she is not sure she wants to leave her job and assume all of the responsibilities associated with running her own operation. Before going any further, she has decided to evaluate her own abilities and desires to determine whether this is the right career move for her.

1. Identify three major characteristics that Mary should have if she hopes to succeed in this new venture. Defend your choices.
2. How can Mary decide if she is sufficiently entrepreneurial to succeed in this new venture?

RECOMMENDED CASES FROM HARVARD BUSINESS SCHOOL ONLINE

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The New Principles of a Swarm Business

Publication Date: 1 April 2007
Author(s): Peter Gloor, Scott M. Cooper
Product Number: SMR246

In every large company groups of creative individuals self-organise to explore and develop ideas that they care deeply about. These collaborative networks often include customers and others outside the company's boundaries. Take, for instance, the automaker BMW, which posts numerous engineering challenges on its website, enabling customers and company designers to network and collaborate on developing various features of future cars. Now collaborative innovation is being extended from the realm of idea generation and product development to the very essence of doing business. In fact, some companies have based their entire business models on collaborative networks. The classic example is Wikipedia, the free online encyclopedia that relies on a swarm of people to write, edit and fact check the information listed in its entries. According to the authors, these 'swarm businesses' pick up where the e-business craze stopped, with one crucial difference – e-businesses were primarily concerned with eyeballs (getting as many people as possible to visit a particular website), whereas swarm businesses strive mainly to create real value for the swarm. As companies like BMW, IBM, Novartis and others are discovering, swarm businesses require a completely new corporate mind-set. Specifically, to reap the benefits of swarm innovation, companies must: (1) gain power by giving it away, (2) share with the swarm and (3) concentrate on the swarm, not on making money. Although these principles differ from the traditional ways of doing business, in a number of fundamental ways they are crucial for companies to succeed in this emerging era of increased collaboration among innovators both inside and outside the organisation.

Leadership in Crisis: Ernest Shackleton and the Epic Voyage of the Endurance

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Author(s): Nancy F. Koehn, Erica Helms, Phillip Mead
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This case provides an opportunity to examine leadership and entrepreneurship in the context of Ernest Shackleton's 1914 Antarctic expedition, a compelling story of crisis, survival and triumph.

Candy Land: the Utopianv Vision of Milton Hershey

Publication date: 5 April 2005
Author(s): Nancy F. Koehn, Erica Helms
Product number: 805066

This case explores the life, work and achievements of Milton S. Hershey and analyses his entrepreneurial achievements, including the creation of the Hershey bar, the founding of the business and the development of the mass market for chocolate. Also investigates the broader contributions that Milton Hershey made to a sustainable, mutually beneficial social contract between business and community.

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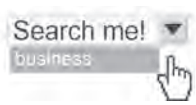


ambiguity
entrepreneurial behaviour
failure
financial risk
networking
risk-taking
stress

3 THE ENVIRONMENT, THE ECONOMY AND ENTREPRENEURSHIP

The trouble with our times is that the future is not what it used to be . . .

French poet and aviator Paul Valéry

When one door closes, another opens; but we often look so long and so regretfully upon the closed door that we do not see the one which has opened for us.

Alexander Graham Bell

In the midst of difficulty lies opportunity.

Albert Einstein

Human creativity focused on problem solving can explode the mythology of resignation and despair.

Kenny Ausubel

chapter objectives

• 01
To appreciate the role of entrepreneurship in times of crisis

• 02
To classify the types of climate change effects on entrepreneurs within the Asia–Pacific context

• 03
To categorise important concepts in climate change economics that impact entrepreneurial activity

• 04
To understand the impact that the financial crisis may have on the entrepreneurial economy

• 05
To appreciate the various emerging frameworks in entrepreneurial ecology.

Every year there is a burning season in Indonesia.[1] Across the vast archipelago, swathes of **rainforest** are cut down and burned off by small-scale entrepreneurs and large corporations to make way for palm oil production. Thousands of Indonesians are employed and many entrepreneurial families are coming out of poverty because of the enterprise. However, the result is an environmental disaster. Indonesia's forest clearing, the largest in the world, has taken the country to a world ranking of 14th in terms of percentages of total **carbon emissions**. Indonesia's per capita emission rate has grown tenfold since the early 1970s. Fuelling the greatest entrepreneurial boom in history, Chinese CO_2 emissions have grown a whopping 66.2 per cent since 2000 (see Table 3.3 on page 78). Around the world, economic growth and entrepreneurial activity are inextricably linked – negatively but also positive – to **global warming**.[2]

This is the first textbook to look at global entrepreneurship in terms of climate change, environmental economics and entrepreneurial ecology. Entrepreneurs who understand the new climate reality – and are willing to invest in preparedness and risk management – are best equipped to seize opportunities. This book is about 'entrepreneurship as if the planet mattered'.

ENTREPRENEURSHIP DURING TIMES OF CRISIS

Some of the most innovative ideas have emerged during times of crisis. Just because credit markets dry up and global warming accelerates, the spirit of innovation does not hibernate. If the most famous theoretician of entrepreneurship, Joseph Schumpeter, were alive today, he would say that recessions 'clean the slate through creative destruction and create lasting, positive change'.

Here are some headlines: 'The stock market is down 50 per cent', 'Banks are in trouble and have curtailed lending', 'Widespread industrial bankruptcies predicted', 'Unemployment rising fast'. It all sounds so familiar, but those headlines aren't from today. They are from 1974![3] Then, as now, those who once thought they had the answers came to realise their assumptions were flawed. Yet opportunity emerged from that crisis as people with creative solutions and the skill to implement them stepped forward and developed new ways to access capital, combine resources and commercialise their innovations. Over the next two years the markets recovered strongly. That skill in finding new opportunities when things look bleak is called entrepreneurship.

During the **Great Depression**, General Electric introduced the fluorescent light bulb, which has twice the lifespan of incandescent lighting but used half the power. Ray Kroc opened the first McDonald's during the **Eisenhower recession**. During the Vietnam War and the 1973 Oil Crisis, Bill Gates and Paul Allen formed Microsoft. During the Reagan recession of the early eighties, Microsoft introduced Word. During the **First Gulf War**, the World Wide Web and Apple PowerBook debuted. When the **Dotcoms crash** and **9/11 attacks** took place, the iPod came to the market. Indeed, 18 of the 30 companies that make up the Dow Jones Industrial Average were launched in recessions or in bear stock markets. As Vivek Wadhwa of Duke University and Harvard Law School has pointed out, 'the pioneers who launched these firms (and others) during the darkest of times [have] less competition, lower costs, ease of recruiting employees, and less pressure to expand . . . Out there in garages throughout the country are entrepreneurs right now who are building the companies that will help lift our economy out of this recession'.[4]

Crisis leads to innovative thinking. The creativity process often happens when our knowledge thresholds are reached and there is a failure in systems to cope. During those periods of bleak crisis you can either sit back and do nothing and sink further into the morass or you can step back, think of a solution, and meet peoples' needs. It is amazing that humans have clever inbuilt navigation systems such as the new **GPS** in cars. When we take a wrong turning we are advised to reroute ('When possible, make a U-turn'). That rerouting is an innovation – a method untried before.

When recession rears its ugly head to sap the spirit of an economy, it is entrepreneurship that infuses vigour back into the economy and society. That's what economist Carl Schramm has observed on the implications of growth and recovery from recession in a business cycle.[5]

Schramm lists four reasons for this: (1) the explosion of creative impulse that leads to innovations, (2) scarcity in available options, (3) lower operating costs and (4) severely hit behemoths (large corporations).

In 1942 Schumpeter, about whom you will hear a great deal in this book, gave warning that the bureaucratisation of capitalism was killing the spirit of entrepreneurship. Instead of risking the turmoil of 'creative destruction' unleashed by entrepreneurs, **Keynesians** believed that only big government and big corporations could provide prosperity. However, perspectives have changed in the intervening decades and Schumpeter's entrepreneurs are once again roaming the globe with creative energies erupting inside the economy and pulling it out of recession. Since the Reagan–Thatcher revolution of the 1980s, governments of almost every ideological stripe have embraced entrepreneurship. The European Union, the United Nations and the World Bank also have become evangelists for entrepreneurship. For a Schumpeterian economist, downturns can act as a good 'cold shower for the economic system', releasing capital and labour from dying sectors and allowing newcomers to recombine them in imaginative new ways.[6] Economic downturns can have positive effects. They can force companies to increase their efficiency, cut waste and strive to do things in smarter ways. In such times it has been claimed that innovation is the single most important condition for transforming crisis into an opportunity.[7]

Now we also are engaged in a great climate war, testing whether or not the human race can endure. Although entrepreneurs must take a great share of the responsibility for global warming, they are also agents of change who may turn the situation around. The pure business logic is music to our ears: 'The benefits of strong, early action on climate change outweigh the costs'. These words appear in bold in the Executive Summary of the Stern Review on the Economics of Climate Change.[8] The numbers underscore the point: Addressing the problem now will cost about 1 per cent of Gross Domestic Product per year. Doing nothing, say many economic models, will cost the world the loss of 5 per cent GDP per year – 'now and forever', says the report. That 5 per cent figure is actually a best-case scenario for doing nothing: If all the risk factors are taken into account and they all hit at once, then the figure could be as high as 20 per cent. These conclusions, and these figures, are what will be most remembered about this report.[9]

CLIMATE CHANGE EFFECTS FOR ENTREPRENEURS

The situation in the Asia–Pacific

Climate change is already having an impact in the Asia–Pacific.[10] As it intensifies it will cause increased disruption and instability that will affect millions of people. Asia's **mega-cities** and densely populated areas along the Pacific and Indian Ocean coastlines are threatened by the rise of sea levels coupled with river flooding from increased upstream precipitation. The combined effects of accelerating climate change and land-use pressures are fragmenting and likely to significantly damage Asian **ecosystems** that comprise some of the richest biodiversity on Earth. Many species of mammals and birds in the Asia–Pacific could be exterminated as a result of the synergistic effects of climate change and habitat fragmentation. Those with the least resources have the least ability to adapt and will be the most damaged by climate change. Increase in global mean temperatures will produce net economic losses in many developing countries for all magnitudes of warming, and the condition is most extreme among the poorest people in these countries.

Nor will Australia and New Zealand be spared. Despite the hopes that climate change will help some crops in those countries, any short-term gains are likely to be overwhelmed by other losses and long-term damage. Droughts and fires will be even more common and water much more valuable as great portions of Australia dry up. Threats from extreme events are likely to change the lives of many Australians. The unique biological evolutionary line that has evolved in Australia and New Zealand over millions of years, as well as some of the richest biodiversity on Earth, could well be devastated by climate change. Australian ecosystems that are particularly vulnerable to climate change include coral reefs, arid and semi-arid habitats in southwest and inland Australia and Australian alpine systems. Freshwater wetlands in coastal zones in both Australia and New Zealand are vulnerable as well.

The small island states of the Asia–Pacific region are already experiencing the effects of sea level rise that is causing erosion, loss of land, dislocation of people, increased risk from storm surges and high costs to respond to and adapt to these changes. Fresh water will become even more crucial to small islands with climate change. The reef fisheries that support populations on small island states are severely threatened by expected weakening and damage to coastal ecosystems. Agricultural limitations will be worsened by the precipitation variability and sea level rise resulting from climate change. The socioeconomic repercussions of climate change threaten small islands' hopes of ecotourism and sustainable development.

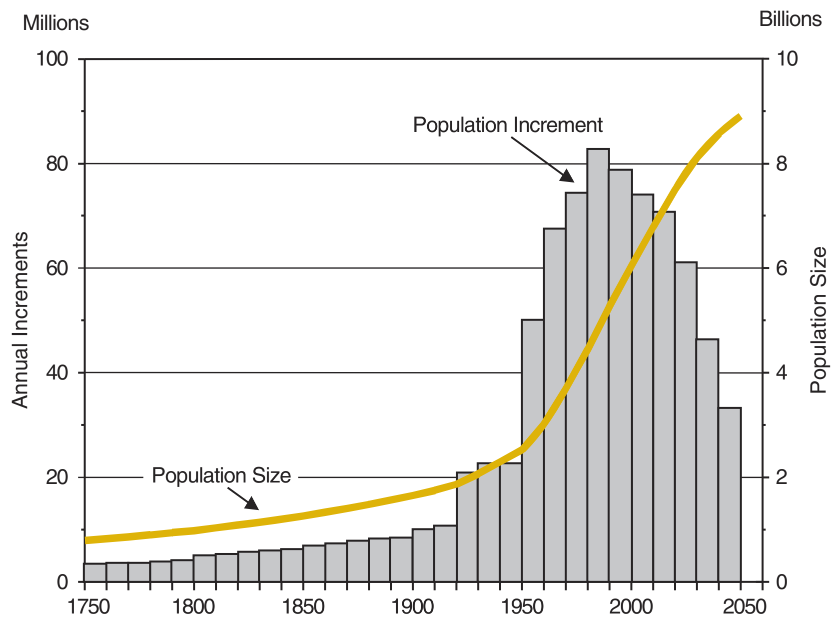
Let's go through the five basic problems: population, water, biodiversity, food and energy.

Population

Our grandparents and great-grandparents entered the 20th century with a world population of less than two billion. As of 2009 that figure is estimated to be about 6.76 billion[11] having risen by one billion in just 12 years (see Figure 3.1). This is the shortest period of time in history for a billion increase in the world's population. Of the 78 million people currently added to the world each year, 95 per cent live in developing regions, especially in Asia and Africa.

Asia, with almost 3.8 billion people, now accounts for over 60 per cent of the world's total population, while China and India comprise 20 per cent and 16 per cent respectively. World population distribution and density is highly unequal, but half of the world's top 25 most populated countries are in the Asia–Pacific.[12] And these very populous countries also have some of the *world's highest rates of entrepreneurial activity* (see Table 3.1).[13] Many of the entrepreneurs

FIGURE 3.1: LONG-TERM WORLD POPULATION GROWTH, 1750 TO 2050



Source: United Nations, 'The World at Six Billion', www.un.org/esa/population/publications/sixbillion/sixbilpart1.pdf, p. 7

TABLE 3.1: ASIA – POPULOUS AND ENTREPRENEURIAL

SIZE RANK	COUNTRY	POPULATION	ENTREPRENEURS, PER CENT OF POPULATION
1	China	1 321 851 888	24.6
2	India	1 129 866 154	11.5
4	Indonesia	234 693 997	19.3
6	Pakistan	169 270 617	na
7	Bangladesh	150 448 339	na
10	Japan	127 467 972	5.4
12	Philippines	91 077 287	39.2
13	Vietnam	85 262 356	na
19	Thailand	65 068 149	28.4
24	South Korea	49 044 790	14.8
Total, 10 Asian countries		3 424 051 549	World average 10.5%

Source: Adapted from 'World's 50 Most Populous Countries: 2007', www.infoplease.com/ipa/A0004391.html; Global Entrepreneurship Monitor, www.gemconsortium.org

who launch businesses in these countries are called **necessity entrepreneurs** because they do so having little alternative (see further information in Chapter 14: 'Global opportunities for entrepreneurs').

One of the most interesting dynamics is that some countries are overpopulated with old people and others with young people. China, Japan, Australia and the nations of North America and Europe are ageing countries. One out of every 10 people worldwide is now 60 years old or older, but that figure will be one out of five by 2050. By 2025 there will be more than one billion people in that age group. China faces not only overpopulation but also a fast-ageing population due to its One-Child Policy. The problem is that one adult child is now supposed to support two parents and four grandparents. Chinese entrepreneurs have great opportunities in aged care. On the other hand, there are regions such as India and Southeast Asia with enormous youth populations. The median age in India, Malaysia and Vietnam is 20–25 years old. Cambodia's median age is only 14–20 years old.

While some might see chaos amid the population problems, entrepreneurs see business opportunities. Here is a quick look at three kinds of opportunities for entrepreneurs:

- **Opportunities due to overpopulation**. Population pressures have opened up a wide variety of opportunities for social and business entrepreneurs. Solutions are needed for: finding fresh drinking water, tackling air and water pollution and soil contamination, fighting infectious diseases such as HIV/AIDS, combating unemployment and crime rates, improving food varieties, finding renewable energy sources, introducing family planning, providing universal education and promoting non-polluting urban and long-distance transportation, to name just a few.
- **Opportunities arising from the youth population**. Here youth market opportunities are seemingly endless and are perfect for small- and medium-sized overseas suppliers. Some of these opportunities are in these fields: social Internet, music, aftermarket support, sport and fitness, head-hunters and freelancer agents, fashion and accessories, cheap cars, environmentally friendly products, interactive media and gaming, electronic toys, creative and educational products and personal communications devices.
- **Opportunities for the ageing population**. The ageing generation is called the baby boomers, who were born after the Second World War. The world has never seen so many well-off elderly people. Opportunities abound in the fields of: age-defying and

POPULATION-PRENEURS

>>ENTREPRENEURIAL EDGE

Around the world there are entrepreneurs dealing with water scarcity, irrigation, sanitation and access to healthy drinking water. This initiative is supported by the Skoll Foundation.

>> Isaac Durojaiyeis is Managing Director of DMT Toilet in Lagos. He launched his company after noticing that even though 20 million people will soon be living in the state, there were very few public toilets, thus creating a health hazard. His mobile toilets are now built locally with local materials, a first in West Africa. Besides improving sanitation and public health, Durojaiye uses the toilets to create jobs. Most are given to street gang leaders (now moving away from crime) and to widows, who in this society are often resourceless.

>> Martin Fisher is CEO of Kickstart, a non-profit social enterprise that addresses a major market failure by manufacturing irrigation pumps such as the Super MoneyMaker to help small farmers in the developing world. 'They have only one asset – a small plot of land. And one basic skill: farming.'

>> Jack Sim founded the World Toilet Organization ('the other WTO!') in 2001 when he realised that 40 per cent of the world population had no toilets: 'Sometimes they have TV, but no toilets!' The day he turned 40, he realised that he was halfway done with his life and decided to do something important: 'A person's life is finite, it doesn't go beyond 80. If you want a full life, you shouldn't focus only on making money. You should find a greater meaning and use this time allocated to you in a useful way and help other people.'

>> Adrien Couton founded International Development Enterprises (India) on exporting drip irrigation technology to Pakistan and East Africa, and looked into creating an SMS system for resellers to place orders and now is serving four million small farmers.

Source: Adapted from 'Global X and the Water Crisis', www.socialedge.org/blogs/global-x/

'ageing by design' products, travel, relationship-building networks, nostalgia products, food preparation services, medical and healthcare provision, labour-saving technologies to replace retirees, holiday-home construction, regenerative medicine and bio-tech and age-related drugs.

Water

In the new millennium our planet, with diverse and abundant life forms, is facing a severe water crisis. All the signs suggest that it is getting worse and will continue to do so. Though water is scarce, the crisis is actually one of water governance – caused by the ways in which we mismanage water – rather than supply. The real tragedy is the effect the water crisis has on the everyday lives of people who are blighted by waterborne disease, who live in degraded and often dangerous environments and who cannot get enough to eat due to water scarcity. The natural environment is also suffering. It is groaning under a mountain of waste dumped onto it daily and from overuse and misuse by those with little concern for the consequences and for future generations.[14]

More than two-thirds of our planet is covered by water and the human body is made mainly from water.[15] Nevertheless, water is one of our scarcest resources. The volume of freshwater resources is about 2.5 per cent of the total water volume. Of this fresh water, 68.9 per cent is in the form of ice and permanent snow cover in mountainous regions, the Antarctic and the Arctic, while 30.8 per cent is stored in underground basins. Freshwater lakes and rivers contain only 0.3 per cent of the world's freshwater supply.[16] This means that only a small proportion of the world's water is available for human use and much of it is used for sanitation, industry, and irrigation.

Water is difficult to purify, not easily transportable and – most importantly – impossible to substitute, yet it has played a great part in the proliferation of the human race. Enterprising engineers, entrepreneurs and innovators early on developed transport and storage facilities for fresh water (such as aqueducts and artificial lakes) that made it possible to have bigger cities further away from freshwater access.

Meanwhile, bio-entrepreneurs created high-yielding crops and animals that consumed astonishing amounts of water. One cup of coffee requires 140 litres of water to produce, while 1 litre of milk requires 1000 litres of water.[17] It can take 15 500 litres of water to make 1 kg of beef or 3000 litres to produce 1 kg of chicken.[18] However, these same livestock produce more than 10 billion tons of mineral-rich effluent each year that is a major source of pollution. In most countries, it is not humans who consume most of the water; it is industry and especially energy production (such as atomic energy plants) and agriculture.

Predictions are that by 2025 more than 35 per cent of the world population will be living in water-stressed regions, which means they will be affected by chronic or recurring shortages of fresh water. Other regions have the reverse problem. They will have a higher frequency of rainfall-related disasters such as floods, mudslides, typhoons and cyclones. It is estimated that about 20 per cent of water scarcity is due to climate change, with 80 per cent caused by economic development and population growth.[19]

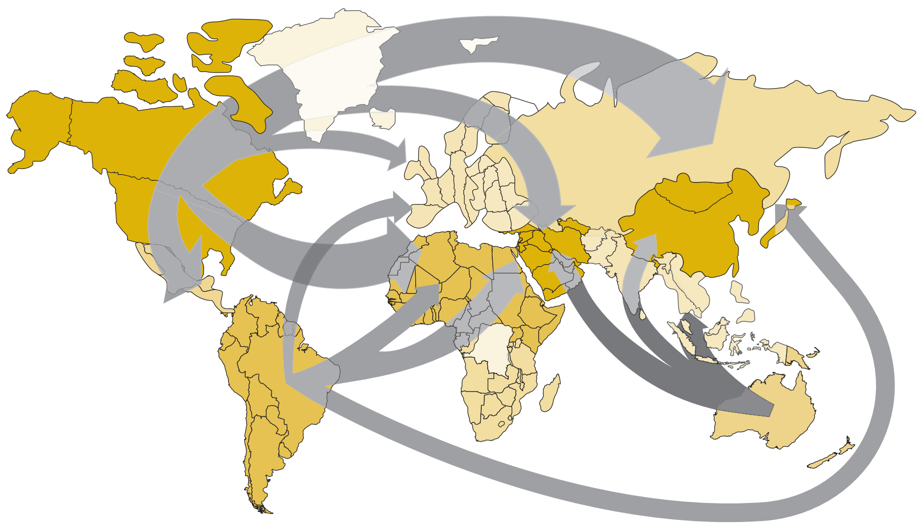
Yet there are numerous business opportunities amid all this gloom as well. Investment in safe drinking water and sanitation contributes to economic growth. For each $1 invested, the World Health Organization (WHO) estimates returns of $3 to $34, depending on the region and technology.[20] In terms of competitive advantage it would be more productive if entrepreneurs in countries with a high amount of water resources concentrated on the production of water-intensive goods. This is called the **virtual water trade,** because water can be 'embedded' in the production of products and services.[21] Entrepreneurs should look at businesses that make use of the virtual water exchange. Water-stressed countries should use their water resources for the production of drinking water and sanitation for their population while water-abundant countries should specialise in exporting agricultural products. The most important exporters of virtual water in Asia are Thailand, India, Australia and Vietnam, while Sri Lanka, Japan, Korea and China are the most dependent on importing virtual water. Entrepreneurs could spot niche opportunities, for example, exporting virtual water from Thailand to Sri Lanka.

TABLE 3.2: VIRTUAL WATER TRADE

TOP ASIAN 'VIRTUAL WATER' IMPORTERS			TOP 'VIRTUAL WATER' EXPORTERS		
WORLD RANK	COUNTRY	NET IMPORT VOLUME, BILLION CUBIC METRES	WORLD RANK	COUNTRY	NET EXPORT VOLUME, BILLION CUBIC METRES
1	Sri Lanka	428.5	1	United States	758.3
2	Japan	297.4	2	Canada	272.5
4	South Korea	112.6	3	Thailand	233.3
5	China	101.9	4	Argentina	226.3
6	Indonesia	101.7	5	India	161.1
13	Malaysia	51.3	6	Australia	145.6
16	Taiwan	35.2	7	Vietnam	90.2

Source: Adapted from A.Y. Hoekstra and P.Q. Hung, 'Virtual Water Trade: A Quantification of Virtual Water FLows between Nations in Relation to International Crop Trade', Value of Water Research Report Series, No. 11, Delft, Netherlands: UNESCO/IHE, 2002: 26, www.ihe.nl/content/download/2614/26914/file/Report11-Hoekstra-Hung.pdf

FIGURE 3.2: **COMPETITIVE ADVANTAGE THROUGH VIRTUAL WATER TRADE**



Source: H. Yang, L. Wang, K. C. Abbaspour and A.J.B. Zehnder, 'Virtual Water Trade: An Assessment of Water Use Efficiency in the International Food Trade', *Hydrology and Earth System Sciences,* 10, 2006: 448, www.hydrol-earth-syst-sci.net/10/443/2006/hess-10-443-2006.pdf

WATER-PRENEURS

>>ENTREPRENEURIAL EDGE

- >> Collect storm water and rainfall more comprehensively. Economically recovering storm water and rainfall is a simple way to increase water supply by as much as 5–7 per cent worldwide. This is a ripe, low-hanging fruit for most rainy season countries. On a smaller scale, households could recycle water for domestic uses other than drinking while cities, towns and villages could collect rain more effectively.
- >> Store and transport water in a sustainable and safe way. There is an enormous need for more reliable solutions to store, transport and deliver already filtered water that is currently wasted or re-contaminated over time. Stored freshwater is prone to contamination. Transporting drinkable water is also a challenge. The water infrastructure is such that more than 30 per cent of water is lost during transportation in India and China. Fixing the infrastructure and regaining that 30-something per cent loss requires higher maintenance and hence more public funding.
- >> Make existing freshwater safe to drink. In India, diseases such as malaria, typhoid, cholera and diarrhoea kill 1600 children every day. In this case when there is freshwater consumers do not trust its quality. They refuse to drink it without controlling its filtration. The primitive solution is to boil the water, which is expensive energy-wise. Another solution is to install a filter and chlorinate or bleach the water before consumption. New types of purification cartridges look promising and are cheap to install. Another solution uses recycled shellfish processing waste that removes suspended sediment, heavy metals and organic contaminants from construction water.
- >> Convert seawater into drinkable water. This process is called desalination. It is enabled by 'reverse osmosis' that separates salt and other contaminants from the freshwater by pushing the seawater though filtration membranes at high speed. Until a few years ago, this process was not affordable as the cost of energy to desalinate seawater was four times the cost of the traditional solution. Funded by venture capital, innovation in desalination takes different forms – some

>>

companies focus on the filtering membranes, others on reducing energy needed for the reverse osmosis process and still others on entirely new approaches that do not require membranes.

>> Conserve available freshwater by reducing the water footprint of existing products and services. This last category is made up of water-conserving solutions that dramatically reduce water usage. Roughly 85 per cent of the world's water is used by agriculture, 10 per cent by industry and 5 per cent by households. There is a tremendous opportunity for new technologies to reinvent agriculture – food will have to be grown on much smaller pieces of land to conserve scarce and probably more expensive water. Other fundamental transformation processes will need to be invented to dramatically reduce the water footprints of industries and households. In the next five years, the key driver for adoption of new technologies and processes will be fast-rising water prices. Another way to reduce one's water footprint is by recycling domestic water.

Source: Adapted from Dominique Trempont, 'Water Shortages: Opportunities for Entrepreneurs', 8 March 2009, www.sramanamitra.com/2009/03/08/water-shortages-opportunities-for-entrepreneurs/

To keep things in perspective it's worth noting that other water-preneurs are responsible for one of the most egregiously wasteful commodities in the world today: bottled water. Bottled water is more expensive than petrol and contributes greatly to greenhouse emissions through the production of plastic bottles made from petroleum, most likely at a factory that burns fossil fuels. Also consider the emissions involved in shipping the bottles long distances (water is quite heavy), keeping them refrigerated and finally, transporting them for recycling or land-fill (yet another ecological impact). In developing economies bottled water increases the gap between the water haves and the water have-nots.[22]

Biodiversity

Of the calamities facing entrepreneurs today, the ongoing extinction of species is probably the worst. Yet again, entrepreneurs are responsible for a large part of this extinction. As Pulitzer Prize-winning biologist Edward O. Wilson of Harvard University once said:

> The worst thing that can happen . . . is not energy depletion, economic collapses, limited nuclear war, or conquest by a totalitarian government. As terrible as these catastrophes would be for us, they can be repaired within a few generations. The one process ongoing that will take millions of years to correct is the loss of genetic and species diversity by the destruction of natural habitats. This is the folly that our descendants are least likely to forgive us for.[23]

Wilson predicted that by 2010 half the world's species would be extinct if present trends continue.[24]

Biodiversity means the variety of life in all its forms. The immense biological diversity on our planet took billions of years to evolve and only a fraction of today's species have been identified and given official names. The Earth cannot function properly without biodiversity because a well-working ecosystem provides the environment with essential services such as purification and protection of air and water resources, soil formations, nutrient storage and

>>ENTREPRENEURIAL EDGE

THE TRUE PRICE OF FIJI WATER

The small island nation of Fiji with its population of about 150 000 is now controlled by a military regime that took control via the 2006 Fijian coup d'état. With such an unstable government, some people suffer while some industries prosper. One of these prospering companies is Fiji Water. Water imported into the US from the small island nation of Fiji is ranked number 2 in bottled waters. France, of course, is number 1.

Today, about one-third of Fiji's people lack access to clean drinking water, leading to incidents of typhoid and other water-related diseases.

The irony of these statistics is that Fiji Water exported about 130 million litres of Fiji water in the past year. To present a 'green face' to the world – Fiji Water returns a token amount of money to bring clean water to certain areas of Fiji. However, according to a recent BBC investigation, the Fiji capital of Suva has an undependable water system with failing infrastructure.

And, let's not overlook the 'transnational' power Fiji Water wields over the relatively powerless rulers of Fiji. In early July of 2008, the Fijian government proposed a tax on bottled water in order to generate income and to help improve and conserve the island's water resources. In a span of a couple of weeks the government had to abort the bottled water tax because of overt economic threats by the bottled water lobby. The threats occurred when bottling companies shut down factories stating that they would not operate under such a tax. This bottled water protest would have cost Fiji up to $3 million in lost export revenues a week. With such a big gun to their heads the Fijian government quickly dropped its proposed tax.

However, there is one vital aspect of this Fijian water debacle that rarely receives mention. And that is the long-term environmental consequence of taking precious water and putting it inside plastic bottles. Fresh water on volcanic islands is rare due to the porous soils and rocks that make up such islands. Therefore, any fresh water that is found on a volcanic island is valuable because it supports tropical ecosystems and usually flows out into the ocean rather quickly. Fresh water is the most precious liquid on Earth. Through the alchemical miracle of our hydrologic cycle – fresh water is naturally manufactured by nature and temporarily stored on land. And, only a small fraction of fresh water, about one-hundredth of one per cent, is readily available for human use.

The key to the success and sustenance of all life is the energetic flow of water through our biosphere. When precious fresh water flows from land and mixes with our world's saltwater – there is a magical explosion of life along the so-called 'coastal zone.' This explosion of coastal life is vital to the foundation of the food chain for our oceans. When we pump fresh water from any volcanic island, such as we find in Fiji we remove a vital life-giving force from that region of our global ocean. In fact, Fiji Water brags about how remote the Fijian Islands are – and thus capitalises on the purity of Fiji water. However, this remoteness is what makes Fijian fresh water all the more valuable to the local people, their tropical ecosystems and the oceanic ecosystems that have evolved in that region over millions of years.

Therefore, each time we see a bottle of Fiji Water let's consider the true price of that bottle to our living world of today and of the future. Hopefully, we will see the price that reaches far beyond the money in our pockets.

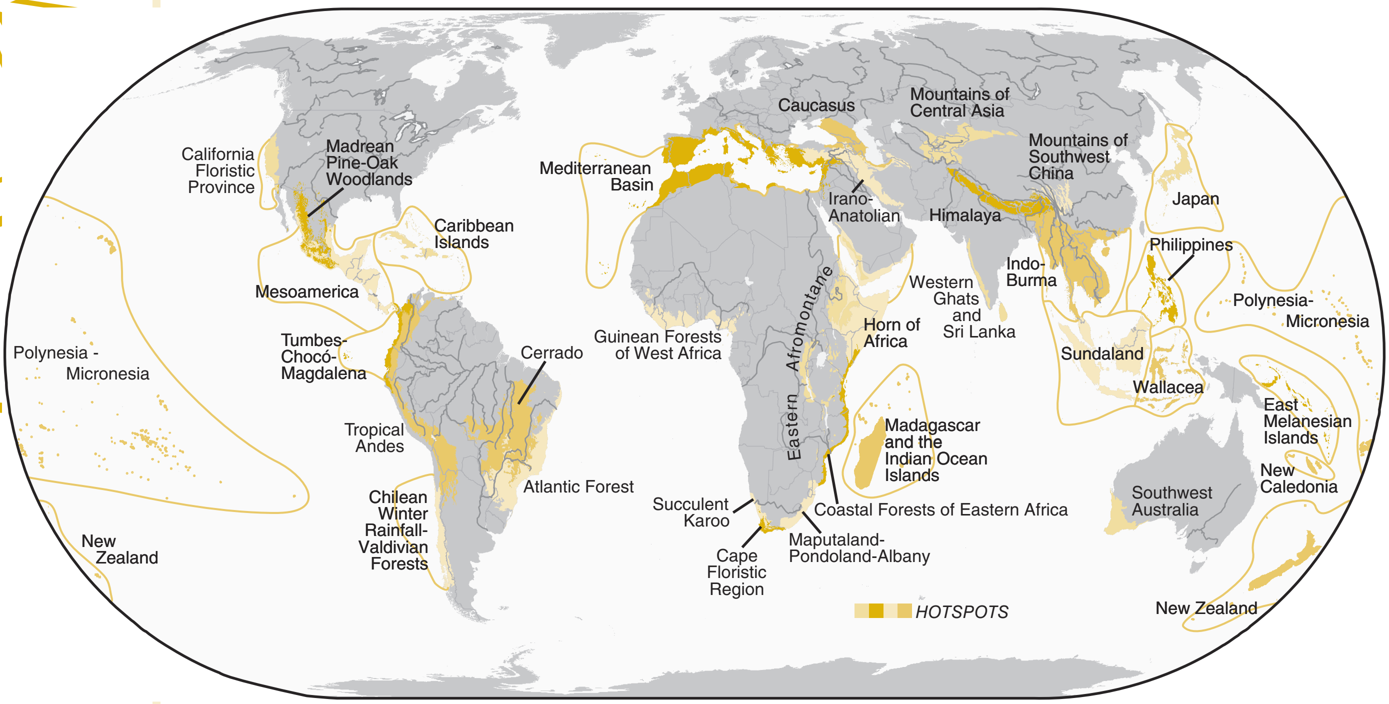
Source: William E. Marks, 'The True Price of Fiji Water', AlterNet, 2 October 2008, www.alternet.org/story/101207/

recycling, stabilisation and moderation of climate, food, medicines, genetic diversity, future resources, leisure and cultural, aesthetic and intellectual benefits.

The problem is that humans have savagely damaged the Earth's biodiversity. Scientists have called this the **Holocene extinction event,** the ongoing mass extinction of species during the Holocene (modern – last 10 000 years) epoch. A good example of how entrepreneurs have contributed to this is given in the 'Entrepreneurship in practice' box headed 'Entrepreneurship and ecocide' on page 114.

About 10 000 years ago when humans developed and spread, the extinction of species started to accelerate – dramatically so since the 1950s. Paradoxically, the reasons for this new mass extinction is derived from human inventiveness and the enterprising spirit as the creation of cities and industries made previous living space uninhabitable for thousands of species.

FIGURE 3.3: BIODIVERSITY HOTSPOTS OF THE WORLD



Source: Biodiversity Hotspots, Conservation International, www.biodiversityhotspots.org/xp/hotspots/Documents/cihotspotmap.pdf

Entrepreneurship and inventions led to higher consumption of resources, which nature could not replace quickly enough. As adventurers criss-crossed the planet, they carried with them the technological means of mass destruction and the threat of introduced, alien species that disturb the balance of ecosystems. This is not what Schumpeter had in mind when he called entrepreneurs the agents of 'creative destruction'.

The greatest damage to biodiversity has likely been done by necessity entrepreneurs in the 'lungs of the Earth' – the rainforests. Rainforests are found in Southeast Asia, including from Myanmar to the Philippines, Indonesia, Papua New Guinea and northeastern Australia. Rainforests continuously process vast quantities of carbon dioxide into oxygen and support tens of millions of species of plants, insects and animals. A bio-fuel entrepreneur who cuts down the rainforest to plant oil palms in Malaysia or Indonesia may well bring his family out of poverty, but his factory upsets the environment's equilibrium and results in a considerable loss of plant and animal species, not to mention the implications for Indigenous culture.

From an entrepreneurial perspective if you had one dollar to invest, in which areas of the world would it contribute most towards slowing the current rate of species extinction? One way to answer such a question is to look at the map of irreplaceable biodiversity hotspots that are most threatened with species extinction (see Figure 3.3).[25]

The Amazon rainforest is the largest and most species-rich in the world. The region is home to about 2.5 million insect species, tens of thousands of plants and some 2000 birds and mammals. Driven by timber and paper industries, very enterprising companies are clear-cutting more and more rain-trees such as teak, mahogany and rosewood.

The declining biodiversity of the seas deserves special mention since they cover more than two-thirds of the Earth's surface.[26] Human activities pose serious threats to the oceans' biodiversity and their capacity to support productive fisheries, recreation, water purification and other services we take for granted. For years the industrious fishers of New England in the US, in their unquenchable quest for market share and to outstrip their competitors, pushed the North Atlantic's George Bank to its limit. Over-fished, polluted, taken for granted and much more fragile and complex than we once thought, this vast living space is deteriorating quickly.

Action is urgently required to halt the loss of biodiversity, but governments and non-governmental organisations (NGOs) cannot do it alone. This is where biodiversity entrepreneurs must step in. Biodiversity business is defined as 'commercial enterprise that generates profits via activities which conserve biodiversity, use biological resources sustainably and share the benefits arising from this use equitably'.[27]

The entrepreneurial business case for biodiversity is easy to make when a firm depends directly on it to operate. This is easy to see in nature-based tourism, where the income stream to private enterprise depends very clearly on the health of the surrounding ecosystem. In such cases, business owners and managers need little persuasion to invest in biodiversity management. Entrepreneurs also can find opportunities in other sectors, where greater

THE TROUBLE WITH PALM OIL

>>ENTREPRENEURSHIP IN PRACTICE

Palm oil is now the world's most popular vegetable oil. However, its rapid rise to market dominance has been at a heavy environmental cost – its production is one of the primary causes of rainforest destruction in Southeast Asia. Environmental campaigners are working to regulate the industry, but time is running out, not just for the 2000 orang-utans killed each year, but for the planet itself.

It has emerged that a large number of our everyday foods and other products are contributing to human rights abuses and perpetuating an environmental catastrophe that is not only causing pollution and accelerating global warming but could see the extinction of one of our closest relatives. Palm oil, valued because it is solid at room temperature, is present in everything from breakfast cereals to soap. The vast majority of the world's palm oil comes from Malaysia and Indonesia, where the expansion of the industry has destroyed millions of hectares of rainforest.

Sooner or later, we will all be confronted with the environmental impact of palm oil. Deforestation is thought to contribute to 20 per cent of the atmospheric carbon dioxide released every year. The palm oil industry is making a significant contribution to this total by burning forest to clear land. The effect is worse when peat swamps are drained and subsequently catch fire because it releases thousands of years' worth of sequestered carbon. This has happened on several occasions during the past decade.

According to some estimates, the area given over to palm oil in Indonesia alone may increase threefold to 16.5 million hectares by 2020. Plantation companies already have concessions in large areas of forest in Aceh in Sumatra and West and Central Kalimantan in Borneo. And the governments of both countries are considering establishing an 18 000 square kilometre palm oil 'fence' along the Malaysian–Indonesian border in Borneo, which would cut through critical orang-utan habitat in both protected and unprotected forest and have serious implications for hydrology throughout the island.

So what can consumers do about it? The obvious answer would be to boycott palm oil and any companies involved in its production and trade. Unfortunately, it isn't that simple. For a start, even though palm oil and its derivatives are all-pervasive, they are difficult to find in product ingredients lists. In most foods, palm oil is simply referred to as vegetable oil, while its derivatives have numerous names, the majority of which would be indecipherable to all but a biochemistry graduate.

Source: Charlie Furniss, 'Seeds of Destruction', *Geographical*, 78(3), 2006: 45–55. © *Geographical* is the property of Circle Publishing Ltd biodiversity is associated with lower costs, increased productivity and ultimately higher profits. For example:

- more diverse ecosystems as destinations for tourism
- biologically diverse soils for more productive agriculture
- marine biodiversity to increase productivity of fisheries
- crop genetic diversity to maintain disease resistance and yields
- diverse tropical forests as prime locations in which to find novel genes and compounds for agricultural, industrial and pharmaceutical uses
- fisheries including aquaculture
- carbon **sequestration** in **biomass**
- payments for watershed protection
- bio-prospecting
- biodiversity management services
- biodiversity offsets – including both mandatory and voluntary schemes
- recreational hunting and sport fishing.[28]

Companies big and small are already making money out of conserving, sustainably using and (in one way or another) sharing benefits from the profits of organic agriculture, ecotourism and other biodiversity pursuits.

Food

The human right to food is embodied in the **Universal Declaration of Human Rights** (UDHR), Article 25, which states, 'Everyone has the right to a standard of living adequate for the health and wellbeing of himself and his family, including food'. This right is most endangered in low-income, food-deficit countries. Hunger and malnutrition are still the number-one risks to health worldwide. There certainly is a wealth of opportunities here for entrepreneurs.

Food – or lack of it – is where a changing climate will exert some of its most troublesome effects in the 21st century. Because of droughts, shifts in rainfall patterns and higher temperatures, we are likely to see major changes in where and when food is produced on the planet's surface. The rich world looks set to reap the benefits while crop yields in the tropics, home to hundreds of millions of subsistence farmers, are likely to drop.

We are an enterprising lot, we humans. We use about a third of Earth's land surface for farming and other purposes.[29] Food production is the most widespread enterprise in the world. Thirty per cent of the world's population farms 40 per cent of the Earth's land surface not locked in ice.[30] By the final quarter of the 20th century, we were actually winning the war against hunger. From 1970 to 1997, the number of people suffering from hunger dropped from 959 million to 791 million – mainly as a result of dramatic progress in reducing the number of malnourished in China and India. In the second half of the 1990s, however, the number of people suffering from chronic hunger in developing countries increased at a rate of almost four million per year.[31] By 2000–02, the total number of undernourished people worldwide had risen to 852 million – 815 million in developing countries, 28 million in countries in transitional economies and nine million in industrialised countries.[32] Today, one in nearly seven people does not get enough food to be healthy and to lead an active life. This makes hunger and malnutrition the main risks to health worldwide –greater risks than AIDS, malaria and tuberculosis combined.

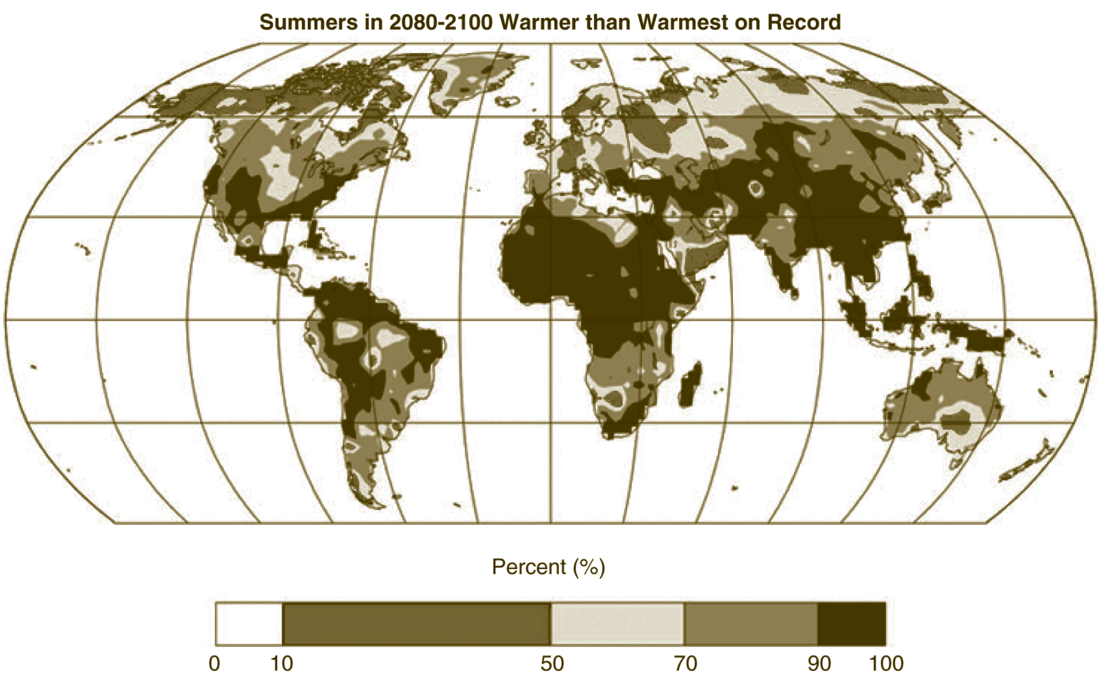
Providing food and combating climate change is a two-way street and the food industry definitely influences climate change. Growing crops and rearing livestock have the largest impact on climate change of all the parts of the food system. If you include clearing forests to create farmland, then agriculture is estimated to be responsible for nearly one-third of global

greenhouse gas (GHG) emissions.[33] Apart from **deforestation**, the biggest causes of agricultural greenhouse gas emissions are the use of fertilisers (38 per cent) and rearing livestock (31 per cent) transforming into methane and nitrous oxide. Both of these gases are released in much smaller quantities than carbon dioxide, but one ton of nitrous oxide or methane has a far greater impact on climate change than a ton of carbon dioxide.

It works the other way as well – climate change is affecting food production. Scientists have not reached a consensus about the potential impact of climate change on harvests because it depends on where farming and ranching are done. The output of some areas (particularly in wealthy countries) may well be boosted by warmer, wetter growing conditions and by increased supplies of CO_2, while other regions (such as developing countries in the tropics) are likely to suffer droughts and floods. Worse still, one-third of the Earth's land surface is threatened by **desertification**. Billions of tons of fertile soil disappear annually. People living in these regions are forced to move elsewhere to find other means of livelihood. Usually they migrate towards urban areas or go abroad and mass migration is a major consequence of desertification. From 1997 to 2020, some 60 million people are expected to move from the deserted areas in Sub-Saharan Africa towards Northern Africa and Europe.

Entrepreneurs now need to judge a particular country's or region's vulnerability to climate change when making business decisions. Vulnerability is a function of exposure, sensitivity and adaptive capacity. Figure 3.4 shows a worse case scenario of vulnerability to climate change by the year 2100.[34]

FIGURE 3.4: SUMMERS IN 2080–2100, LIKELIHOOD THEY WILL BE THE WARMEST ON RECORD



Source: www.sciam.com/media/inline/2009-01/2009-01-globaltemps_2.jpg

Energy and climate

The Earth has warmed about 0.85 degrees Celsius in the past 100 years. Calendar year 2008 was the coolest year since 2000, according to the NASA Goddard Institute for Space Studies (GISS) analysis of worldwide temperature measurements, but it was still in the top 10 warmest years since the start of record-keeping in 1880. Given the range of uncertainty in the measurements, the GISS team concluded that 2008 was somewhere between the seventh and the 10th warmest year on record. The 10 warmest years have all occurred within the 12-year period from 1997 to 2008.[35] The summer of 2005 has been the hottest ever.[36]

Fossil fuels are a non-renewable source of energy. By burning them this energy is released. The substantial use of fossil fuels goes back to the time of the Industrial Revolution. Think about the entrepreneurs and their inventions that depend on fossil fuels: airplanes, automobiles, electrical power plants, paper, plastic, rockets, steam engines, steel and electric lights. Nowadays, more than 85 per cent of the world's energy demands are met by fossil fuels. One litre of regular petrol is the time-rendered result of about 23.5 metric tons of ancient organic material deposited on the ocean floor. The total fossil fuel used in the year 1997 was the result of 422 years of all plant matter that grew on the entire surface and in all the oceans of the ancient Earth.[37]

Problems such as **resource depletion** and overpopulation are in part the consequence of energy-intensive agriculture, pollution and other environmental problems. While energy consumption is growing minimally in the Western world (for example, North America) or even stagnating (for example, the European Union), total energy consumption is growing continuously. The main reason is the current boom in energy consumption growth in Asia where the largest volumes are in China and India. Vietnam has increased its consumption by almost 300 per cent, yet Singapore's consumption is declining (see Table 3.3). As society continues to consume more and more energy won by burning fossil fuels, reserves are decreasing steadily.

TABLE 3.3: ASIA–PACIFIC CARBON PERFORMANCE SORTED BY GREATEST ECOLOGICAL FOOTPRINT RANK[38]

COUNTRY	ECOLOGICAL FOOTPRINT			CO_2 EMISSIONS			CARBON EMISSIONS PER CAPITA		
	ECOLOGICAL FOOTPRINT	ECOLOGICAL RESERVE	RANK	TOTAL CO_2 EMISSIONS IN METRIC TONS	% WORLD TOTAL	RANK	METRIC TONS, 2004	INCREASE SINCE 1990	RANK
China	2.1	-1.2	1	7 010 170	24.40%	91	3.84	82.9%	72
Thailand	2.1	-1.2	2	6 049 435	22.20%	10	20.40	7.9%	75
India	0.9	-1	4	1 342 962	4.90%	33	1.20	50.0%	131
Indonesia	0.9	0	5	1 257 963	4.60%	34	9.84	13.1%	132
Singapore	4.2	-4.1	9	465 643	1.70%	39	9.77	74.5%	32
Vietnam	1.3	-0.5	14	378 250	1.40%	123	1.69	111.3%	109
Australia	7.8	7.6	19	326 757	1.20%	13	16.30	0.6%	5
South Korea	3.7	-3	22	268 082	1.00%	81	4.28	137.8%	36
Japan	4.9	-4	26	177 584	0.70%	54	7.05	127.4%	22
United States of America	9.4	-4.4	38	98 663	0.40%	135	1.18	293.3%	2
New Zealand	7.7	6	43	80 512	0.30%	144	0.97	38.6%	6
Philippines	0.9	-0.3	59	52 252	0.20%	23	12.20	-18.7%	135
Malaysia	2.4	0	69	31 570	0.10%	50	7.80	13.0%	64

Source: Wikipedia, 'List Of Countries By Ecological Footprint', http://en.wikipedia.org/wiki/List_of_countries_by_ecological_footprint#cite_ref-0; Wikipedia, 'List Of Countries By Carbon Dioxide Emissions', http://en.wikipedia.org/wiki/List_of_countries_by_carbon_dioxide_emissions

One of nature's cardinal rules of **sustainability** is to rely on renewable energy of which there are five main sources:

1. Earth (geothermal): energy extracted from the heat within the Earth
2. Sun (solar): radiation converted to electricity
3. Wind: electricity from climate and geography that produce winds which blow across the landscape
4. Water (hydro): using moving or falling water power to generate hydroelectricity
5. Biomass: energy stored in wood and dry crops.

Currently renewable sources of energy provide only 18 per cent of the world's energy.[39]

Some entrepreneurs are betting their future on hydrogen gas (H_2). When hydrogen burns in air or in fuel cells, it combines with oxygen and produces water vapour. Widespread use of hydrogen as a fuel would eliminate most of the air pollution problems we face today. However, there are problems. Hydrogen is attached to other molecules and does not exist by itself unless energy is applied to free it. In other words, hydrogen is not a source of energy in itself; it is a fuel produced by using other sources of energy and it does not make sense to use fossil fuels to release hydrogen. However, low-polluting, renewable sources such as wind, solar and geothermal could do the trick. Iceland, with its huge geothermal resources, wants to turn itself into the world's first 'hydrogen economy'.[40]

CLIMATE CHANGE ECONOMICS FOR ENTREPRENEURS

Entrepreneurs need to know the basic principles of **climate change economics** (also known as environmental economics). This field looks at how economic activity – including entrepreneurial activity – affects the environment. It seeks economic solutions to minimise harm to the environment while allowing maximum economic benefit. It addresses environmental problems such as pollution, negative externalities and valuation of non-market environmental effects.[41] First we review some of the basic concepts in climate change economics and then later we go on to look at how *sustainable entrepreneurship* can help resolve the environmental problems of global socioeconomic systems.

Market failure in the commons

There clearly has been **market failure** in protecting the Earth's resources. Market failures not only prevent entrepreneurial action to resolve environmental problems but actually motivate environmentally degrading behaviour.[42] This explains why business entrepreneurs have been some of the greatest violators and polluters in their headlong quest for creating value.

Successful markets are supposed to be characterised by perfect information where all competitors can see the moves of other competitors, as well as their consequences. Consumers then can choose the best products, and the market will reward the best companies with higher sales. Much to our disappointment, markets have very real imperfections. We know these as *externalities*, both positive and negative.[43]

- A **positive externality** is a benefit that people might receive even though they are not part of the decision and are not considered in any way by the entrepreneur. For example, the attractiveness of well-kept farms spills over into the tourism industry. Another good example is when an entrepreneur invents something or creates valued-added information, then others can benefit by exploiting the invention or information.

- A **negative externality** is where costs spill over onto someone not involved in producing or consuming the good. In the magnitude of potential harms, climate change from greenhouse gas emissions has been ranked as the number one externality of economic activity. But who will pay to clean it up? To date, business has been free to exploit the atmosphere and leave the clean-up to governments and the public.

The dilemma here is that valuable public goods such as the atmosphere or water supplies can suffer from Hardin's famous **tragedy of the commons**.[44] Imagine shepherds who share a common pasture (the commons), on which they are all entitled to let their sheep graze. Each shepherd wants to put as many cows as possible onto the land even if the commons are damaged as a result. The individual shepherd gets all the profits while the damage to the commons is shared by the entire group. If all the shepherds make this rational decision individually then the commons are destroyed and all suffer. In this sense there is little incentive for an individual entrepreneur to curb his activities to benefit others. No one owns the resource yet everyone depends on it. It is difficult to identify who has rights and responsibilities and free markets cannot effectively allocate such goods as atmospheric resources. Businesses are free to exploit and plunder while downstream recipients must clean up the mess or restore the resource.

The situation becomes chaotic. Governments step in to address the risks, but international cooperation is hard to achieve. Developed countries – responsible for the overwhelming bulk of emissions into the atmosphere – are reluctant to take on increasingly expensive commitments when they see that there are cheap alternatives to constrain emissions in developing countries. Developing countries – the chief source of emissions growth in the future – want to have the opportunity to pollute to gain a higher standard of living. They are reluctant to curb their emissions when they have historically contributed so little to the increase in greenhouse gases concentrations and may suffer disproportionately more of the negative effects if nothing is done. The international consulting group KPMG believes that 'this market failure is likely to be corrected over time by a combination of international cooperation, regulation, technology promotion and market-based incentives'.[45]

Emissions trading programs

One of the well-known economic solutions to minimise harm to the environment is **emissions trading**. This is an entrepreneurial way of controlling environmental pollution by providing economic incentives for achieving emissions reductions. It is sometimes called **cap and trade** and Asian countries are at the forefront. World Bank figures show that the emissions trading market was worth $47 billion in 2007, of which Asia accounted for about 80 per cent.[46]

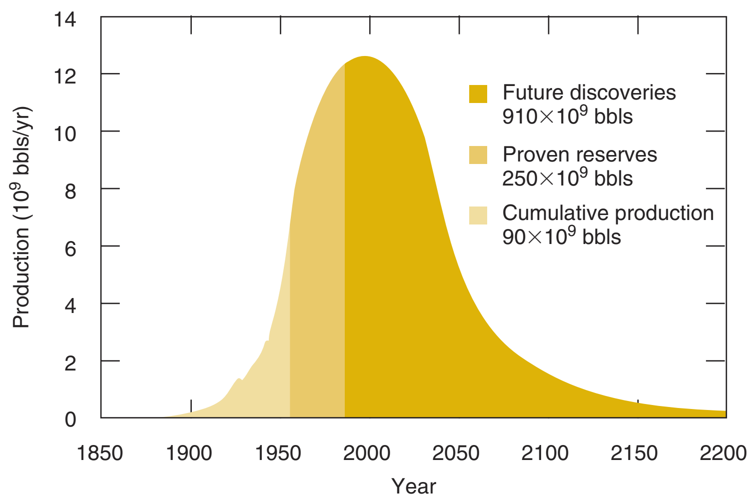
The logic of a cap and trade program is simple. Drawing upon scientists' estimates, governments set peak levels (caps) on permitted greenhouse gas (or carbon) emissions in a particular geographic location that can be emitted over time (for example, a year). A governmental (sometimes private) authority then deals out permits to release emissions that amount to the total cap. Government passes laws that impose punitive fines or other sanctions on any party that violates its permitted emission, possibly including criminal penalties for company owners or executives. At that point the market mechanism of trade and exchange begins. Businesses that need to emit pollutants to make a profit can trade or sell the permits they do not need to those that need them more. This assumes that any business that can cut emissions for less than the price of the permits will cut emissions instead of buying permits. In theory this mechanism should speed up investment in emissions-savings technologies, including those involving both energy efficiency and clean energy.

The major problem that cap and trade programs face is not only who issues the permits but also to whom are the permits issued and on what basis. Should current emitters be given permits to help them stay in business and contribute to jobs and growth? Should permits go to every man, woman and child, so the poor theoretically could sell their permits to get the money to pay for energy and energy-saving devices? Or should the government collect fees on all trades to finance efforts to improve energy efficiency and promote more investment in clean energy? In Australia, the Garnaut Climate Change Review in 2008 recommended that emissions permits should be sold competitively and not allocated free to carbon polluters. It recognised the need for low-income families to be compensated and recommended more support for research into low-emissions technologies.[47]

Peak resource theory

Hubbert **peak resource theory** predicts the depletion of various natural resources. Hubbert used it initially to measure the end of finite resources such as coal, oil, natural gas and uranium, but the theory is now used increasingly with other resources such as water and wheat. A 'peak curve' applies to any resource that can be harvested faster than it can be replaced.

FIGURE 3.5: HUBBERT PEAK THEORY – HOW LONG WILL THE RESOURCE LAST?



Source: Hubbert peak theory, http://en.wikipedia.org/wiki/File:Hubbert_peak_oil_plot.svg

TABLE 3.4: WHEN WILL IT ALL RUN OUT?

2010	Peak oil is the point in time when the maximum rate of global petroleum extraction is reached, after which the rate of production enters terminal decline.[48]
2025	Peak water is reached when the rate at which water is demanded is higher than the rate at which the supply is replenished.[49]
2025	Peak coal is the point in time at which the maximum global coal production rate is reached, after which the rate of production will enter irreversible decline.[50]
2030	Peak gas is the point in time at which the maximum global natural gas production rate is reached, after which the rate of production enters its terminal decline.[51]
2035	Peak uranium is the point in time that the maximum global uranium production rate is reached. After that peak, the rate of production enters a terminal decline.[52]

Mitigation versus adaptation

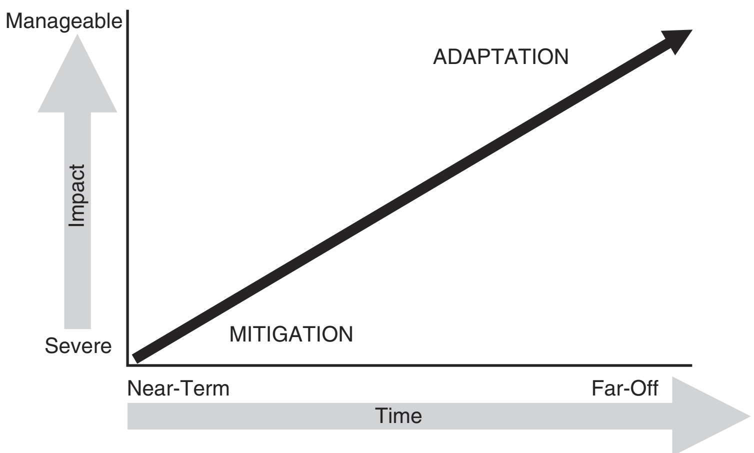
To set a firm's approach to climate change and to assess strategic opportunity, entrepreneurs need to look *inside out* to understand the impact of the firm's activities on the climate as well as *outside in* to look at how changing climate (in both its physical and its regulatory manifestations) may affect the business environment in which the firm competes. Inside-out strategy is known as **mitigation**. The flip side of this is **adaptation** strategy.[53] Here are the basic questions:

- Should you aggressively *mitigate* these risks; for example, by reducing greenhouse gas emissions? This means managing the social, regulatory, reputational and marketplace risks from emissions, or
- Should you gradually *adapt* to changes in temperature, sea level, storm patterns and so forth? This means changing practice due to the new conditions.

Of course these strategies are not mutually exclusive, but over the medium term the movement will definitely be from mitigation to adaptation, which the IPCC defined as 'adjustment in natural or human systems in response to actual or expected climate stimuli or their effect, which moderates harm or exploits beneficial opportunities'.[54] From a strategic perspective this means the entrepreneur has to come to grips with how to make changes to cope with new climate conditions.

Some adaptation will almost certainly be required even if emissions stopped immediately. However, from a strategic point of view, there is a trade-off between mitigation, which is reactive, and adaptation, which is proactive. Strategy is shaped by an analysis of risks and expected costs as well as by public perception. If you believe that the impacts of climate change are far off and manageable, then your course is adaptation. But if you believe that the impacts are near-term and severe, then mitigation is your strategic course.

FIGURE 3.6: ADAPTATION VERSUS MITIGATION



Source: Citigroup, *Climatic Consequences: Investment Implication of a Changing Climate*, www.climateactionproject.com/docs/Citigroup_2007.pdf, p. 19

UNDERSTANDING THE ECONOMICS OF ADAPTATION

Adaptation is crucial to deal with the unavoidable impacts of climate change to which the world is already committed. It will be especially important in developing countries that will be hit hardest and soonest by climate change.

Adaptation can mute the impacts but cannot by itself solve the problem of climate change. Adaptation will be important to limit the negative impacts of climate change. However, even with adaptation there will be residual costs; for example, if farmers switch to more climate-resistant but lower-yielding crops.

There are limits to what adaptation can achieve. As the magnitude and speed of unabated climate change increase, the relative effectiveness of adaptation will diminish. In natural systems, there are clear limits to the speed with which species and ecosystems can migrate or adjust. For human societies, there are also limits – for example, if sea level rise leaves some nation states uninhabitable.

Without strong and early mitigation, the physical limits to – and costs of – adaptation will grow rapidly. This will be especially so in developing countries, and underlines the need to press ahead with mitigation.

Adaptation will in most cases provide local benefits, realised without long lag times, in contrast to mitigation. Therefore some adaptation will occur autonomously, as individuals respond to market or environmental changes. Much will take place at the local level. Autonomous adaptation may also prove very costly for the poorest in society.

But adaptation is complex and many constraints have to be overcome. Governments have a role to play in making adaptation happen, starting now, providing both policy guidelines and economic and institutional support to the private sector and civil society. Other aspects of adaptation, such as major infrastructure decisions, will require greater foresight and planning, while some, such as knowledge and technology, will be of global benefit.

Studies in climate-sensitive sectors point to many adaptation options that will provide benefits in excess of cost. However, quantitative information on the costs and benefits of economy-wide adaptation is currently limited.

Source: Nicholas Stern, *The Economics of Climate Change: The Stern Review*, Cabinet Office – HM Treasury, Cambridge University Press, 2007: 457

Climate risk analysis

Entrepreneurs of the 21st century must now evaluate the specific risks and economic impact of their activities. Who runs the most risk for climate change? There are four types of risks:

- **Physical risks:** These are the direct impacts of weather-related events, including water availability, rainfall levels, sea levels, damage to property, asset losses, heat-related illness or disease, enforced relocation of operations and increased commodity prices. Insurers now believe they have underestimated the financial cost of climate change damage and are warning that they could double premiums. The last three years (2006–09) were the costliest catastrophe years for the insurance industry in history, with disaster-related economic losses of $269 billion.[55]
- **Reputation risks:** These are threats to a company's brand value. Brand value constitutes as much as 70 per cent of a company's **market capitalisation**.[56] Climate change has already become a mainstream consumer concern (see Chapter 10, 'Marketing challenges for entrepreneurial ventures'). Consumers are paying much more attention to business behaviour and companies that do not prepare for climate change run the risk of damaging their market and brand values. Those who do can find ideal opportunities to differentiate themselves with measures aimed, for example, at reducing their carbon footprint (see Chapter 11, 'Measuring performance for entrepreneurial ventures').

- **Regulatory risks:** Climate change is increasingly seen by governments and the public as a serous market failure that can only be correct through regulations and government intervention. Entrepreneurial companies must adjust to new laws and regulations that create competitive disadvantages because regulatory uncertainties make it difficult to plan ahead. There are two types of regulations: legislation such as permits and product requirements, and market-based regulation such as carbon taxes, emissions-trading schemes and fuel tariffs.
- **Litigation risks:** Greater regulation leads to more litigation. There doubtless will be court actions against emitters, challenges that relate to carbon taxes and control, as well as scrutiny of disclosure of greenhouse gases in annual reports.

According to KPMG, there are six business sectors that are in the danger zone of being vulnerable to **climate change risk**. These are aviation (emerging regulation and risks to reputation), healthcare (increased cost of treatment due to climate-induced disease), the financial sector (faulty investments and increased insurance liability), tourism (reduction in tourists), oil and gas (regulatory risk) and transport (particularly trucking and aviation). Safe-haven sectors in terms of vulnerability to climate change risks are telecommunications, chemicals and food and beverage. For chemicals the safe designation is due to their high level of preparation.[57]

While climate change is a global phenomenon, there are regional differences in risk assessment. Sixty-nine per cent of Australians believe that climate is a 'serious and pressing problem, and that we should take steps now even if this involves significant costs', while China weighed in at 42 per cent with the Philippines and Thailand both at 27 per cent. Indians are the most sceptical about the need for action against global warming with just 19 per cent saying that the problem is pressing enough to merit immediate, costly measures.[58]

Social discount rate

Everyone prefers to have something they need now rather than later, all other things being equal. Economists refer to that preference pattern as the *discount rate* on the future. That is the rate at which you discount the future return when compared to an immediate or present return. Let's assume that sea levels will inundate coastal Bangladesh in 2050. A 50-year-old Bangladeshi grandmother with a life expectancy at birth of only 37 years, today has a slender chance of living to 100. But her 10-year-old granddaughter today has a life expectancy of 61 years.[59] The grandmother would be more likely to ignore risks of catastrophic events.

But we cannot say for certain whether coastal Bangladesh will actually be flooded in 2050. We may see rising temperatures and more storms today, but we cannot accurately predict their consequences. Will coastal flooding lead to the extinction of a particular species that, unknown to us, has contributed to our welfare? Or will hydrogen power become feasible such that we can maintain high energy consumption without adding to greenhouse gas emissions? What may seem catastrophic to us now may be technologically manageable to others later, so the real cost to them may be small and accurately reflected in a discounted value today.

So climate change economists have come to agree that a constant discount rate on the future is not appropriate. They increasingly agree that we must calculate the **social discount rate**, which is a measure used to help guide choices about the value of diverting funds to social projects. It is basically the rate used to compare the wellbeing of future generations to the wellbeing of those alive today. Since climate change is upon us, it is important to determine an accurate social discount rate on the benefits of reducing CO_2 emissions and greenhouse gases. Some people have argued that 'giving future generations less weight than the current generation is ethically indefensible'.[60]

Equity versus efficiency

In the hasty quest to efficiently lower carbon emissions there can be serious equity issues that ignore how the resulting costs and benefits are legitimately distributed among the community. Coal-fired power might be cheaper than wind or solar, so poor communities might prefer fossil fuels. More efficient systems to capture methane from waste sites might have negative impacts for poor communities in the surrounding areas. Jobs might be eliminated in manufacturing industries that have to apply emissions controls. This means that entrepreneurs who can grow the economy in the process of adapting to climate change will have a greater chance of success.

It is not just an **equity gap** between richer and poorer communities; it is also a matter of location equity. Mitigation or adaptation efforts that only benefit suburbs or rural areas may be opposed by those that see only costs to them and gains to others. The concern for equity is not only morally correct, but it must also be made profitably correct.

Free trade and the environment

An area that entrepreneurs should monitor is the trade and environment debate that has emerged as a result of pressure from environmental groups in industrialised economies to introduce environmental issues to trade debates taking place at the World Trade Organization. **Free trade** allows entrepreneurs to act and transact without interference from government. World trade increased significantly until the global economic crisis when it experienced its greatest decrease since the Great Depression.

There is a trade-off between economic activity and environmental preservation. Industry and production that are necessary for trade use resources that deplete our environment and emit by-products that harm the environment. The basic trade theory model has ignored negative externalities resulting from economic activity that damages the environment. Current research is contradictory, but it can be said that free trade does affect the environment and because of negative impacts the environment must be protected to some degree.

The trade–environment debate continues to polarise economists. There are those who believe increased trade undermines environmental quality and others who believe free trade enables countries to grow out of their environmental problems and to generate revenues necessary to put in place stringent environmental regulations. Moreover, higher per capita income creates a powerful stimulus for higher demand among consumers for improved levels of environmental quality. Whatever the outcome of the debate, successful entrepreneurs should take these concerns into account and adapt to customer demands.

Sub-prime mortgage crisis

The global financial crisis affected everyone. Markets fell, institutions collapsed, and governments in even the wealthiest nations had to come up with rescue packages to bail out their financial systems. The financial bubble has burst.

From the US **sub-prime mortgage crisis** to the end of the property boom in other countries, no economy escaped the consequences. Worse still, the crisis revealed many underlying and long-hidden weaknesses in the global financial system and undermined trust in that same system.[61]

In broad terms the world economy was based on betting that almost anything could create enormous sums of money out of almost nothing. It was based on market sentiment. It was a worldwide financial fiasco brought about by sub-prime mortgages, collateralised debt obligations, frozen credit markets and credit default swaps.

How did this happen? Investors normally seek ways to increase their money. Traditionally they invest in government bonds, which in the wake of the dot-com bust and September 11 were cut drastically to one per cent to keep the economy strong in the US. The upside of this was that investors could borrow money for only one per cent and they also had access to cheap credit from Japan, China and Arab countries. This money was used to leverage into greater profits.

>>ENTREPRENEURSHIP IN PRACTICE

THE CREDIT CRISIS FOR DUMMIES

Take an entrepreneur trading in coffee beans. The entrepreneur buys a container of coffee beans for $10 000 and sells it to a coffee retailer for $11 000 for a $1000 profit. Then he thinks, 'Why don't I find a bank and borrow enough money to buy 100 containers of coffee beans'. For that, he needs another $990 000. Using the logic of leverage, he goes to banks awash with cheap cash and banks that can borrow money from the central bank at only one per cent, explains the good deal and borrows $990 000 more. He buys 100 containers for $1 million and sells them to retailers for $1 100 000. He then pays back the $990 000 loan plus $10 000 in interest. After his initial investment of $10 000, he is left with a $90 000 profit. This was a great way for both the entrepreneur and the bank to make their money. Here is how this escalated:

A family wants a house, so they save for a down payment and contact a mortgage broker. The mortgage broker connects the family to a lender, who gives them a mortgage. The broker gets a nice commission. The family buys a house and become homeowners. This is great for them because house prices have been rising practically forever. Everything works out nicely.

One day the lender gets a call from an investment banker who wants to buy the mortgage. The lender sells it to him for a very nice fee. The investment banker then borrows millions of dollars, buys thousands of more mortgages and packages them into a nice box. This means that every month he gets the payments from the homeowners of all the mortgages in the box.

Then his financial wizards put the box into three slices: safe, okay and risky investments. They pack the slices back up into the box and call it a '**collateralised debt obligation**' or CDO. The CDO works like three cascading trays. As money comes in, the 'safe' tray fills first, then spills over into the 'okay' tray and whatever is left into the 'risky' tray. The money comes from homeowners paying off their mortgages. If some owners don't pay and default on their mortgages, less money comes in and the risky tray may not get filled. This makes the bottom tray riskier and the top tray safer. To compensate for the higher risk, the risky tray receives a higher rate of return (for example, 10 per cent). The top tray receives a lower but still nice rate of return (for example, 4 per cent), which the okay tray has a 7 per cent rate of return. To make the top tray even safer, the banks insure it for a small fee, called **credit default swap**.

The banks do all this work so the credit rating agencies will call the top slice a safe AAA investment, the best rating there is. The okay slice is BBB, still pretty good. And they don't bother to rate the risky slice. Because of the AAA rating, the investment banker can sell the safe slice to the investors who only want safe investments. He sells the okay slice to other bankers, and the risky slice to hedge funds and other risk takers. The investment banker makes millions. He then repays his loans.

Finally, the investors have found a good investment for their money, much better than the one per cent central bank bills. They are so pleased that they want more CDO slices and more mortgages. The lender calls up the broker to find more homeowners, but the broker can't locate any more. Everyone that already qualifies for a mortgage already has one. But they have an idea.

When homeowners default on their mortgage, the investor gets the house, and houses are always increasing in value. Since they are covered in the homeowner's default, lenders can start adding risk to new mortgages: for example no down payment, no proof of income, no documents at all. And that's exactly what they did. Instead of lending to responsible homeowners, called prime mortgages, they started to get some that were less responsible. These are sub-prime mortgages.

This is the turning point. Just like always, the mortgage broker connects the family with a lender and a mortgage, making his commission. The family buys a big house. The lender sells the mortgage to an investment banker, who turns it into a CDO and sells slices to the investors. This works out nicely for everyone and makes them all rich.

No one was worried because as soon as they sold the mortgage to the next guy, it was his problem. If the homeowner were to default, they did not care. They were selling off their risk and making millions: like playing hot potato with a time bomb.

>>

Not surprisingly, the homeowner defaults on their mortgage, which at this moment is owned by the banker. This means the banker forecloses and one of his monthly payments turns into a house. No big deal. He puts it up for sale. But more and more of his monthly payments turn into houses. Now there are many houses on the market, creating more supply than there is demand and housing prices are not rising any more. In fact, they plummet.

This creates an interesting problem for homeowners still paying their mortgages. As all the houses in their neighbourhood go up for sale, the value of their house goes down and they start to wonder why they are paying back their $300 000 mortgage, for the house is now worth only $90 000. They decide that it does not make sense to continue paying even though they can afford to, and they walk away from their house.

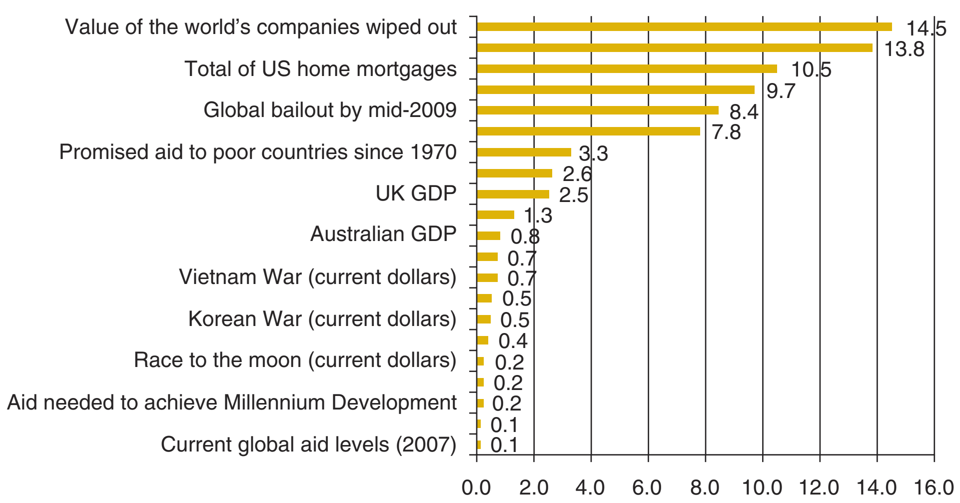
Default rates sweep the country and prices plummet. Now the investment banker is holding a box of worthless houses. The whole financial system is a **frozen credit market**. Everybody starts going bankrupt.

Source: Jonathan Jarvis, 'The Short & Simple Story of the Credit Crisis', © 2009 Jonathan Jarvis, http://crisisofcredit.com/

How much did the global financial crisis cost? Figure 3.7 shows how expensive the crisis was compared with other measures.

How did it affect Asia? The rise in food prices, coupled with financial instability and unpredictability elsewhere are having a compounding effect in the Asia–Pacific. High fuel costs, soaring commodity prices and fears of global recession are worrying many developing country analysts. Many falsely believed that Asia was decoupled from the Western financial systems. Asia did not have sub-prime mortgage crisis and enjoyed rapid growth and wealth creation in recent years. But this led to enormous investment in Western countries which increased Asia's exposure to problems stemming from the West. From 2007 to 2008 India's economy grew by a whopping 9 per cent fuelled largely by its domestic market. But India's growth has slowed rapidly in recent times. China similarly has experienced a sharp slowdown and has seen unrest over job losses. As have other countries, India and China have poured billions into recovery packages.

FIGURE 3.7: GLOBAL FINANCIAL CRISIS IN COMPARISON, $ TRILLIONS



Sources: CIA Factbook; and Oxfam, 'G20: Global bailout enough to end world poverty for 50 years', 1 April 2009, www.oxfam.org.uk/applications/blogs/pressoffice/?p=4080

Ironically it was innovative financial entrepreneurs that led to global economic collapse. As Nobel Prize-winning economist Joseph Stiglitz has said:

> They were innovating, all right, but not in ways that made the economy stronger. Some of America's best and brightest were devoting their talents to getting around standards and regulations designed to ensure the efficiency of the economy and the safety of the banking system. Unfortunately, they were far too successful, and we are all – homeowners, workers, investors, taxpayers – paying the price.[62] This crisis raises fundamental questions about globalization, which was supposed to help diffuse risk. Instead, it has enabled America's failures to spread around the world, like a contagious disease.[63]

Perhaps it is appropriate to quote the father of the free market, **Adam Smith**, who said: 'Our merchants and master-manufacturers complain much of the bad effects of high wages in raising the price, and thereby lessening the sale of their good both at home and abroad. They say nothing concerning the bad effects of high profits. They are silent with regard to the pernicious effects of their own gains.[64]

ENTREPRENEURIAL ECOLOGY

In 1987 a commission led by Norwegian Prime Minister Gros Harlem Brundtland was established by the UN's World Commission on Environment and Development (WCED) to explore the state of the world's natural systems and provide an outlook for global environmental health. The report, entitled *Our Common Future*, outlined an ominous situation wherein the world's population was living well beyond the means of the planet to replenish natural resources, absorb pollution and regulate important climatic conditions such as temperature. The long-term solution would be for human society to become *sustainable*, a term which the commission defined as: 'Meeting the needs of the present generation without compromising the ability of future generations to meet their needs'.[65]

The **Brundtland Report** led to the idea that markets were both the cause and the potential solution to the sustainability puzzle. It also has led us to rethink the concept of entrepreneurship. While climate change economics may lead us to the conclusion that environmental degradation results from the failure of markets, entrepreneurship literature argues that opportunities are inherent in market failure. Combining these two positions we see that *market failures represent opportunities for achieving profitability while simultaneously reducing environmentally degrading economic behaviours*. It also makes us look at how entrepreneurs seize the opportunities that are inherent in environmentally relevant market failures.[66]

In the era of **industrial entrepreneurship**, from the 19th century through to the new millennium, entrepreneurs were not obliged to consider the environment in their planning and design. They focused on extraction of scarce resources with little regard to their replenishment, on global distribution without regard to distance, on rampant construction without regard to environmental consequences and on supply-chain shortcuts without regard to equity. Entrepreneurs were usually not oriented towards the prevention of negative effects, to the reversal of degradation, or to net improvement in the physical and social universes. In the age of industrial entrepreneurs, waste was not a design consideration. In the end these entrepreneurs had a negative impact on the environment and society.

Now, in the age of **sustainable entrepreneurship**, we need to think ecologically about the **biosphere** and to consider the waste embodied in products. We need to move beyond simplistic input–output analysis without regard to the consequences and to apply new concepts that take into account the living dimension of the products and services that we produce. In essence, we need to create net positive **entrepreneurial impact loops** because the biosphere is linked to the **sociosphere** and the **econosphere**. These entrepreneurial impact loops can trigger effects that can amplify the degradation or the restoration in the biosphere.[67]

The term 'sustainable entrepreneurship' bridges three concepts. It puts the focus on the initiative and skills of an entrepreneurial person or team to achieve market success through innovations that protect and enhance the environment. More broadly, sustainable entrepreneurship is the intersection of the sociosphere, the econosphere and the biosphere.[68] The biosphere consists of all of the living and non-living things on Earth. The sociosphere consists of all the people in a social system, all the roles they occupy and all their patterns of behaviour, all their inputs and outputs relevant to other human beings and all the organisations and groups they belong to. The econosphere consists primarily of the segment of the sociosphere that is organised through exchange, especially commodity exchange, where the exchange is mediated through prices. Australian researchers Diesendorff and Hamilton defined the econosphere as 'the total capital stock, that is, the set of all objects, people, organisations and so on, which are interesting from the point of view of the system of exchange'.[69] From a material point of view, we see objects passing from the biosphere into the econosphere in the process of production, and we similarly see products passing out of the economic set as waste as their value becomes zero.[70] Slightly modifying the comments of the father of cradle-to-cradle design, Michael Braungart, we might say:

> The biosphere and econosphere are key concepts in the cradle-to-cradle philosophy. They are both closed, never-ending cycles, in which materials can get reused over and over again, because they remain valuable. They should contribute something valuable to either the biosphere or the econosphere. And then we ask which sphere its components belongs to. If they belong to the biosphere then the question is whether you can give it back to nature: Is it biodegradable, does it leave only nutrients that organic systems can feed on? If it's meant for the econosphere, then the key issue is how easily the product can be dismantled and materials can be reused.[71]

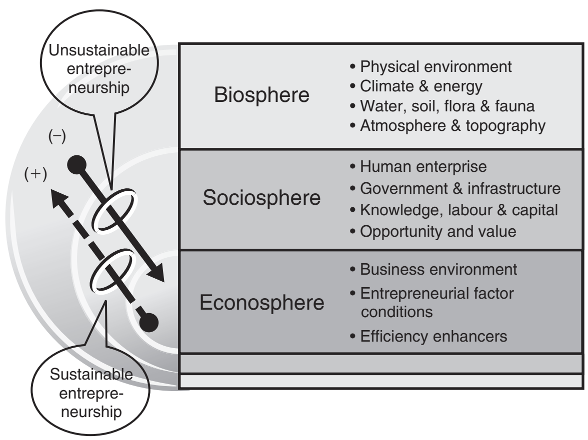
We might see these concepts in an equation:

$$SE = f(B + S + E)$$

The elements are arranged in order of historical sequence. If we use '$\in$' to mean 'embedded in or a subset of', we get

$$SE = (E \in S \in B)$$

FIGURE 3.8: ENTREPRENEURIAL ECOLOGY



Entrepreneurial ecology focuses on the sustainable combination of environment and entrepreneurship. The central idea is that there is a parallel between the natural system and the entrepreneurial system. Entrepreneurial ecology shifts the entrepreneurial process from linear (open loop) systems, in which resource and capital investments move through the system to become waste, to a closed loop system where wastes become inputs for new processes.

How are Earth, people and the economy connected?[72] The flow of energy and materials taken from and returned to their external environments is called *throughput*. For the most part this is an uneven exchange. Figure 3.8 shows that unsustainable entrepreneurs extract huge resources thus depleting Earth (negative sign). Normally they return them as waste in devalued form. Sustainable entrepreneurship means returning resources in value-added form (dotted line to the positive sign). All three spheres share a struggle for survival. They extract a constant source of energy and materials to maintain their self-organised state of a rate of low degradation. Otherwise they would run down to the point of zero energy. In physics we call the degradation **entropy** and the state of zero energy is called **inertia**.[73] All three systems must engage in a continuous process of want-satisfying. This provisioning involves identifying, extracting and processing of value. The problem is that entrepreneurs of the past have devalued this process with wanton extraction.

Another thing that unites the three spheres is the way they process materials. In the biosphere, natural processes create biomass, which is the mass of all living organisms and dead matter such as wood, leaves and other organic matter. Assuming no human intervention, these processes are optimised regarding the use of energy and materials. Redundancy enables the biosphere to deal with changes. There are repair mechanisms that reverse degradation. Error accumulations lead to the **mutational breakdown** of species, but Darwin has shown that there are 'repair kits' to correct for such errors. There is a huge amount of diversity created by variation and natural selection. Species appear and disappear in the course of evolution. Nonetheless, their superior evolved characteristics may remain. This enables the biosphere to react to changes. It creates a robustness that can survive major disasters.

Doesn't this sound like the economy? Indeed, the econosphere has analogous mechanisms. Let us consider a coherent group of industrial processes as an organism. Then the economic market also has a process of 'Darwinian' natural selection in the services and products that it produces. The econosphere has memory. It can revive old processes such as windmills. It copes with degradation through repair mechanisms. Errors that occur at reproduction are like a failed start-up business. It has various 'repair kits' such as law enforcement, environmental policy and education.

Up until the present, some entrepreneurs have greatly undervalued the biodiversity, ecosystems and means of survival that nature provides, including resources such as energy, water, free space and materials. We have not valued nature as a living ecosystem. Rather than adding value to living materials we only aim to reduce (for example, through recycling) the quantity of dead resources. In the end, society has to implement complex regulations, incentives and tools to penalise entrepreneurs or to encourage them to reduce waste and mitigate the effects of **negative entrepreneurship**. What **positive entrepreneurship** can do is generate positive impacts through value adding and eliminating designed waste, duplication, disposability, planned obsolescence and wasteful end purposes. Positive entrepreneurs create net positive-impact loop systems and innovations that create levers for biophysical improvements and social transformation.

Recycling is a case in point. Here we must make the distinction between down-cycling and up-cycling.

- **Down-cycling** transforms waste materials and goods to lower uses. While it may address post-consumer waste, this is a small fraction of the waste entailed in extraction and processing. The obvious example is the recycling of plastics, which turns them into lower grade plastics without regard to the huge energy losses that were incurred in its production.

- With **up-cycling**, waste materials are used to provide new, higher-valued products.[74] This is the practice of taking something that is disposable and repurposing it into a product of higher quality. An example would be reconstructing old mattresses, repairing and reusing carpet squares, turning wooden pallets into designer furniture and converting waste into art, edible chopsticks and compostable shoes.

Frameworks in entrepreneurial ecology

Michael Morris, Donald Kuratko and Minet Schindehutte wrote an excellent article on how to understand entrepreneurship through *frameworks* that could help organise the field in a systematic way. They attempted to present a series of frameworks to explain entrepreneurship. A framework provides a blueprint that converts abstraction into order, allows prioritisation of valuables or issues and helps identify relationships.[75] The field of sustainable entrepreneurship is only just beginning. Researchers have yet to seriously consider how the two literatures of entrepreneurship and the environment interrelate, but there are some outstanding *candidate frameworks* that are beginning to emerge.

Natural capitalism

Natural Capitalism*: Creating the Next Industrial Revolution* is a 1999 book co-authored by Paul Hawken, Amory Lovins and Hunter Lovins. The authors view the world's economy as part of the larger economy of natural resources and the ecosystem services that sustain it. Only through recognising this essential relationship between the Earth's valuable resources and the business environment can entrepreneurs gain advantage and prosper. According to the authors, the next industrial revolution depends on four central strategies: (1) the conservation of resources through more effective manufacturing processes; (2) the reuse of materials as found in natural systems on biological models with closed loops and zero waste; (3) a change in values from quantity to quality; for example, shifting from the sale of goods (for example, light bulbs) to the provision of services (illumination); and (4) investing in natural capital, or restoring and sustaining natural resources'.[76]

Cradle-to-cradle design

In the book *Cradle to Cradle*, McDonough and Braungart envision a world without waste, a world without poisons and a world in which all materials are continuously recycled. It already exists. We call it nature. In the natural system there is no waste and the same materials have been recycled for billions of years. The new industrial revolution is all about absorbing the lessons we should have learned from nature long ago. The key to sustainability is making the market work for the environment instead of against it.[77] The authors identify three fundamental principles: (1) Use current solar income. The biological productivity of the planet is fuelled by solar energy – the only resource that comes from outside our planet; (2) Waste equals food. There is no waste in nature; waste from one organism provides nutrients for another; and (3) Celebrate diversity. Life thrives on diversity. Nature finds solutions by constantly adapting to fill niches. The industrial application of cradle-to-cradle design creates a cycle for industrial materials. Like the Earth's nutrient cycles the flow of materials eliminates the concept of waste (cradle-to-cradle, rather than cradle-to-grave). Each material in a product is designed to be safe and effective, as well as to provide quality resources for subsequent generations of products; in other words, materials are conceived as nutrients and designed to circulate safely and productively.

Economic gardening

The term **economic gardening** is used to illustrate that sometimes it is better to grow your own entrepreneurial activities than to go out and hunt for them. Like gardening, the strategy relies on identifying entrepreneurial seeds, then fertilising and watering them to make them grow. Thus, the idea of sustainable development implies that communities need to respect their surrounding environments and avoid irreversible damage to, or depletion of, available resources.[78] The general principles of economic gardening rest on the value of creating a sustainable and diverse local economic base. This grow-your-own strategy was inspired by the realisation that business attraction and retention programs, which largely rely on economic development groups for implementation, were failing to produce and maintain highly skilled, value-added activities. Economic gardening moves away from offering financial incentives directly to a small number of firms. It attempts to foster economic growth by establishing well-articulated public policies based on 'extensive strategic planning, public–private collaboration, foundations of technology, human resources and capital and the development of strategic industrial clusters'.[79] Economic gardeners locate local entrepreneurs (who typically possess deep roots in the area), then provide them with the technical information, financial planning, or networking assistance they need to stay and grow before they get into financial difficulties or plan for relocation.[80]

The Natural Step

During the transition from rampant exploitation of the planet towards sustainable cultivation of resources, entrepreneurs will have to address the complexity and the dynamics of ecosystems and climate in relation to societal activity. They will, of course, also face the traditional complexity and dynamics within society, such as the pace of technological change, the uncertainty of consumer expectations and the unpredictability of new regulations. Making intelligent decisions in a complex, dynamic and uncertain system invariably requires system thinking. When the overall principles have been identified, all the details in the system can be related to them.

Starting from this reasoning, a process called '**The Natural Step**' was begun in Sweden in 1989 in which scientists tried to identify what they were able to agree on (rather than what they disagreed on) regarding sustainability. This led to the formulation of four non-overlapping principles for sustainability.[81] The principles are used as a non-prescriptive starting point for system thinking about sustainability. Starting from the principles, different actors within science, business, organisations and municipalities (who are experts within their own fields) ask themselves relevant questions and draw conclusions about what these principles will imply for their specific activities. The principles have also been used in strategic planning in a large number of corporations with differing fields of activities; for instance, manufacturers such as Interface, Electrolux and JM Constructions; trading companies such as IKEA and Hemkop; and service companies such as Swedish McDonald's and Scandic Hotels. They are also used by a growing number of municipal authorities (see Figure 13.6 on page 495).

Industrial metabolism

Let us take the word 'industry' to mean a 'balanced, quasi-stable collection of interdependent firms belonging to the same economy'.[82] The word 'metabolism' usually refers to the internal processes of a living organism that are necessary for the maintenance of life. Using a biological analogy, **industrial metabolism (IM)** was first proposed by Robert Ayres as 'the whole integrated collection of physical processes that convert raw materials and energy, plus labour, into finished products and wastes'.[83] Just like a living organism, industrial metabolism deals with the integration of physical processes that convert raw material, energy and labour into finished products and wastes. Labour input and consumer output act as the human components. Both industrial metabolism and ecological metabolism are examples of *dissipative systems*, which are self-stabilising. A manufacturing enterprise or firm may also be described as a self-organising entity, and the concept of industrial metabolism again applies. IM focuses on developing networks of industries that create eco-efficiencies and eco-interdependencies. They create a permanent waste exchange system where the by-product of one company becomes the raw material for another.

Natural advantage of nations

Building on Porter's famous *The Competitive Advantage of Nations*',[84] the Australian approach to the '**natural advantage of nations**' brings environmental improvement and competitiveness together. The natural advantage of nations shows that this new form of development – sustainable development – is far from being in conflict with economic goals and actually builds on the traditional central goal of economics that seeks to improve the wellbeing of all. The central message is that it is possible for economies to achieve high economic and job growth rates while dramatically reducing their negative impacts on the environment. Economic growth and negative environmental load on the planet can be decoupled.[85]

In particular, the natural advantage of nations presents a development framework: a clear blueprint for nations and business to make the switch to fully sustainable economies, and to do it profitably. It is a framework that engages mainstream business and government through discussion of innovation, competitive advantage, business theory, strategy development and industry policy. It does this without losing sight of the environmental purpose, and by illustrating that the drive for an ecologically sustainable world does not have to be in conflict with economics and business practices. The purpose is to inspire and demonstrate how business, government and civil society can take integrated approaches to make genuine progress; to show how through such integrated approaches much of Agenda 21 (the UN's blueprint for action on sustainability) could be put into practice; and to move hearts and minds across all sectors to elicit progress. This approach should be of particular interest for leaders in government, business, science, engineering and academia who now are exploring the cutting edge in the new sustainability economy.

Lean manufacturing and the seven wastes

This framework asserts that the expenditure of resources for any goal other than the creation of value for the end customer is wasteful and should be eliminated. Lean manufacturing is a philosophy generally associated with the Toyota Production System (TPS). It is renowned for its focus on reducing the original Toyota seven wastes in order to improve overall customer value. The following seven wastes are called **Muda** (無駄) in Japanese. They identify and classify resources which are commonly wasted.

1. **Rework**: Quality defects prevent the customers from accepting the defective product. The effort to create these defects is wasted. New waste management processes must be added in an effort to reclaim some value for the otherwise scrap product.
2. **Overproduction**: Overproduction happens each time you engage more resources than needed to deliver to your customer. For instance, large batch production due to change over a long period exceeds the strict quantity ordered by the customer. For productivity improvement operators are required to produce more than the customer needs. Extra parts will be stored and not sold. Overproduction is the worst muda because it hides or generates all others, especially inventory.
3. **Conveyance**: Each time a product is moved it stands the risk of being damaged, lost, delayed, etc. as well as being a cost for no added value. Transportation does not make any transformation to the product that the consumer is supposed to pay for.

4 **Waiting**: Refers to both the time spent by the workers waiting for resources to arrive, the queue for their products to empty as well as the capital sunk in goods and services that are not yet delivered to the customer. It is often the case that there are processes to manage this waiting.

5 **Inventory**: Inventory, be it in the form of raw materials, work-in-progress (WIP), or finished goods, represents a capital outlay that has not yet produced an income either by the producer or for the consumer. Any of these three items not being actively processed to add value is waste.

6 **Motion**: As compared to Conveyance, Motion refers to the producer or worker or equipment. This has significance to damage, wear and safety. It also includes fixed assets and expenses incurred in the production process.

7 **Overprocessing**: Using a more expensive or otherwise valuable resource than is needed for the task or adding features that are not needed by the customer. There is a particular problem with this item regarding people, who may need to perform tasks they are overqualified for in order to maintain their competency. This training cost can be used to offset the waste associated with overprocessing.

Ecology of commerce

This framework is based upon Paul Hawken's book *The Ecology of Commerce*. When we say **ecology of commerce** we focus on how the human uses of the Earth are threatening not just future uses but also the biological bases of human reproduction. The solution to threat is, incredibly, the market. The dynamics of the market itself, and particularly its generation of technical and organisational innovation, can be used not simply to slow the progress of environmental degradation but also to reverse it, by making waste and pollution costly and by creating commercial value in ecological integrity. [86]

SUMMARY

We began this chapter by examining how our times are so fraught with crisis. But even during crisis, entrepreneurial people with creative solutions can step forward to help save the planet and generate economic prosperity. Innovation sometimes happens when we see failure in the system. Schumpeter appreciated these 'cold showers' in our economy that release new waves of creativity. Today we also are engaged in a great climate war and an economic calamity, but to entrepreneurs, 'perseverance in adversity' is music to our ears. As the I Ching says, 'Perseverance furthers'.

Our Asia–Pacific region accounts for over 60 per cent of the world's total population. From Asia's mega-cities down to the Pacific islands, the effects of climate change are significantly damaging ecosystems. We are facing a severe water crisis, especially in safe drinking water and sanitation. Agriculture is responsible for one-third of toxic emissions. Our species has caused the mass extinction of thousands of species. The greatest damage to biodiversity has been done by entrepreneurs in the rainforests. Some of the world's most successful entrepreneurs, innovators and inventors are responsible for the planet's utter dependence on fossil fuels. Sadly, resource depletion and overpopulation are both products of the enterprising spirit.

The chapter then went on to look at climate change economics. Market failures not only deplete and destroy our environment, but they also sometimes actually motivate environmentally degrading behaviour. Entrepreneurs can cause negative externalities, where costs to the environment spill over onto the consumer and the public, leading to the 'tragedy of the commons'. Emissions trading is an entrepreneurial way of controlling pollution by providing incentives for achieving reductions. Peak resource theory applies to any resource that can be harvested faster than it can be replaced. This leads to the dilemma of simply mitigating risk versus truly adapting to a hotter future. Climate risk analysis must now be part of the way entrepreneurs evaluate their activities.

Global warming affects the bottom line because it affects how we analyse cost versus benefit. It leads even to the cold-hearted analysis of the social discount rate of losing millions of people due to rising oceans. There is an equity gap between rich and poor countries that not even free trade can correct. There is a trade-off between economic activity and environmental preservation. As if this were not enough, the financial bubble burst in 2009. Markets fell, institutions collapsed and governments in even the wealthiest nations had to come up with rescue packages to bail out their financial systems.

The chapter then moved on to look more deeply at entrepreneurial ecology. Research evidence argues that opportunities are inherent even in times of crisis, market failure and environmental decline. Yet from the 19th century, industrial entrepreneurship carries out the mass extraction of scarce resources without regard to consequences. Entrepreneurs greatly undervalued biodiversity and ecosystems. Sustainable entrepreneurship takes into account the living dimension of the products and services. Entrepreneurs must seek net positive entrepreneurial impact loops with the biosphere. Positive entrepreneurship eliminates designed waste, duplication, disposability, planned obsolescence and wasteful end purposes. Positive entrepreneurs create net positive-impact loop systems and innovations that create levers for biophysical improvements and social transformation.

Certain conceptual frameworks help us look at entrepreneurial ecology. Natural capitalism looks at the larger economy of natural resources and the ecosystem. Cradle-to-cradle design shows how to create a world without waste. Economic gardening seeks to avoid irreversible damage to, or depletion of, available resources. The Natural Step puts this all together in principles for sustainability and business. We can even imagine an entrepreneurial metabolism that bring together Earth's physical processes with human enterprise. Some countries actually seek the 'natural advantage of nations'. They aim to identify and classify resources which are commonly wasted and create an ecology of commerce. Entrepreneurship is central to this transformation.

KEY TERMS & CONCEPTS

9/11 attacks
Adam Smith
adaptation
biodiversity
biomass
biosphere
Brundtland report
cap and trade
carbon emissions
climate change economics
climate change risk
collateralised debt obligation
cost–benefit analysis
cradle to cradle
credit default swap
deforestation
desertification
dotcom crash
down-cycling
ecology of commerce
economic gardening
econosphere
ecosystem
Eisenhower recession
emissions trading
entrepreneurial ecology
entrepreneurial impact loops
entropy
equity gap
First Gulf War
fossil fuels
free trade
frozen credit market
greenhouse gas
global warming
GPS
Great Depression
Holocene extinction event
industrial entrepreneurship
industrial metabolism
inertia
Keynesian
market capitalisation
market failure
mega-cities
mitigation
Muda
mutational breakdown
natural advantage of nations
natural capitalism
necessity entrepreneurs
negative entrepreneurship
negative externality
peak resource theory
positive entrepreneurship
positive externality
rainforest
resource depletion
Universal Declaration of Human Rights (UDHR)
Schumpeterian
sequestration
social discount rate
sociosphere
sub-prime mortgage crisis
sustainability
sustainable entrepreneurship
temperature anomalies
the Natural Step
tragedy of the commons
up-cycling
virtual water trade

REVIEW & DISCUSSION QUESTIONS

1. What does 'as if the planet mattered' mean to you?
2. What evidence is there that entrepreneurial activity can bring an economy out of recession?
3. What is the difference between a Keynesian and a Schumpeterian economist?
4. How is the Asia–Pacific region faring as far as climate change is concerned?
5. What is a necessity entrepreneur and how is this connected to population?
6. What are some of the opportunities that you can name for entrepreneurs in terms of changing world populations?
7. Can you name another product that is analogous to Fiji Water?
8. Are entrepreneurs responsible for global warming?
9. What animals in your area are part of the Holocene extinction event?
10. Does the palm oil economy in Malaysia and Indonesia help or hurt entrepreneurs?
11. From an entrepreneurial perspective, which energy sources have the best prospects?
12. Can you describe an environmental market failure in your area?
13. Name three of your business ideas. For each one, are you a mitigator or an adaptor?
14. For each of these three business ideas, what type of climate change risks might you face?
15. For each of them, can you give a rough idea of the 'social discount rate' on the future?
16. Are you for or against free trade when it comes to the environment?
17. Would you have qualified for a sub-prime mortgage?
18. What is the difference between industrial entrepreneurship and sustainable entrepreneurship?
19. What part of your life belongs to the biosphere? To the sociosphere? To the econosphere?
20. Name three products that express positive entrepreneurship and three for negative entrepreneurship.
21. Give three good examples of up-cycled products.
22. Which of the eight new frameworks of entrepreneurial ecology appeals to you the most?

EXPERIENTIAL EXERCISE: CLEAN GREEN FACTORY

Clean Green Factory is an interactive exercise in which a group manufactures a product and examines its varieties of wastes. It is best to use coloured modelling clay. A children's Play-Doh Fun Factory™ with clay and moulds is perfect. You will need the shapes or moulds to form your products. You also need to use the 'Waste Table' (overleaf).

Two things are not allowed. First, you cannot recycle material. Choose the exact quantity and quality of materials before you begin. All the material that is fed into the 'factory' is either product or waste. Second, you cannot put raw material back to the stock. All the material that is taken either becomes product or waste.

1. Invent a company name.
2. The client urgently orders: 4 Yellow Leaves, 5 Green Stars and 3 Red Triangles.
3. The Yellow Leaves and Green Stars are bio-degradable and non-hazardous.
4. The Triangle is toxic and expensive. You should touch the Red as little as possible.
5. Each person selects a function or position in the company (and keeps it). This could be manager, production manager, waste manager, shop foreman, or health and safety manager, for example.
6. Plan your production process in advance and in detail before you touch the materials and begin manufacturing.
7. Manufacture your products according to your production plan.
8. Sort your three types of waste (see 'Waste Table' overleaf). Do a thorough clean-up and keep the Clean Up Waste separate.
9. Place your products and wastes in their proper quadrants on the 'Waste Table'.
10. Discuss what happened. Reflect on your planning and the results. Recall all your trial and errors. Explain how you could reduce waste, increase production efficiency and quality. What product innovations did you make?

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CLEAN GREEN FACTORY/FINISHED PRODUCTS AND WASTES			
Product	Three types of waste		
Put your finished products here that pass your internal and the client's quality checks	Put your 'quality waste' here that you selected for manufacture, but didn't use	Place your 'production waste' here that you collected during the manufacturing process	Place your 'clean up waste' here that you collected by cleaning the tools and workplace
Yellow			
Green			
Red			

(Copy this Table onto a large sheet of paper)

EXPERIENTIAL EXERCISE: HOW TO READ *THE ECONOMIST*

Some people believe that *The Economist* is the greatest magazine in the world. It is required reading for every aspiring entrepreneur. The scope of reporting spans the globe from the Tamil Tigers in Sri Lanka to the furniture industry of North Carolina. But it is the back few pages of each edition called 'Weekly Indicators' that are the most important for globally oriented entrepreneurs. Using either the magazine itself or the website www.economist.com/markets/indicators/, study the following information and answer the questions below.

WORLD MARKETS

Market index

Market measures consist of weighted values of the components that make up certain lists of companies. The stock market index tracks the performance of certain stocks by weighting them according to their prices and the number of outstanding shares by a particular formula. The Commodities (Price) Index assigns weighted averages to such commodities as energy, precious metals, base metals, or futures contracts known as 'softs'. In different columns you may also see *The Economist* 'Commodity Price Index' and the 'Markets' index.

OUTPUT, PRICES AND JOBS

Gross Domestic Product

A country's Gross Domestic Product, or GDP, is one of several measures of the size of its economy. The most common approach to measuring and understanding GDP is the expenditure method:

$$\text{GDP} = \text{consumption} + \text{investment} + \text{exports} - \text{imports}$$

'Gross' means that depreciation of capital stock is included. Without depreciation, with net investment instead of gross investment, it is the Net Domestic Product. Consumption and investment in this equation are the expenditure on final goods and services. The exports minus imports part of the equation (often called net exports) then adjusts this by subtracting the part of this expenditure not produced domestically (the imports), and adding back in domestic production not consumed at home (the exports).

Industrial production

This is a key economic indicator that relates to the total output of all factories, mines and utilities. Monthly per cent changes in the index reflect the rate of change in output. Changes in industrial production are widely followed as a major indicator of strength in the manufacturing sector.

Consumer prices

This is what people are usually thinking of when they worry about inflation. This is the price paid by whomever finally consumes goods or services, as opposed to the price paid by firms at various stages of the production process (see, for example, factory prices).

Unemployment rate

This represents people who were not employed during that week, but who were actively seeking work, waiting to be called back to a job from which they were laid off, or waiting to report within 30 days to a new payroll job. This is a measure of the number of workers that want to work but do not have jobs.

FOREIGN RESERVES

Foreign exchange reserves are the foreign currency deposits held by central banks and monetary authorities. These are assets of the central banks which are held in different reserve currencies, such as the dollar, euro and yen and which are used to back its liabilities; for example, the local currency issued, and the various bank reserves deposited with the central bank, by the government or financial institutions. The purpose of reserves is to allow central banks an additional means to stabilise the issued currency from excessive volatility, and protect the monetary system from shock, such as from currency traders engaged in buying an asset and quickly reselling (or 'flipping') it for profit. Large reserves are often seen as a strength as it indicates the backing a currency has. Low or falling reserves may be indicative of an imminent bank run on the currency or default, such as in a currency crisis.

MONEY AND INTEREST RATES

Money supply

This is the amount of money (coins, paper currency and cheque accounts) that is in circulation in the economy. If there is too much money in the economy, interest rates tend to go down while inflation tends to rise. Conversely, if there is too little money in the economy, interest rates tend to go up and prices and production tend to go down This can cause unemployment and idle plant capacity.

TRADE, EXCHANGE RATES, BUDGET BALANCES AND INTEREST RATES

Trade balance

Balance of trade figures are the sum of the money gained by a given economy by selling exports, minus the cost of buying imports. They form part of the balance of payments, which also includes other transactions such as the international investment position.

Current account balance

This very important figure is the difference between the nation's total exports of goods, services and transfers and its total imports of them. Current account balance calculations exclude transactions in financial assets and liabilities. The current account balance helps a country to evaluate its competitive strengths and weaknesses and to forecast the strength of its currency.

Currency units

This is the same as the exchange rate in US dollars over two time periods.

Budget balance percentage of GDP

This measures how much of the annual GDP is made up by the government's budget.

Interest rate

This is the cost of borrowing money, expressed as a percentage, usually over a period of one year. For example, when the mortgage balance is $100 000, and the interest rate is 6 per cent, one single annual payment will include $6000 interest.

RETAIL SALES, PRODUCER PRICES, WAGES AND EXCHANGE RATES

Retail sales

Key components of retail sales include automobiles, building materials, furniture, department store sales, food store sales, gasoline, clothing, restaurant sales and pharmacy sales. High retail sales are an indication of economic growth and an expanding economy. In commerce, a retailer buys goods or products in large quantities from manufacturers or importers, either directly or through a wholesaler, and then sells individual items or small quantities to the general public or end user customers, usually in a shop, also called a store. Retailers are at the end of the supply chain. Marketers see retailing as part of their overall distribution strategy.

Producer prices

This measure contains data on prices by stage of processing, sector, industry, and commodity. Price increases that wholesalers and manufacturers are paying now cause consumer price increases in products and services later.

Wages/earnings

A wage is the amount of money paid for some specified quantity of labour. When expressed with respect to time (usually per hour), it is typically called the wage rate, and is specified in pre-tax amounts. It is often the main monetary item upon which the worker and the employer focus when negotiating an employment contract.

Trade-weighted exchange rate

This is a given country's exchange rate with the currencies of its trading partners weighted by the amount of trade done by the country in each currency. A trade-weighted currency index is a weighted average of a basket of currencies that reflects the importance of a country's trade (imports and exports) with these countries. Sometimes a trade-weighted currency index is taken as a crude measure of a country's international competitiveness.

BIG MAC INDEX

Burgernomics is based on the theory of *Purchasing-Power Parity*, the notion that a dollar should buy the same amount in all countries. Thus, in the long run, the exchange rate between two countries should move towards the rate that equalises the prices of an identical basket of goods and services in each country. Our 'basket' is a McDonald's Big Mac, which is produced in about 120 countries. The Big Mac PPP is the exchange rate that would mean hamburgers cost the same in America as abroad. Comparing actual exchange rates with PPPs indicates whether a currency is undervalued or overvalued.

QUESTIONS

1. Which world share market is doing best right now?
2. Which stock (share) has dropped the most?
3. How is the price of cocoa tracking?
4. What are the trends in world oil prices?
5. What is the price of one barrel of West Texas Intermediate crude oil?
6. Which country has the highest predicted increased in GDP from this year to the next?
7. Which country has the lowest GDP growth and which the highest?
8. Which region of the world has the lowest industrial production?
9. Which country has the highest and which the lowest trade balance?
10. Which country has the highest budget balance as per cent of GDP? Based upon interest rates, where would you ideally invest your money?
11. Which country, Australia or New Zealand, is doing better in retail sales volume?
12. In which country do they sell a Big Mac at the best value? Which is the worst?
13. Make up five more questions that could be added to this exercise.

CASE 3.1: THE CARPET CLEANER

Ray Anderson's conversion – what he calls a 'spear to the heart' – came in 1994 while he was reading Paul Hawken's *The Ecology of Commerce*. In it, Hawken argued that business should inspire a more sustainable model that respects, and even mimics, the natural world. Anderson, CEO of carpet maker Interface, was so struck by Hawken's message that he sent his staff to tally up the resources used by Interface and its suppliers. The results were staggering: 1.2 billion pounds of raw material were extracted from the earth to produce the roughly $800 million worth of carpeting Interface sold in 1995. Anderson, you might say, was floored.

It's one thing to be green when you make yogurt, toothpaste, or ice cream. But what do you do when your product is made largely from oil, takes 20 000 BTU of energy per pound to produce, and lasts in the environment for 50 000 years? As Anderson wrote in his widely cited 1998 memoir, *Mid-Course Correction*, 'I am a plunderer of the earth and a thief [but] by our civilization's definition, I am a captain of industry . . . a modern day hero, an entrepreneur'.

That dichotomy sums up the challenge facing a sustainable business model. Traditional economic and accounting systems value growth and profit, without much concern for the means. Standard accounting has no place for the forests, oceans, streams and atmosphere, and the services they provide, such as recycling carbon dioxide, producing oxygen, processing waste and generally sustaining life. Nor does a company's income statement count the depletion of these resources as a cost. 'The Soviet Union collapsed because it was economically dishonest,' says Anderson. 'If we collapse, it will be because we are ecologically dishonest.'

Anderson makes this pronouncement from Interface's headquarters on the 20th floor of an office tower atop a bluff on the outskirts of Atlanta, Georgia, US. It was from this vantage point, he says, that General William Tecumseh Sherman watched the city burn during the American Civil War, and it is here that Buddy Hay plots to stave off damage of another sort. A former accountant, Hay is the manager of sustainability operations at Interface. His small but eclectic group – composed of engineers, accountants and an environmental lawyer – monitors Interface's EcoMetrics, or what Hay describes as 'our metabolism: how much we take in, in raw materials and energy, and what comes out, in the form of products and waste'. Each of Interface's 15 plants around the world reports on hundreds of EcoMetrics – ranging from employees' commuting miles to energy usage per unit of product – that Hay and his team analyze quarterly. The metrics serve mainly as internal measures of progress; such efforts barely register in conventional financial circles. 'Wall Street only cares about one thing, and that's the bottom line,' says John Baugh, an analyst who tracks Interface for brokerage firm Stifel Nicolaus & Co. While Baugh admits that Interface's environmental initiatives appeal to its customers, they don't factor into his analysis. 'Did they get a return on the money spent? That's hard to measure,' he says.

By its own measure, Interface has made significant returns on its green investment. Since 1995 the company has eliminated $316 million worth of waste, enough to entirely fund its sustainability efforts. As Hay gets more specific, the numbers fly by: 93 million pounds of material diverted from landfills, enough to carpet the Empire State Building 45 times. The energy used to manufacture each square metre of carpet is down 41 per cent, a savings that, last year, equalled 61 000 barrels of oil. Greenhouse gas emissions are 56 per cent lower – the equivalent of taking 21 000 cars off the road for a year. Water usage is down 73 per cent, one-third of factory smokestacks are shuttered, [and] more than half of all effluent pipes have been closed off. Meanwhile, sales have increased to $1 billion, making Interface the world's largest seller of modular carpet tiles. The company is almost halfway to its goal of zero waste by 2020, earning it the good will of environmentalists and spawning a green office industry. But there have been missteps.

When Interface embarked on its first major recycling effort in 1996 – of carpet backing made of vinyl – the assumption, logically enough, was that any recycling was good. Interface sent used carpet off to a contractor, which recycled it into sheets of backing material and shipped it back. But a few years later, when Interface analysed the full life-cycle costs of the program, it found that once the contractor's coal-fired process and waste streams were factored in, the recycled product had a greater environmental impact than carpet made of virgin materials. 'That was a real eye-opener,' says Paul Firth, Interface's manager of environmental initiatives. So Interface brought its recycling efforts in-house. One result is the new Cool Blue recycling process at the company's carpet-backing plant in LaGrange, Georgia, 70 miles from Atlanta. A 300-foot assembly line snakes through the factory floor. It begins with receptacles boldly labelled 'Cool Blue Food' – carpet scraps and other plastics that are ground into 'crumb'. The crumb is fed into what resembles a giant pasta machine, which then spits out plastic pellets that are blown onto a conveyor belt and ferried into a hulking oven where they are pressed into sheets of carpet backing. The whole operation is run on natural gas generated from a local landfill.

Life-cycle analysis has also become a standard practice at the company, and Firth, a chemical engineer who joined Interface in 1999 while still in college, is the company's resident expert. He points to an intricate spiderweb of a chart as he explains that each decision – whether to use a new material, adopt a new process, or launch a new product – is meticulously studied for its impact on a dozen or more areas. Energy usage, water usage, global warming potential, ozone depletion and human toxicity are all considered, from the moment raw materials are extracted to the final disposal of a product.

This footprint analysis is a powerful tool, but it can sometimes raise perplexing questions. For example, if an alternative material reduces energy use by 50 per cent but introduces a material that could degrade into a dangerous toxin, which is the better choice? Some critics have knocked Interface for using polyvinyl chloride (PVC), which can break down into dioxin, a carcinogen, in its carpet backing. 'I respect many things Interface has done to reduce its environmental impact, but they are wrong on the PVC issue,' says Tom Lent, technical policy coordinator at Healthy Building Network. But while other carpet makers have switched to alternatives such as ethyl vinyl acetate (EVA), Interface's preliminary life-cycle analysis found EVA can be four to five times more toxic than PVC.

Gathering data is another issue. 'The biggest problem is when your supplier doesn't know,' says Firth. To get around that, Interface relies on data from governments and consultants that track environmental and toxicity figures. Even when a supplier has analysed its product, there can be complications. Since 2003, Interface has been using polylactide (PLA), a corn-based fibre made by NatureWorks – a subsidiary of food giant Cargill – to supplement nylon in its carpet facing. Replacing oil-intensive nylon with a bio-based renewable material should be a no-brainer, right? But once the resources involved in growing and harvesting the corn are factored in, the picture is hazier. Fertilizer, for example, contributes to aquatic toxicity and acid rain. Firth says, 'The idea of PLA is great, but it's not the end-all answer yet'.

These issues are thorny enough. But think for a moment of the wider costs – of deploying troops to protect oil interests, for example, or repairing flood damage made more severe by global warming, or medical expenses stemming from pollution-related illnesses. 'What is the true cost? Can you ever really say?' asks Hay.

Maybe not. But unlike most companies, Interface has taken great steps to try. And lately, Anderson has been busy fielding calls from other business leaders who are beginning to grapple with the same questions. Interface has created a new consulting group, Raise, to help other organizations starting down the path to sustainability. Anderson sees this as a key step toward his goal of turning Interface into a 'restorative company'. One of his clients is Wal-Mart.

Source: Amy Cortese, 'The Carpet Cleaner', *Mother Jones*, (31)6, Nov/Dec 2006: 56–7,
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CASE 3.2: SUSTAINABLE DESIGN AT FORMWAY FURNITURE

Formway Furniture represents an important example of how corporate commitment, strategic planning and phased practical implementation can deliver sustainable design solutions in the office furniture sector.

The Wellington, New Zealand-based company – which exports to the world – has been proactively evolving its sustainable design methods for several years and has recently begun a more comprehensive sustainability program.

Formway has come a long way since its modest beginnings as an engineering company making steel furniture for the New Zealand market in the 1950s. Today, it is an international company with over 200 employees, showrooms in Auckland, Wellington, Sydney and Melbourne, and manufacturing plants in both New Zealand and Australia.

All production of goods has an environmental impact and office furniture is no exception. The production process is materials intensive, drawing on both natural and synthetic resources from wood-based products and metals through to plastics and textiles. Through the smarter and more responsible specification of all material types, Formway is striving to cut emissions, reduce solid wastes as well as eliminate and/or significantly minimise the presence of potentially hazardous substances in products and processes.

For more than 10 years Formway has enjoyed strong growth in both products and distribution. This has included significant expansion into Australia, vertical development of its distribution channels and entry into new markets through the design and launch of ranges of work stations, high performance seating and soft seating and storage products.

Formway's environmental strategy is being implemented in five environmental management programs:

Product Design – Eco Innovation. Formway design teams are constantly searching for new materials and technologies to ensure future products are at the leading edge of commercial environmental product design.

Supply Chain Management. Formway recognises that its suppliers' efforts are vital to deliver a sustainable production system, accordingly supplier environmental requirements and continuous improvement actions are part of routine supplier dialogue.

Operations – Environmental Management Systems. Formway has joined the Landcare Research EnviroSmart scheme to achieve EnviroMark certification for its Environmental Management System (EMS).

Product Stewardship – End-of-life focus. Formway's first priority is to ensure its furniture is designed to give many years of service without being made redundant through obsolescence or fashion change. However, work is also ongoing to develop a robust and practical end-of-life management approach that maximises environmental and economic value.

Stakeholder Communications. Sustainability communications are undertaken both within the company and with all other environmental stakeholders, particularly architects and designers.

The Life Chair is one of Formway's most influential and commercially successful products in recent years. Formway personnel collaborated with Royal Melbourne Institute of Technology and Product Ecology to develop a detailed EcoDesign brief which aimed to eliminate and/or minimise a range of life-cycle environmental impacts. The following summary outlines several key Design for Sustainability outcomes related to the Life Chair.

- The Life Chair is designed for reupholstery – the seat and back sub-assemblies and upholstery toppers can both be easily removed and replaced.
- The chair contains 30 per cent recycled content (combined post-consumer and post-industrial) and is over 90 per cent recyclable.
- User instructions are integrated into the chair's physical design; that is, under the seat.
- The Life Chair is approximately 23 per cent and 65 per cent lighter than its two main competitors, reflecting advanced material efficiencies and high strength to weight ratios.
- It has approximately 18 per cent fewer components than its primary competitor.
- Materials-efficient '3D knit-back suspension fabric' eliminates the need for a 'materials-intensive' upholstered foam back or solid plastic frame.
- Most of the chair's adhesives have been replaced with snap fits, hinge pins or spring clips.
- Plastic parts have in-mould labels to help quickly identify material types and enable easier/faster sorting, separation and recycling. No PVC is specified.
- The Life Chair is Greenguard certified to verify low off-gassing during use.

Source: www.mfe.govt.nz/issues/sustainable-industry/tools-services/subjects.php?id=12

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Strategic Activism: The Rainforest Action Network

Publication Date: 29 July 2004
Author(s): David P. Baron, David S. Barlow, Ann M. Barlow, Erin Yurday
Product Number: P44

The Rainforest Action Network (RAN) worked 'to protect the Earth's rainforests and support the rights of their inhabitants through education, grassroots organising and non-violent direct action'. RAN accomplished its mission by organising campaigns to redirect corporations away from the destruction and exploitation of non-sustainable forest resources. RAN worked with other non-governmental organisations, student groups and Indigenous forest communities. Founded in 1985, RAN had 10 000 members and an annual budget of $2 million in 2003. Over time, the scope of RAN's campaigns had broadened. RAN sought to stop the logging of old growth forests, protect fragile ecosystems and reduce the threat to forests and the environment due to climate change. RAN's three campaigns in 2004 – the Old Growth Campaign, the Global Finance Campaign and Jumpstart Ford – focused on these objectives. In April 2003 RAN's board of directors appointed as executive director Michael Brune, the former campaigns director for the organisation. Brune and the board of directors began a review of RAN's strategy and mission in light of the expanded scope of RAN's campaigns. RAN had limited resources and was stretched to conduct three campaigns. What changes to RAN's strategy, structure and resource base would be required if it were to expand its mission, for example, to include natural systems such as clean air, clean water and the climate?

The End of Oil

Publication Date: 1 January 2009
Author(s): Anita McGahan
Product Number: 9-ROT-009

Make no mistake, the end of oil is on the horizon, and with it will come significant implications for business and opportunities for the redesign of industry. The forthcoming end of petroleum-derived oil will fundamentally change the course of business on the scale of the Internet, the credit crisis and perhaps even climate change. Three sets of ideas, explored here, play an important role: finding substitutes for oil, collaborative innovation between industries and sectors, and facing the fundamental sociopolitical implications of moving away from petroleum.

A Road Map for Natural Capitalism

Publication Date: 1 July 2007
Author(s): Amory B. Lovins, L. Hunter Lovins, Paul Hawken
Product Number: R0707P

No one would run a business without accounting for its capital outlays. Yet in 1999 when this article was originally published, most companies overlooked one major capital component – the value of the Earth's ecosystem services. It was a staggering omission. Calculations at that time placed the value of those services – water storage, atmosphere regulation, climate control, and others – at $33 trillion per year. The authors maintain that not accounting for that cost has led to waste on a grand scale. This article shows how a few farsighted companies, such as DuPont and Xerox, were able to find powerful business opportunities in conserving resources on a similarly grand scale. Their early embrace of natural capitalism is even more important to emulate today. Natural capitalism comprises four major shifts in

business practices. The first involves dramatically increasing the productivity of natural resources – by as much as a hundredfold. In the second stage, companies adopt closed-loop production systems that yield no waste or toxicity. The third stage requires a fundamental change of business model – from selling products to delivering services. For example, instead of selling light bulbs, a manufacturer sells lighting services, with both the seller and the customer benefiting from the development of extremely efficient, durable bulbs. The last stage involves reinvesting in natural capital to restore, sustain and expand the planet's ecosystem. The authors argue that because natural capitalism is both necessary and profitable it will subsume traditional industrialism just as industrialism subsumed agrarianism. And companies that are furthest down this road will have a competitive edge.

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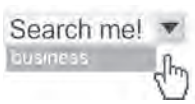


biodiversity
biosphere
carbon emissions
climate change economics
cost–benefit analysis
deforestation
desertification
ecosystem
emissions trading
externality
fossil fuels
free trade
global warming
Keynesianism
rainforest
Schumpeterian
sequestration
sub-prime mortgage crisis
sustainability
Tragedy of the Commons
Universal Declaration of Human Rights (UDHR)
virtual water

4

ETHICAL, ENVIRONMENTAL AND SOCIAL ENTREPRENEURSHIP

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

Traditional saying

What is the business case for eliminating life on Earth?

Interface CEO Ray Anderson

Social entrepreneurs are change-friendly, opportunity-oriented, innovative, resourceful, value creators. They see resources and they find a way to mobilize or move them to areas of higher productivity and yield. They find a way to create value. Social entrepreneurs are entrepreneurs who intentionally pursue the public good. They act as change agents in the social sector by: adopting a mission to create and sustain social value; relentlessly pursuing opportunities to serve their mission; continuously innovating, adapting and learning; acting boldly without being limited by resources currently in hand; [and] exhibiting a heightened sense of accountability to the constituencies served and for the outcomes created.

J. Gregory Dees, Center for the Advancement of Social Entrepreneurship, Duke University[1]

chapter objectives

- **01** To recognise the entrepreneur as a rapacious plunderer of the planet
- **02** To define the term ethics
- **03** To study ethics of criminal entrepreneurs and their similarities to other entrepreneurs
- **04** To examine environmental crime and its temptations for entrepreneurs
- **05** To introduce the concept of ecopreneurship
- **06** To examine cross-cultural concepts of ethics and corruption
- **07** To examine the concept of social entrepreneurship
- **08** To focus on the challenges that face disadvantaged entrepreneurs and to appreciate the diversity of entrepreneurship around the world.

In the past century we used to hear that 'the business of business is business'. What that meant was that profit and shareholder value trumped employee welfare or protection of the environment. This *laissez faire* attitude may have built a base of prosperity for some, but at considerable social cost for many and lasting environmental costs for the planet. For many years, *corporate social responsibility* was all the rage. This meant that a company was supposed to align its business operations with social values. The problem was that this really meant only activities that increased profits. Doing anything else would violate the contract that the company had with shareholders to maximise returns. We are now in a different era.

There is no longer any serious scientific doubt that every major ecosystem in the world is in decline. Why? As the United Nations Millennium Ecological Assessment 2005 said, 'human activity is putting such strain on the natural functions of the Earth that the planet's ability to support future generations can no longer be taken for granted'. Former UN General Secretary Kofi Annan added: 'The very basis for life on Earth is declining at an alarming rate'.[2]

As Thomas Friedman says, the world has a problem: 'It is getting *hot, flat, and crowded*. New middle classes have emerged throughout the world. Rapid population growth may reach a point that tips toward famine and battles for *Lebensraum*. The planet is becoming socially and environmentally unstable with diminishing energy, extinction of species and accelerating global warming. We have cleared a large portion of the planet's forests, overfished and overhunted our animals and polluted our atmosphere to the point of global warming'.[3]

It is also a matter of the market size for social justice. As Microsoft founder Bill Gates has said:

> Why do people benefit in inverse proportion to their needs? Market incentives makes that happen. In a system of capitalism, as people's wealth rises, the financial incentives to serve them rises. As their wealth falls, the financial incentive to serve them falls until it reaches zero. We have to find a way to make the aspects of capitalism that serve wealthier people serve poorer people as well.[4]

These are sobering words for entrepreneurs of the 21st century because the primary instrument that has created the disparity between the rich and the poor and accelerated Earth's destruction has been business, led by entrepreneurs, as we have sought to fulfil society's rapacious appetite for goods and services. What will entrepreneurs think of next to destroy the planet? Or as business leader Ray Anderson famously asked 'What is the business case for ending life on Earth?' If we insist on ruining our planet, we have to stop claiming we are a superior species. In her song *Big Yellow Taxi*, Joni Mitchell captured it this way: 'They took all the trees, Put 'em in a tree museum . . . They paved paradise, And put up a parking lot'.

Fortunately for entrepreneurs, research evidence increasingly shows that profit and sustainability can go hand in hand.[5] A sustainable business must produce a net gain but an eco-sustainable business can turn that into a competitive business advantage. A savvy new group of entrepreneurs called *ecopreneurs* or green entrepreneurs are increasingly crossing over to the business of climate change. They are the ones who can create 'the tools, systems, energy sources, and ethics that will allow the planet to grow in cleaner, more sustainable ways'.[6] Sustainability is not just a new form of making profit – it is a new form of ethical wealth creation.

This chapter has a wide remit. It first looks at the issue of entrepreneurial **ethics**. From there we examine the hallmarks of **social entrepreneurship** and the characteristics of social entrepreneurs. It's then just a short hop to environmental entrepreneurship, or **ecopreneurship**. We examine entrepreneurial ethics cross-culturally by focusing on such things as corruption and bribery. We conclude with some remarks about the importance of disadvantaged entrepreneurs.

As management topics go, these are all comparatively new concepts. What unites them? There is a Chinese proverb that says, 'When the wind changes direction, there are those who build walls and those who build windmills'. In the 21st century we must build windmills in every shape, size and colour, use them ourselves and export them to others.

DEFINING ENTREPRENEURIAL ETHICS

Social entrepreneurs are highly ethical people, but many business entrepreneurs are not. Throughout the Asia–Pacific, social and business entrepreneurs confront corruption and business crime on a regular basis. Ethics in the business world is certainly not a new topic. Ethics has figured prominently in philosophical thought at least since Socrates, Plato and Aristotle. Derived from the Greek word *ethos*, meaning custom or mode of conduct, ethics has challenged philosophers for centuries to determine what exactly represents right or wrong conduct. About 560 BCE, the Greek thinker Chilon offered the opinion that a merchant does better to take an honest loss than to make a dishonest profit. His reasoning was that a loss may be painful for a while, but dishonesty hurts forever – and that still is timely advice.[7]

Notorious scandals of the 1980s and 1990s, when some of our most famous entrepreneurs were involved in wanton plunder and greed, contributed greatly to the present century's economic and climatic crises. This 'avarice at any cost' is best expressed by Gordon Gekko (played by Michael Douglas) in the 1987 film *Wall Street*.

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

Ultimately a big share of the blame for today's economic crisis lies with Wall Street CEOs who encouraged bad lending by packaging it into ever more complex securities and then invested in it themselves by the billions. As far back as 2002 US Federal Reserve Bank Chief Dr Alan Greenspan testified that 'an infectious greed seemed to grip much of our business community . . . Too many corporate executives sought ways to "harvest" some of those stock market gains'.[8] The global economic crisis of the present century is all about greed. Predatory lending coupled with criminal profiteering was behind the **sub-prime mortgage crisis** mess (see pages 85–7). And greed also played a big part in the pell-mell rush to move land out of food production and into ethanol bio-fuels.

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

In the broadest sense, ethics provide the rules for how society conducts any activity in an 'acceptable' manner.[9] Ethics prescribe a behavioural code about what is good and right or what is bad and wrong at any given time. Morals are values held by an individual (or a moral community) and define what constitutes a good life. The planet is operating in an ever more dynamic and changing environment so a moral consensus does not exist.[10] Entrepreneurs are confronted by shareholders, customers, managers, the community, government, employees, private interest groups, unions, peers and so on. Values, mores and societal norms all constantly fluctuate. A definition of ethics in such a rapidly changing environment must be based more on a process than on a static code.

Figure 4.1 illustrates a conceptual framework for viewing this process. As one ethicist states, 'Deciding what is good or right or bad and wrong in such a dynamic environment is necessarily 'situational'. Therefore, instead of relying on a set of fixed ethical principles, we must now develop an ethical process'.[11]

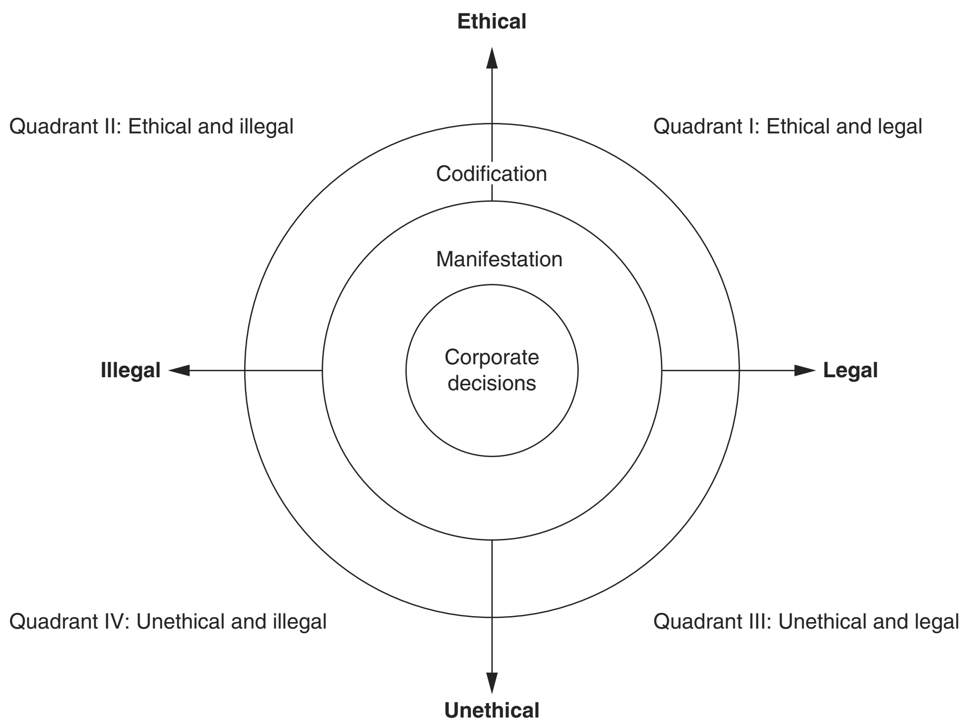
The quadrants depicted in Figure 4.1 demonstrate the age-old dilemma between law and ethics. Moving from the ideal ethical and legal position (quadrant I) to an unethical and illegal position (quadrant IV), one can see the continuum of activities within an ethical process. Yet legality provides societal standards but not definitive answers to ethical questions.

Morally questionable acts

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

One research study developed a typology of morally questionable acts.[12] Table 4.1 summarises the distinctions made in this typology. Morally questionable acts are either 'against the firm' or 'for the firm'. In addition, role behaviour differs according to the various acts. **Non-role acts** are those the person takes outside of their role as manager or entrepreneur, yet they go against the firm. Examples would include expense account cheating and embezzlement. **Role failure** acts are also against the firm, but they involve a person failing to perform their role, including superficial performance appraisals and not confronting someone who is cheating on expense accounts. **Role distortion** and **role assertion** behaviours are rationalised as being 'for the

FIGURE 4.1: CLASSIFYING DECISION USING A CONCEPTUAL FRAMEWORK



Source: Verne E. Henderson, 'The ethical side of enterprise', *Sloan Management Review*, 23(3), 1982: 37–48.

TABLE 4.1: TYPES OF MORALLY QUESTIONABLE ACTS

TYPE	DIRECT EFFECT	EXAMPLES
Non-role	Against the firm	Expense account cheating Embezzlement Stealing supplies
Role failure	Against the firm	Superficial performance appraisal Not confronting expense account cheating Palming off a poor performer with inflated praise
Role distortion	For the firm	Bribery Price fixing Manipulating suppliers
Role assertion	For the firm	Investing in Zimbabwe Using nuclear technology for energy generation Not withdrawing product line in face of initial allegations of inadequate safety

Source: James A. Waters and Frederick Bird, 'Attending to Ethics in Management', *Journal of Business Ethics,* 5, 1989: 494

firm'. These acts involve entrepreneurs who rationalise that the long-term interests of the firm are foremost. Examples here include bribery, price fixing, manipulating suppliers, or failing to withdraw a dangerous product from the market.

There are times when ethical conduct must indeed break the law. Just think of Greenpeace's harassment of whaling ships.[13] Law may overlap with, but often does not duplicate, society's moral standards. Think of these examples:

- Tour operators bring the tourists to certain shops where the salespeople charge higher prices than other shops and later the profits are shared between the operators and the shop owners.
- Tobacco companies based in Britain and the US are largely responsible for the spread of the smoking habit to developing countries. Advertisements for Marlboro cigarettes show young, athletic, outdoorsy men and women, yet cigarettes kill millions each year.
- Alcoholic drinks are advertised as products that will bring sexual prowess, success and power.
- Harry Potter sells Coca-Cola to kids.
- Coke and other sodas are filled with empty calories that are making kids fatter and put them at risk of serious diseases, not to mention dental cavities.
- Nestlé promotes infant formula as a substitute for breast milk around the world.

These vignettes demonstrate the conflicting needs that the free enterprise system puts on people. On the one hand are profits, jobs and efficiency; on the other hand, environmental protection, personal and social respect, honesty and integrity.

Certainly one of the most morally questionable acts is environmental crime, which is perpetuated by everyone from the largest corporations down to the naive start-up enterprise. As governments ramp up their regulatory regimes, firms find new ways to violate laws put in place to protect the environment. The consequences of activities such as illegal logging and timber smuggling, wildlife smuggling, the black market in ozone-depleting substances and dumping of other forms of hazardous wastes and chemicals fit the profile applied to other forms of transnational crime.[14] These firms are polluting the air, water and land. They are pushing commercially valuable wildlife species closer to extinction and they are significantly impacting the biological integrity of the planet. Disposing of waste correctly requires time and money. Some companies try to beat the system by disposing of theirs illegally. Pollution crime not only damages the environment, but also results in significant profits for criminals. The illegal disposal of waste into waterways, the air and the ground can significantly damage a community's livelihood, destroy jobs and lower property values. The illegal actions of one company can have far-reaching consequences.

Unfortunately, such behaviour can generate unfair economic advantage. Entrepreneurial 'transit nations' such as Singapore play a key role in illegal environmental trading schemes for smugglers to disguise material origins and make paper trails harder to follow.[15] At its most extreme, unfair advantage translates into what Pollution Issues (2008) calls 'environmental racism' in which environmental decisions are made for racial advantage.[16] Fingers often point to WalMart for taking unfair advantage by exploiting the environment to achieve its fabled low prices.[17] In today's global economy there is a need for an international strategy to deal with this type of action.

>>ENTREPRENEURIAL **EDGE**

ENTREPRENEURSHIP AND ECOCIDE

For thousands of years, entrepreneurs have raped and pillaged the environment. Today we might call it entrepreneurial ecocide, namely large-scale environmentally catastrophic business activities by an entrepreneur. Ecocide is also a term for killing a species in an ecosystem to disrupt its structure and function. However, it has only recently been classified as a crime. For centuries people admired the entrepreneurial spirit that launched such ecocidal industries as whaling, the felling of indigenous forests and the harvesting of coral reefs. In the Pacific both Europeans and the Indigenous Polynesians, the Māori, carried out mass exterminations of species in the name of enterprise.

One intrepid New Zealand entrepreneur solved the 'oil crisis' of the 1890s by killing and boiling up millions of penguins from 1889 to 1914. New Zealand's Joseph Hatch may go down in history as the most ecocidal entrepreneur ever. He was a man of his time – a time when entire species were brought to near extinction in the quest for profit.

Hatch emigrated as a young man from London to Melbourne, Australia, where he started out with a wholesale druggist firm. Recognising his entrepreneurial talent, in 1862 the firm sent him to open a branch in Dunedin, on the South Island of New Zealand. Hatch was what we call today a 'serial entrepreneur'. Besides operating chemist shops, he established a bone mill fertiliser plant, manufactured soap and candles, developed sheep-dip and rabbit poison, exported rabbit skins and built railways.

In the 1870s Hatch spotted a huge market niche in rope manufacturing. At the time ropes were essential for hunting, pulling, fastening, attaching, carrying and lifting. One could say that ropes were indispensable to economic progress. Ropes needed 'batching oil' as a lubricant for drawing and combing the jute fibres together. Up until then rope makers relied on seal oil and whale oil from creatures that required huge industry and energy to capture. But Hatch worked out that it was much easier to catch penguins, which he rendered 900 at a time in huge digesters, resulting in one-half litre per bird. He saw his oil as an integral part of an industrial complex that was the glorious Victorian Age of Empire.

Hatch gained a licence from the Tasmanian government and set up shop on Macquarie Island, a bleak, inhospitable island with no sheltered anchorage about halfway between New Zealand and the Antarctic. He eventually was closed down by public protest but over nearly 30 years, from 1890 to 1919, Hatch killed about two million penguins on Macquarie Island.

Hatch's activities generated the first truly international conservation campaign. After the First World War, Antarctic explorers began to publicly criticise Hatch's Southern Isles Exploitation Company on Macquarie Island and, in 1919, the Tasmanian government withdrew his licence. Many of the great names of the time such as Baron Walter Rothschild and H.G. Wells lined up against him. It could easily have been fur or whales that stirred a global reaction, but unluckily for Hatch, saving the penguin became the vogue cause of the day. This was really the first global ecological campaign. Macquarie Island was declared a wildlife sanctuary in 1933 and in 1977 it became the first biosphere reserve in the Southern Ocean.

Sources: Nigel Benson, 'The Good Oil on Mr Hatch', *Otago Daily Times*, 10 September 2008, www.theatreview.org.nz/reviews/printreview.php?id=626; Philip Matthews, 'The Penguin History', *New Zealand Listener*, 10 March 2007; Alan De La Mare, 'Hatch, Joseph 1837/1838? – 1928', *Dictionary of New Zealand Biography*, updated 22 June 2007. The original version of this biography was published in the *Dictionary of New Zealand Biography Volume Two* (1870–1900), 1993, www.dnzb.govt.nz/; Wikipedia, Licensed under the GNU Free Documentation Licence from the Wikipedia article 'Joseph Hatch'; Geoff Chapple, 'Harvest of Souls: the Oil Baron of Invercargill', *New Zealand Geographic*, 74, 2005: 40–53

ENTREPRENEURSHIP AND ORGANISED CRIME While discussing the dark side of entrepreneurship we might make mention of actual criminal entrepreneurs: the crims themselves. Imagine having to run a criminal start-up and growth enterprise in an enduringly hostile landscape![18] Moselli called it 'human resource management in the Cosa Nostra'.[19] Bolton and Thompson have a fascinating chapter on criminals such as Al Capone. A study of drug entrepreneurs shows they are shaped by shifting opportunity structures.[20] The diversity ranges from boot-legging cigarettes, through hydroponic cannabis growers, to pimping and prostitution.[21] These people have to be excellent risk managers and information managers. They are future-oriented organisation builders. Like business entrepreneurs, they are continually working the edge or the margin. The other *sine qua non* for any crime entrepreneur is his information management skills. As they say, for entrepreneurs 'know-who' is as important as know-how. Many criminal entrepreneurs are very family oriented. Criminal entrepreneurs are leaders with vision and delegate to trusted associates. Whether engaged in petty crime like Martha Stewart, large-scale embezzlement like Michael Milken, **Ponzi schemes** like Bernard Madoff, or organised crime like the Gambinos, criminal entrepreneurs share one thing in common – they steal from innocent people. This can often mean from other entrepreneurs.

China is now a centre for criminal entrepreneurship. There is a new trend in collective corruption whereby private companies, entrepreneurs and organised crime groups now play an important role in initiating and coordinating networks of criminal activity.[22] As Linter said:

> Secret societies have always been endemic to Chinese overseas communities, surviving on fear and corruption and prospering through their involvement in a wide range of legal and illegal businesses. For many years, Hong Kong was seen as the 'capital' of this worldwide Chinese criminal fraternity and, in the 1980s, many outside observers and analysts thought the gangs that were based in the then–British colony would leave once it reverted to Chinese rule in 1997. In the end, the reverse turned out to be the case. Not only did the Hong Kong Triads make arrangements with the territory's new overlords, but in Chinatowns all over the world, close links were also forged with mainland Chinese interests.[23]

THE RISE AND FALL OF CRIMINAL ENTREPRENEURS IN AUSTRALIA

>>ENTREPRENEURSHIP **IN PRACTICE**

While we are considering the ethics of entrepreneurship, there is also a very dark side to entrepreneurial activity and here we make mention of actual criminal entrepreneurs. Just as social and business entrepreneurs share many personality traits, there are many of those traits that they share with criminal entrepreneurs. These people have to be excellent risk managers and information managers. They are future-oriented organisation builders. Like business entrepreneurs, they are continually working the edge or the margin.

Back in the 1980s, it all looked so easy, the way the Aussie business magazines told it. The answer was simple. Australia's ideal was the high-flying entrepreneur – not in the sense of a risk taker developing a new enterprise, but more as a corporate predator making money from shuffling paper assets.[24] Such were the excesses that it cost Australia's commercial standing and the reputation of its entrepreneurs dearly and that damage continues to this day.

In 1992, the Australia Institute of Criminology described **entrepreneurial crime** this way:

> Entrepreneurial crime as a concept refers to punishable acts which are committed by individuals in controlling positions within corporations, using the resources and power deriving from the corporate form as a vehicle to achieve ends which benefit the entrepreneur personally . . .

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Factors contributing to the commission of entrepreneurial crime range from the psychological characteristics of individuals operating in a corporate culture which values risk taking, to factors at the macro-economic level which may provide opportunities for such individuals.[25]

Here's a rogue's gallery of Australia's criminal entrepreneurial past whose legacy present-day entrepreneurs must confront.

- Christopher Skase's activities are now the stuff of legend. Born in Melbourne in 1948, Skase became Australia's most wanted white collar criminal when he lost $1.5 billion of other people's money and then skipped the country. He exploited the adventurous spirit of Australian investors and then, when it all unravelled, began a perverse appeal to the Australian sense of a fair go. Skase fled to Majorca, lived in material comfort, complained at every attempt to bring him back and died thumbing his nose at the prosecutors. The Brisbane *Courier Mail* editorialised philosophically after Skase's death in 2001: 'If Skase represented most of the failings of corporate behaviour in the 1980s, the failure to bring him to justice spoke of the inability of successive governments to protect ordinary investors'.[26]
- Alan Bond came to Perth from England as a boy. He put together a land speculation company with just $1000 and interests eventually included Swan brewery, Channel 9, radio, property development and oil exploration. By the mid-1980s his personal wealth was put at some $400 million and he splashed it around with abandon. The stock market crash of 1987 gave him a $980 million loss. In 1997 Bond went to jail for criminal dishonesty in his business dealings. He was released from prison in 2000 but he still owes thousands of investors.
- Abe Goldberg, Australia's biggest bankrupt, is one 1980s entrepreneur who found a refuge in Poland. His Lintner textiles group, which produced garments under the Speedo, King Gee, Stubbies and Bradmill labels, collapsed owing $1.5 billion. Goldberg himself had personal debts of more than $790 million when he left the country in 1990, just days before his bankruptcy action began. However, in 1995 his creditors accepted $5.1 million and Abe Goldberg was discharged from his bankruptcy.
- George Herscu is also living in exile after his property and retail business Hooker Corporation went into liquidation in 1989 with debts of nearly $1.7 billion. Herscu mortgaged Hooker to the hilt and then expanded into the US with a series of disastrous shopping malls that increased debts by $1 billion in three years. He completed a five-year jail term for paying $100 000 in bribes to a Queensland State government minister.
- John Spalvins resides on Hamilton Island following the mid-1990s disintegration of his $2 billion Adelaide Steamship group, one of the country's largest industrial and retail combines, with debts of $470 million. In the 1980s Adelaide Steamship was one of Australia's largest industrial groups with a market capital of $2 billion and ownership of Woolworths, Penfolds Wines, Petersville and David Jones. By the mid-1990s it was worth a mere $10 million with debts of $470 million.
- New Zealander Bruce Judge built up a small Brisbane quarry operation called South Pine Quarries into Ariadne, a $1.8 billion conglomerate, before the global share market crash of October 1987 sent the company down. He was behind a myriad of acquisitions and projects that were often done on the telephone or over lunch and often on a handshake with the paperwork done later. Judge's voracious expansion appetite led to Ariadne acquiring companies in a dozen countries with assets ranging from frozen bean curd to Alaskan oil, American building societies to the Wet'n'Wild theme park on the Gold Coast, swimming pools in Cincinnati, a finance company in England and property developments in Hong Kong. Judge has retired to the south of France and obscurity.

Fortunately there has been a significant shift in Australians' attitudes. Once a negative term – thanks to corporate cavaliers – an entrepreneur is now someone to be admired. Entrepreneurs and the brands they stand behind are being embraced by consumers who now see big companies as the bad guys, not entrepreneurs. Today's Australian entrepreneurs are regarded as people prepared to have a go and take some risks.[27] 'People have stopped associating the word entrepreneur with the likes of the Bonds and Skases and now see them as battlers prepared to take on the big corporations', *BRW* said. Some 97 per cent of people who responded to a *BRW* survey said they admired anyone who went out and started their own company, whereas 64 per cent said they did not trust big companies.

ETHICS IN THE CROSS-CULTURAL BUSINESS WORLD One of the most vexing issues is that there are conflicting perspectives on how to conduct business within and across cultures. The two extreme positions are **relativist ethics** or **absolutist ethics**. The relativist says 'when in Rome, do as the Romans do'. The absolutist argues that the home country's values must be applied everywhere as they are at home.

Of course it is difficult to ask the question, 'How much did you receive or pay last year in bribes?' The *Global Corruption Report* is an annual evaluation of the perception of **corruption** around the world, produced by Transparency International, the world's leading anti-corruption non-government organisation (NGO). The Corruption Perceptions Index relates to perceptions of the degree of corruption as seen by business people, academics and risk analysts and ranges between 10 (highly clean) and 0 (highly corrupt). The scores for the Asia–Pacific countries are shown in Table 4.2.

Clearly the globally oriented entrepreneur is going to face a myriad of business environments in the Asia–Pacific, ranging from relatively clean New Zealand and Singapore through to appalling business corruption in such countries as the Philippines and Indonesia. Even doing business in South Korea can mean running the gauntlet of petty officers and bribes while huge markets such as China can require a whole new orientation to dealing with corruption.[28]

As an example, take **bribery** (an offer or receipt of any gift, loan, fee, reward or other advantage to or from any person as an inducement to do something which is dishonest, illegal or a breach of trust, in the conduct of the enterprise's business).[29] There is growing awareness of the risks posed by bribery, particularly in the light of recent scandals and the public is expecting greater accountability from the business sector.

TABLE 4.2: ASIA–PACIFIC CORRUPTION PERCEPTIONS INDEX 2008

WORLD RANK	COUNTRY	2008 CORRUPTION PERCEPTIONS INDEX
1	New Zealand	9.3
4	Singapore	9.2
9	Australia	8.7
12	Hong Kong	8.1
18	Japan	7.3
40	South Korea	5.6
47	Malaysia	5.1
72	China	3.6
80	Thailand	3.5
85	India	3.4
121	Vietnam	2.7
126	Indonesia	2.6
141	Philippines	2.3

SMALL BUSINESS IN CHINA IS ABOUT KNOWING HOW TO BRIBE

>>ENTREPRENEURSHIP IN PRACTICE

It's not easy to be a small-business owner in Beijing. Bribes, gifts, and payoffs are part of monthly expenses and eat away at the bottom line. If you are not being shaken down by mobsters, then you are being shaken down – or worse yet shut down – by various departments of the government. If you plan on opening and operating any kind of successful business then you had better have *guanxi*.

Guanxi is the Chinese word for connections and having friends in high places. Nothing in China of any significance is done without it. If you want a raise and

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promotion in a state-owned enterprise, you need it. If you want to build a new upscale housing development that will displace hundreds if not thousands of poor local residents, you need a lot of it.

Even if you want to open a small shop among a group of other small shops, you have to have some *guanxi* or you won't be around long. Shakedowns and payoffs are just another business expense for many small business owners in Beijing.

A few months back, a couple of friends and I were enjoying some Western pub fare when a group of fire officials and police walked into the bar. They made a show of inspecting the pipes, sprinklers and air vents. They then had a stern talk with the owner and left. I asked him what that was all about and he just laughed and said it was another shakedown. No big deal.

A good friend of mine runs a bar in the Sanlitun area of Beijing. Sanlitun is one of the nicest areas of Beijing. Its tree-lined streets are home to European-style cafes, North-American-style sports bars, embassies and official residences, as well as upscale shops and boutiques. Rents are high, but so are returns for successful businesses.

My friend says his bar employs a full-time '*guanxi* guy' to deal with payoffs and shakedowns. This *guanxi* guy has several restaurants and bars as clients, and he uses his *guanxi* to work out reasonable payments to various government officials and to make any mobsters back off if they come looking for protection money. They pay him the equivalent of about $500 a month for his services.

Payoffs come in all shapes and sizes, my friend says, and it's important to pay the right people or the situation can be made worse. If the police come by, usually a bottle or two of booze or a few free meals do the trick, but you must make sure you give it to the top guy or else lower-ranking officials will keep coming back looking for handouts.

If the fire department comes by and says your bar is not up to code, and it will cost you about 3000 renminbi ($700 AUD), you call your *guanxi* guy and he will work out a deal for probably only half that amount. My friend says payoffs can run from as low as a few packs of cigarettes for the neighbourhood watch person to an envelope full of cash for the city planning department.

Bribes are not asked for overtly. Almost always it's a matter of 'not being up to code'. For instance, a city official and a fire department representative will come in and tell you that odours from your restaurant are bothering local residents and you need to upgrade your ventilation system.

If you don't understand the dance then you might actually upgrade your ventilation system only to have the same two guys come back in to tell you that residents are still complaining and you need to upgrade again.

At this point, unless you are Homer Simpson, you know they don't really want you to upgrade your vents: they want you to pay them off. You then take their names and numbers and have your guy call around and work out an appropriate fee paid to the appropriate people.

However, my friend figures the cost of doing business in China is no higher because of the payoffs than it is in Canada or the United States. The only difference is that instead of paying business fees and taxes to the various levels of government in the West, the money he pays out in Beijing goes into people's pockets. He says he actually doesn't mind paying the money. What bothers him is the frustration factor of figuring out who to pay.

Chinese restaurant and bar owners have it worse, because they can't plead ignorance to various city and government officials. Adding to the problem for Chinese entrepreneurs is organized crime. Most of the criminals leave foreign-owned businesses alone, because foreigners tend to call the police or start throwing punches when faced with violent confrontation.

Chinese owners tend to be more pliable, as they have homes and families to worry about. One Chinese bar owner told me he was asked to pay protection money to a group of gangsters, but instead of calling the police directly he called his *guanxi* guy and he then called the police. A deal was worked out and police waited for the gangster to come back and they violently arrested him when he came looking for his payoff. The bar owner explained to me that his *guanxi* guy had more *guangxi* than the mobsters did, so it all worked out in his favour.

Spring and summer are the busiest months for bars and restaurants in Beijing. They are also the busiest months for paying out bribes. Some might think the corruption starts at the top of the Communist government and works its way down the authority ladder, but the central government would like nothing better than to stop this sort of illegal activity. Corruption is bad for business and bad for the country's international reputation.

The problem is the system. The courts, the educational system, the media, the police, the various levels of government and especially the economy all run on *guanxi*. There is definitely money to be made in China, and the cost of doing business is most likely cheaper than in Canada, but the trick is to learn to work the system and build your *guanxi*.

Source: Trevor Metz (2008). 'Small Business in China Is about Knowing How to Bribe', 14 March 2008, Canadian Broadcasting Corporation, www.cbc.ca/news/viewpoint/vp_metz/20080314.html

SOCIAL ENTREPRENEURSHIP

After looking at criminal entrepreneurs and ecocidal entrepreneurs it may seem that the field of entrepreneurship is pretty bleak! Fortunately, we can now move on to the more positive side of the diversity of entrepreneurship, the social entrepreneurs. London Business School Dean, Laura Tyson, once defined the social entrepreneur as a person 'driven by a social mission, with a desire to find innovative ways to solve social problems that are not being or cannot be addressed by either the market or the public sector'.[30] Bill Drayton, founder of the US-based Ashoka Fellows (a network of social entrepreneurs), distinguishes the spectrum this way:

> The professional succeeds when she solves a client's problem. The manager calls it quits when he has enabled his organisation to succeed. Social entrepreneurs go beyond the immediate problem to fundamentally change the system, spreading the solution and ultimately persuading entire societies to take new leaps.[31]

Given its importance, it is amazing that the field of social entrepreneurship has received such little attention in research or teaching.[32] Part of this has to do with the lack of an agreed definition of entrepreneurship with a social focus and part of it is its transparency. While the name may be relatively new, individuals who adopt entrepreneurial strategies to tackle social issues are not. Social entrepreneurship has been around for as long as humans have lived in community. But many people see right through the phenomenon in the same way that people don't see their own culture – it's transparent.

There has been a lively debate in simply defining social entrepreneurship. One problem is that a social enterprise can cover everything from not-for-profits, through charities and foundations, to cooperative and mutual societies and finally to for-profit firms and trusts – even to governments! – with social goals. It is probably better to go beyond a business definition, however, because social entrepreneurs act as *change agents in the social sector*. They innovate and act according to the desire to create and sustain social value for others. They consider themselves to be accountable to the constituencies they serve. Their assets and wealth are used to create community benefit. They use (at least in part) trading activities to achieve this. Profits and surpluses are reinvested in the business and community rather than distributed to shareholders. There is either a double or triple bottom-line paradigm that balances economic, social and possibly environmental returns.[33] Sources of social revenue are equally diverse. Not all social entrepreneurs have 'cash sales' (even from grants).

Social entrepreneurs, like their business counterparts, go through four growth stages (see Table 4.3) ranging from an apprenticeship through the launch and take-off stages and on to maturity.

TABLE 4.3: STAGES OF GROWTH FOR SOCIAL ENTREPRENEURS

STAGE ONE: APPRENTICESHIP	STAGE TWO: LAUNCH	STAGE THREE: TAKE-OFF	STAGE FOUR: MATURITY
◦ Acquire skills and experience ◦ Learn the field, problems, players and existing approaches ◦ Conceive of, investigate and flesh out new ideas	◦ Devote 100% of energy to implementing new ideas ◦ Create motivational base of operations ◦ Test and refine role model programs ◦ Attract support	◦ Spread ideas to regional and national levels ◦ Consolidate institution and funding ◦ Ideas are recognised and respected	◦ Innovations are widely accepted as a new pattern in society ◦ Social entrepreneur is recognised as a change-maker in their field ◦ Social entrepreneur may start other innovations and/or play a broader leadership role in society
Duration 10+ years	Duration 3–5 years	Duration 5–15 years	Duration unlimited

Source: Ashoka Institute, 'Innovators for the Public', cited in *The Jobs Newsletter: Essential Information on an Essential Issue*, 147, 27 June 2001, www.jobsletter.org.nz/jbl14700.htm

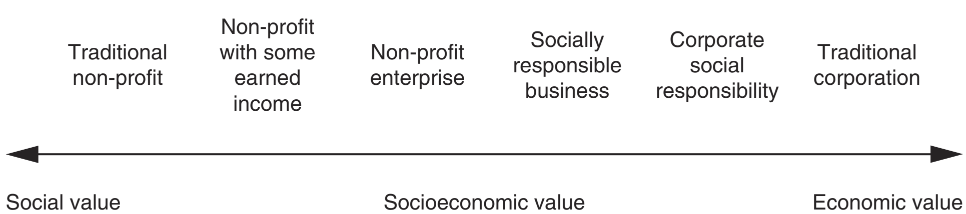
Schwab Foundation has characterised three types of social businesses.

- **Leveraged non-profit ventures:** The entrepreneur sets up a non-profit organisation to drive the adoption of an innovation addressing a market or government failure. In doing so, s/he commits a cross-section of society, including private and public organisations as well as volunteers, to drive forward the innovation through a multiplier effect. The organisation depends on outside funding for its survival, but its longer-term sustainability is enhanced because of the commitment of a multiplicity of actors to the vision and objectives of the organisation, which often ends up transcending the organisation itself. Over time the founding entrepreneur can morph into a figurehead, in some cases for the wider movement, as others assume responsibilities and leadership.
- **Hybrid non-profit ventures:** The entrepreneur sets up a non-profit venture, but the model includes some degree of cost recovery through the sale of goods and services to a cross-section of institutions, public and private, as well as to target population groups. However, to be able to sustain the transformation activities in full and address the needs of clients, who are poor or otherwise marginalised from society, the entrepreneur must mobilise other sources of funding from the public and/or the philanthropic sectors. Those funds can be in the form of grants or loans, and even quasi-equity.
- **Social business ventures:** The entrepreneur sets up a business to drive the transformational change. While profits are generated, the main aim is not to maximise financial returns for shareholders but to grow the social venture and reach more people in need effectively. Wealth accumulation is not a priority and profits are reinvested in the enterprise in order to fund expansion. Entrepreneurs seek investors who are interested in combining financial and social returns on their investments.[34]

Another way to look at it is the value creation continuum created by both profit-making and non-profit organisations (see Figure 4.2). This ranges from the predominantly social value of the traditional non-profit to the predominantly economic value of the traditional corporation. There are also interesting gradations in the middle, such as the socially responsible business. Indeed, social enterprises can be found at any place along this continuum except the extremes. Where the value generated by an enterprise can be seen as a blend of social and economic values then it can be called a social enterprise.

Every culture has its social entrepreneurs. Harding concluded that 3.2 per cent of the adult population around the world today could be considered social entrepreneurs. That is precisely 139 505 457 people between the ages of 18 and 64. Younger people are the most likely to be involved in social entrepreneurial activity. Education is also a good predictor of propensity to be a social entrepreneur. Students are more likely to be engaged with social entrepreneurial activity than other groups. Interestingly, non-white ethnic groups are more likely to be active as social entrepreneurs than their white counterparts. Income and deprivation do not appear to be good predictors of social entrepreneurial activity.[35]

FIGURE 4.2: VALUE CREATION CONTINUUM



In the Asia–Pacific, social entrepreneurs are concentrated in the Indian subcontinent, especially in India, Pakistan and Bangladesh. Reasons for this include political problems that the region has suffered since partition in the 1940s, the sheer scale of poverty-related dilemmas in those countries, and the extraordinary number of natural disasters that have occurred there.

Is social or environmental innovation compatible with large organisations? We'll get to that in Chapter 16 when we discuss the question of whether there are corporate equivalents of social entrepreneurs. The answer of course is yes. *Social intrapreneurs* demonstrate that business and social values can be aligned.

SOCIAL ENTREPRENEURS IN THE ASIA–PACIFIC

>>ENTREPRENEURIAL EDGE

- **Australia**: Nic Frances. Organization: cool nrg International. Model: Social Business. Focus: Energy, Environment. Innovation: Cool nrg International Pty Ltd (Cool nrg) designs, develops and delivers innovative energy efficiency action that reaches millions of consumers worldwide and results in large cuts in carbon dioxide while reducing the cost of energy bills. A former stockbroker, Frances left the City of London at the height of the 1980s boom for Liverpool where he built the Furniture Resource Centre into a leading social enterprise. He was ordained as an Anglican priest in 1996. In 1998 he emigrated to Australia. There he led the Brotherhood of St Laurence, a leader in the fight against poverty, until 2004. Cool nrg was established in 2007, building on his efforts to reverse climate change begun by Easy Being Green, the company he co-founded in 2004.
- **India**: Ashok Khosla. Organization: Development Alternatives. Year Founded: 1983. Website: www.devalt.org. Model: Hybrid Non-Profit, Social Business. Development Alternatives (DA) has turned out one new technology or method after another for the last 25 years, always combining two goals: creating income for the poor and regenerating the environment. Among its successes are machines that produce standardised and affordable products for rural markets, such as roofing systems, compressed earth blocks, fired bricks, recycled paper, handloom textiles, cooking stoves, briquette presses and biomass-based electricity. Ashok Khosla holds a PhD in Experimental Physics from Harvard University. He abandoned a promising scientific career to focus on issues of environment and development.
- **China**: Wu Qing. Organization: Beijing Cultural Development Center for Rural Women. Year Founded: 1993. Website: www.nongjianv.org. Model: Leveraged Non-Profit. The Innovation: To accomplish her vision of rule of law and empowerment of women, Wu Qing has had to consistently think outside of the box while being within the box. As a democratically elected People's Deputy, she has worked tirelessly to fight for the rights of people in general, and women in particular, using as her tool the Chinese Constitution. She has helped set up a women's hotline and co-founded the *Rural Women* magazine and its outreach projects. Wu Qing is a role model for other Chinese women and for Chinese politicians. Her family background undoubtedly contributed to instilling the leadership qualities she demonstrates. Her mother was China's most celebrated female author and her father brought the study of sociology to China. Both were Chinese, but studied in the best US universities, returning to their country to serve its people.
- **Thailand**: Mechai Viravaidya. Organisation: Population and Community Development Association (PDA). Year Founded: 1974. Website: www.pda.or.th. Model: Hybrid Non-Profit, Social Business. PDA focuses on controlling unsustainable population growth as a first step to free up resources for development. The first organisation to use non-medical personnel to distribute oral contraceptives (and condoms) in villages and urban neighbourhoods, PDA developed creative and humorous approaches to promote family planning that appealed to the Thai sense of fun, and destigmatised reproductive matters. Mechai is a dynamo constantly coming up with new ideas and possibilities that can be used to improve the quality of life in Thailand and abroad.

Source: Schwab Foundation, 'Profiles of Social Entrepreneurs', www.schwabfoundation.org

One important part of social entrepreneurship relates to human rights. Entrepreneurs can provide countervailing power against local human rights violators. Human rights organisations have long addressed concerns about businesses since they are no less significant than other actors on the world stage. A significant step in this direction was taken in August 2003 by the UN Sub-Commission on the Promotion and Protection of Human Rights, when it approved the UN Norms on the Responsibilities of Transnational Corporations and Other Business Enterprises with Regard to Human Rights.

These UN Norms address the human rights responsibilities of businesses within their 'spheres of activity and influence'. These responsibilities include ensuring equal opportunity and non-discrimination; not violating or benefiting from the violation of the security of persons; protecting workers' rights, including freedom from forced labour and exploitation of children, safe and healthy working environments, adequate remuneration and freedom of association; avoiding corruption and maintaining transparency; respecting economic, social and cultural rights; and ensuring consumer protection, public safety and environmental protection in business activities and marketing practices, including observance of the precautionary principle. The UN Norms also outline potential steps for implementation and enforcement. The UN Norms are not an international treaty and are not legally binding on countries or corporations. However, for the most part, the text of the UN Norms draws on existing human rights law and principles, which embody moral and political commitments of governments and corporations and represent standards of law in development.[36]

ECOPRENEURS

Certainly one of the world's worst 'crimes' is global warming. In the past, some entrepreneurs simply tried to deny the planet's problems. At worst, they exploited scarce resources even more intensively so that they could get their 'fair share' before the resources were completely wiped out. Of course, that just made the problem worse. To counter this behaviour, governments have put in place an increasingly bewildering series of regulations to limit such environmental excesses. This, in turn, increases the compliance costs on entrepreneurial firms, which leads to a vicious downward spiral as business resistance to regulation leads to more government pressure, which in turn creates more resistance.

Fortunately for us in the 21st century, a growing cohort of entrepreneurs has realised that an environmentally friendly approach does not necessarily translate into a higher bottom line. In fact, it can even lead to gains in profitability. An entrepreneurial firm can gain competitive leverage by:

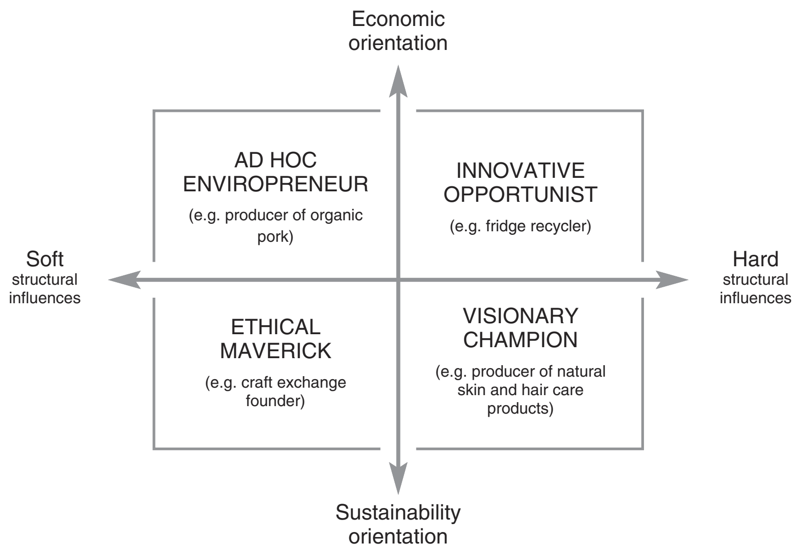
- reducing costs by cutting back on pollution outputs and decreasing raw materials they use
- fostering greater customer loyalty by satisfying the demand for eco-friendly goods
- creating a desirable environment in which to work, thereby making recruiting easier and being able to retain trained staff.

The literature highlights the role that entrepreneurial individuals and organisations play in the transformation toward sustainability.[37] The term '*ecopreneurship*' is a combination of two words: 'ecological' and 'entrepreneurship'. An entrepreneur sometimes strives for success by exploiting market opportunities regardless of the consequences. This may be seen as inconsistent with the need to conserve the planet and prevent environmental damaged cause by market forces. But an **ecopreneur** combines the unrelenting drive and imagination of the entrepreneur with the stewardship of a conservator.

Ecopreneurship has become a concept in business research since the early 1990s. Elkington and Burke in their book *The Green Capitalists* argued that environmentalism is in entrepreneurs' best long-term interests as resource depletion and transportation congestion reduce profits.[38] Important to the 'green capitalist' argument is that: (1) business can adjust its behaviour; and (2) that consumers can make environmentally friendly purchase decisions. Steven Bennett's *Ecopreneuring* focused on opportunities for innovative entrepreneurs to create growth-oriented eco-businesses such as waste recycling, reducing air pollution, 'atmospheric businesses', fuel for the planet, waterworks, safe foods, enviro-investment and education on environment.[39] They, together with Berle[40] and Blue,[41] began to use terms like 'environmental entrepreneur', 'green entrepreneur', 'eco-entrepreneur' and 'ecopreneur'. In the late 1990s, Andersen's 1998 book, *Enviro-Capitalists,* investigated what it takes to be a successful entrepreneur in the environmental arena. Most interesting are the entrepreneurial histories of three famous early American environmentalists: James John Audobon (1785–1851), John Muir (1838–1914) and Aldo Leopoldo (1887–1948). (Find out more about them on Wikipedia.)

Researchers Walley and Taylor[42] put the various definitions of ecopreneur into a 'typology of green entrepreneurs' (see Figure 4.3). Obviously there is a lot of overlap but it is instructive to look at the four 'ideal types'. The vertical axis is the 'orientation', namely whether the ecopreneur is oriented toward 'economic' profit or toward non-profit 'sustainability'. The horizontal axis refers to the two types of structural influences. 'Soft' influences here mean people and personal networks. 'Hard' influences refer to concrete market incentives and signals as well as government regulation. These two axes result in four types. Moving clockwise, at the upper right are the 'Innovative Opportunists' who, for example, see government regulations on recovering chloro-fluorocarbons (CFCs) as a market niche for a business recycling refrigerators. Also on the hard side is the 'Visionary Champion' type of ecopreneur. This is the kind of person (for example, Anita Roddick, producer of natural skin and hair products) who starts a business to 'change the world'. On the softer side is the 'Ethical Maverick', who is influenced by friends, personal networks and past experiences rather than by some vision to change the structural of the world.

FIGURE 4.3: TYPOLOGY OF ECOPRENEURS



Source: E.E. (Liz) Walley and D.W. (David) Taylor, 'Opportunists, Champions, Mavericks . . .', *Greener Management International,* Summer 2002: 40

These would be the alternative lifestylers who set up businesses on the fringes of society (such as a craft exchange or a vegetarian cafe). Finally, we have the 'ad hoc enviropreneur' who comes to the green movement more by chance. For example, a producer of organic pork may just be serving a market need rather than some philosophical trend.

In actuality, many aspiring entrepreneurs are simply *ad hoc enviropreneurs* seeking to find opportunities in a carbon-constrained world. These people depend on their ability to find products and services that hedge against physical climate risk, perhaps mitigate regulatory costs, or improve/repair corporate reputations through green business. These are the numerous, non-ideological savvy entrepreneurs who seek to manage climate risk in the supply chain, invest in low-carbon activities and innovate new technology that sells while improving the planet. Here we find the *business of climate change* entrepreneurs who seek competitive advantage on a warming planet rather than being driven by climate change ideology.

According to Lash and Wellington,[43] there are two potential profitability drivers for climate-change-oriented entrepreneurs:

Revenue drivers

- What percentage of climate-related costs will we be able to pass through to customers?
- How can we generate streams of revenue from new low-carbon products?
- What new forms of income (for example, carbon credits) will become available?
- What threats do we face from low-carbon substitute products?
- What will be the impact of weather patterns on revenue?

Cost drivers

- How will regulatory policy affect our costs? (Will we need to purchase emissions allowances?)
- Is there a chance that emissions will be taxed?
- What capital expenditures do we face as a result of emissions-reduction plans?
- How much will our raw materials costs escalate? How much will those of our suppliers escalate?
- How much will our energy costs rise?
- How will our risk profile affect our insurance premiums?

This view is close to that of Josef Schumpeter (1949) who saw entrepreneurial activity as a 'process of creative destruction' and saw entrepreneurs as 'agents of change'. As Schaltegger writes, 'Ecopreneurs destroy existing conventional production methods, products, market structures and consumption patterns and replace them with superior environmental products and services. They create the market dynamics of environmental progress'.[44]

Ecopreneurs are driven by both commercial gain and also ethical and moral values. As Australian educator Michael Schaper has said, 'Entrepreneurship is about harnessing the enthusiasm, initiative and creative energy of individuals. When this dynamism is applied to developing business solutions that help move enterprises into more sustainable pathways, then the results have the potential to be truly fascinating – and rewarding'.[45]

There are two types of ecopreneurial businesses, according to Isaak.[46] There are the 'green' businesses that are moving from the status quo to more environmental responsibility. Then there are the 'green-green' businesses that offer green products and services from their start-up. By this ideal-type definition an ecopreneur would be someone who 'creates green-green businesses in order to radically transform the economic sector'. But in between these extremes, says Isaak, it is also possible to have 'incremental ecopreneurial efforts that aim towards cost-reduction by means of efficiencies which reduce resource use and thereby contribute to sustainability'.

>>ENTREPRENEURIAL EDGE

THE HONEY BEE NETWORK

Amateur inventors are solving practical problems in developing countries that the professionals never bother to tackle.

What do a bicycle that goes faster over bumps, a lever that allows car pedals to be operated by hand and a pedal-powered washing machine have in common?

They are all examples of 'deviant research', so called because they were developed by amateurs trying to solve problems that dogged their daily lives rather than to make money. A pedal-powered washing machine, for example, was invented by Remya Jose, who as a 14-year-old schoolgirl from the Malappuram district of Kerala in south India found that the time it took to wash clothes by hand was getting in the way of her studies.

Such grassroots innovations are driven by adversity, so they are often created by people who are prevented by problems of language, literacy or geography from getting their inventions into the hands of others who might have a use for them. As if these weren't obstacle enough, deviant researchers risk being ridiculed by their own communities for daring to try to banish their problems in this way, rather than putting up with them like everyone else.

One effort to overcome those barriers and lubricate the wheels of deviant R&D is the Honey Bee Network, set up almost 20 years ago by Anil Gupta of the Indian Institute of Management in Ahmedabad. It was Gupta who coined the term 'deviant research'. The network uses community organisations, local-language newspapers, multimedia presentations and other channels to find deviant researchers. It then connects them with each other and to scientists and other academics, who can test the inventions and provide help with patents and business plans.

The Honey Bee Network is now the repository for more than 10 000 inventions. One example is a bike that goes faster when ridden on bumpy roads, developed by Kanak Das, who lives in an isolated part of northeast India. Energy from the shock absorbers is used either to help turn the pedals via a set of springs or, in Das's latest prototype, to charge batteries, creating an electric bike.

The Honey Bee network also talent-spots inventors during its twice-yearly Shodh Yatra (Sanskrit for 'walk to find knowledge'). These week-long treks take Gupta and a crew of facilitators through remote regions of India at a pace slow enough to stop, talk and find out who has invented what. The last one, through the Anantnag district of Kashmir, found Abdul Rashid Dar, inventor of a lever that locks onto a car's clutch pedal, allowing people with limited use of their legs to operate it by hand.

Now Gupta wants to dig out deviant researchers in the industrialised world. With that in mind, the 20th Shodh Yatra, the first outside of India, is being planned to start near Newcastle in northeast England as early as next month.

Source: 'Deviant Research', *New Scientist*, 22 September 2007: 56

ENTREPRENEURSHIP AND DISADVANTAGED GROUPS Yet another way to look at ethical entrepreneurship is to focus on those entrepreneurs who come from a background of hardship or suffering. What do we mean by **disadvantaged entrepreneurs**? There are a number of ways to take that word.

Here is a list of restraints or barriers that disadvantaged people face when they consider the option of self-employment:

- **Social and individual**: Lack of or inadequate food, shelter or clothing; disabilities; financial problems and related stress; difficult family environment or onerous family responsibilities; low self-esteem; literacy problems; low level of formal education and qualifications; lack of skills and qualifications needed for employment; negative experience of education; psychosocial problems; drug or alcohol abuse; disaffection for or alienation from the democratic system; and disenfranchisement from democratic processes.
- **Geographic**: Rural isolation; disadvantaged urban neighbourhoods with intergenerational unemployment; and lack of local access to training and educational opportunities.

- **Community**: Lack of cohesive local approaches to enabling the transition to employment; lack of social capital networks with those in employment; and information deficits relating to training and employment opportunities.
- **Cultural**: Language barriers experienced by immigrants and refugees; cultural differences experienced by immigrants and refugees; experience of racism on the part of ethnic minorities; and experience of discrimination on the basis of gender, race, class, religion, age, sexual orientation, disability or family status.
- **Economic**: Few or no jobs available; lack of childcare provision to allow those with children to work; and disincentives to work arising from the welfare/tax system.
- **Political and structural**: Lack of state provision for social services and infrastructure; government policies restricting eligibility to training programs; lack of accessible information on citizenship rights and issues; and constraints on entitlement to work for asylum seekers.
- **Organisational**: Training organisations and employers using restrictive recruitment practices; training organisations having restrictive eligibility criteria, training approaches, venues and structures; training organisations lacking social supports for trainees; and training programs and employers lacking engagement with the client group.[47]

The point is that *being disadvantaged may actually lead one to become more entrepreneurial*. For example, Scase and Goffee suggest that 'entrepreneurs may be more likely to emerge from those groups in society which are deprived or marginal; that is, groups which are discriminated against, persecuted, looked down upon or exceptionally exploited'.[48] Some research has even looked at entrepreneurs in the context of being marginalised characters. Shapero addressed the issue of the entrepreneur as being a displaced person.[49] This corresponds with what is called the **social marginality** theory put forward by Stanworth and Curran, who suggest that the incongruity between an individual's perceived prodigious personal attributes and the position that person holds in society might propel them to be entrepreneurial.[50] Hagen suggests that where the behaviour of a group is not accepted or where a group is discriminated against, then a **psychological disequilibrium** would occur.[51] This might drive a person into enterprising behaviour to compensate for this imbalance.

Of course, these theories do not account for all entrepreneurs, but it is an interesting hypothesis to think that disadvantaged persons would be more likely to start a new venture than other people. In the developed world this usually refers to groups such as women, youth, Indigenous people and immigrants; for example, African–Americans in New Orleans, female Indian immigrants in London, or overseas Chinese living in Singapore. But it could also mean gay entrepreneurs in Sydney or San Francisco, Palestinian entrepreneurs in the Gulf, or even enterprising religious minorities such as Sikhs in Australia. No chapter could ever effectively address all of these fascinating stories. But here's a little of that rainbow of disadvantaged entrepreneurs:

- **Gay entrepreneurs in Nepal**: Lesbian entrepreneurs started a grocery in the upmarket area of Baluwatar, Nepal, to support themselves entrepreneurially and to create jobs for their community. Most of the women in the group, known as the Mitini Group, had been thrown out by their families after they disclosed their sexual preferences and refused to marry the men chosen for them. Social prejudice has led to their landlord kicking them out of their premises and to harassment by the Royal Nepalese Army.[52]
- **'Reindeerpreneurs' of Eastern Siberia**: Only 80 years ago, Siberian hunters and herders, known as the Kalar Evenks, lived a traditional way of life. But their sustainable, enterprising lives have constantly been disrupted. The Soviet revolution put their reindeer herding into collectives and moved the people into villages. Then came

perestroika and the resulting socioeconomic crisis of high morbidity, economic dislocation, unemployment, alcoholism and the loss of traditional cultural values. Yet over the past 20 years the Kalar Evenks have been adapting their entrepreneurial skills to new forms of enterprise to preserve traditional values and find ways to benefit from the larger economic world. Today, Evenk entrepreneurs are finding new profitable ways to maintain their unique subsistence culture based on nomadic patterns of resource exploitation and such 'archaic' industries as hunting and reindeer herding.[53]

- **Tourism entrepreneurs in Kerala**: The Indian state of Kerala recognised that the lack of entrepreneurial skills among the Indigenous populations was holding back economic development. If Kerala was to conserve and sustain its natural and cultural assets, local entrepreneurs had to ramp up their skills. The transformation of the native houseboats into a tourism product represents an illustration of Indigenous innovation and enterprise that has potential to add value to the local community and economy. Its appeal has been strengthened by relatively low barriers to entry, combined with demand for a modern, more socially responsible approach to holidays. Furthermore, it has revitalised traditional industries and crafts and strengthened social systems and cultural traditions.[54]
- **The Dhivehis of the Maldives**: There are no finance companies, investment banks or trading banks in the Maldives. Nor does this country have a stock market. Yet, with little formal education, Dhivehi entrepreneurs, unskilled people using simple technology, carry out important economic functions. They do not perceive the lack of formal infrastructure or the lack of capital as a constraint. Nor are they concerned with risk. While the islands thrive on a subsistence market economy, the capital city is a town of small enterprises. Unemployment never exceeds 1 per cent and the Dhivehi people are on average the richest in the region.[55]

Indigenous entrepreneurs

The term '**Indigenous people**' has no universal definition. But most definitions encompass cultural groups that have a historical continuity with a region before its colonisation and who have lived largely independent or isolated from the influence of the larger nation–state. These are people who have maintained at least in part their distinct linguistic, cultural and social/organisational characteristics. Characteristics common across many Indigenous groups include reliance upon subsistence-based production and a predominantly non-urbanised society.[56]

Indigenous societies are found in every inhabited climate zone and continent.[57] Everywhere they suffer from chronic poverty, lower education levels and poor health. The first wave of direct economic assistance produced only mixed results since these programs often only tried to heal the symptoms and disregarded the cause of Indigenous social and economic dysfunction. What some now refer to as the 'second wave' of assistance is an activist process where the efforts of Indigenous people themselves are concentrated to improve their social and economic position through entrepreneurial enterprise – through creating **Indigenous entrepreneurs**.[58]

In all nations with significant Indigenous minorities, the economic and social deprivation of Indigenous peoples has long been of deep policy concern. Colonisation and post-colonial practices deprived Indigenous people of their land, their culture and their human rights. The loss of self-determination denied Indigenous peoples the right over their own responsibility to manage their own affairs. Around the globe this has proved to have been socially and economically destructive. Stimulating a new sense of self-determination through Indigenous entrepreneurship has been a positive step for some groups, but it is not the answer for all Indigenous people.

Around the world there is a growing social awareness that policies directed to re-igniting and/or developing new Indigenous entrepreneurial activity has the potential to dramatically improve the economic and social positioning of its participants. Best-practice lessons show that the poor (both Indigenous and non-Indigenous) can achieve improved standards of living through enterprise, so much so that the previous UN Secretary-General Kofi Annan, in a break from that organisation's previous disregard of the private sector, initiated a Commission on the Private Sector & Development.[59] This has created more transparency and is a positive process in finding increased opportunities, and enhancing economic and social improvement.

While there is substantial literature, particularly in North America, about minority entrepreneurship (for example, African–Americans and Hispanics), the field of Indigenous entrepreneurship is very underdeveloped. Perhaps most researched are the Indigenous people of North America, particularly Native American Indians and Canadian Inuit, but there are many interesting studies of Indigenous entrepreneurs around the world.[60] Indigenous people around the globe are embracing entrepreneurship in the post-colonial, post-settler society. Here we focus on the Indigenous inhabitants of Australia and New Zealand and look at their entrepreneurial endeavours.

Indigenous entrepreneurs in Australia[61]

The Indigenous inhabitants of Australia consist of two distinct groups. The first comprises what is commonly referred to as the mainland Aboriginal people and the second is the Torres Strait Island people who are from an archipelago of some 274 islands, of which only 17 are inhabited. The Torres Strait Islanders are scattered across 48 000 square kilometres of ocean between the northern tip of Cape York Peninsula and the southern tip of Papua New Guinea, a distance of only 150 kilometres. The Torres Strait Island people have a Melanesian heritage. Australia's 2001 census identified only 6.4 per cent of the Australian Indigenous population as being of Torres Strait Islander origin.[62] In general, the Torres Strait Islander culture remains strong and their entrepreneurial pursuits within contemporary Australian society are worth discussing, however, there has been little empirical research undertaken on Torres Strait Islander entrepreneurs, both within their homeland and/or on mainland Australia.

Mainland Aboriginal Australians comprise 89.4 per cent of the estimated 410 000-strong Indigenous population as shown in the 2001 census. The ethnic composition of mainland Aboriginal Australians is complex; Australian Aboriginal people are not all the same. While there are similarities there are many cultural differences which, when combined with over 400 different language groups, produces a huge diversity of cultural groups.

Archaeological evidence suggests that Aboriginal people have lived in Australia for at least 50 000 years and, prior to invasion and colonial contact, they engaged in wide-ranging trade and entrepreneurial pursuits.[63] An example is the Gunditjmara people of what is now called Lake Condah in southwest Victoria, who conducted an enterprise that involved an 8000-year-old aquaculture industry.[64] Their main product was smoked eel. This was not a subsistence or hunter-and-gatherer existence as the Gunditjmara lived in stone homes in permanent to semi-permanent settlements. They constructed extensive dams and water channels to enable them to manage water flows from the local river and rainfall, optimising eel and fish production in a series of man-made lakes. Upon harvesting they added value to their product by smoking it, extending its durability (or shelf life) and enabling the product to be traded or sold over a vast area.

Aboriginal people live in all States and mainland Territories of Australia, with the highest population concentrations in Queensland and New South Wales. One of the most widespread misunderstandings (fuelled by stereotyping and the tourism industry) is that they predominantly reside in the 'outback'. This is incorrect as the majority of Indigenous Australians (72.6 per cent) reside in metropolitan areas.[65] The bottom line is that Indigenous Australians are in the main an urban people who suffer high welfare dependency, few marketable skills, low work experience and a very low economic base.[66] In 1991 the Royal Commission into Aboriginal Deaths in Custody concluded that Aboriginal and Torres Strait Island people are 'the most socially, economically and culturally disadvantaged group in Australian society'.[67]

Indigenous people are often caught in a spiral of discrimination that is scarcely conducive to authentic entrepreneurial activity. They experience discrimination and prejudice in the workplace. They have high levels of unemployment (38 per cent or 54 per cent depending on the interpretation of government statistics).[68] They often lack marketable skills and have an almost non-existent capital base. Many suffer cultural deprivation and a social hopelessness fuelled by an indifferent welfare system. Building an enterprising spirit is a large ask.

There has been wide discussion but little carefully focused research on Indigenous entrepreneurship in Australia.[69] A seminal study is Foley's 'Successful Indigenous Australian Entrepreneurs'. His preliminary studies provide a definition of Indigenous Australian entrepreneurs who are successful in business. He writes:

> The Indigenous Australian entrepreneur alters traditional patterns of behaviour by utilising their resources in the pursuit of self-determination and economic sustainability via their entry into self-employment, forcing social change in the pursuit of opportunity beyond the cultural norms of their initial economic resources.[70]

Foley indicates that the Indigenous Australian entrepreneur is motivated more by a need to correct negative social perceptions and racial discrimination than by a need for wealth creation. However, this work identified that the major motivator for being entrepreneurial was to provide for the entrepreneur's children and to give them a better life. This is a justification of the pursuit of self-determination or self-fulfilment as outlined by the interviewees in this and a subsequent work by Foley.[71]

Indigenous Australians have suffered post-colonial policies of segregation, assimilation and the forced removal of children in a systematic government-controlled program to uproot mainland Aboriginal people. The driving factor of their business activities is to ensure that their children do not suffer the same indignities to their human rights that they experienced. The same research also indicates that the Indigenous entrepreneur may risk losing links to the Indigenous community and culture because the requirement for success in business may clash with Indigenous cultural norms and this is an area that requires further understanding.[72]

Hindle and Lansdowne distilled the collective wisdom of Indigenous Australian and American Indian entrepreneurs and entrepreneurial experts. Their definition of Indigenous entrepreneurship is:

> Indigenous entrepreneurship is the creation, management and development of new ventures by Indigenous people for the benefit of Indigenous people. The organisations thus created can pertain to either the private, public or non-profit sectors.[73]

Both definitions add to the understanding of this growing field. The true state of Indigenous entrepreneurship in Australia, however, is unknown and may be in decline. Based on the 1996 census the estimated proportion of Indigenous self-employed in the labour force was 2.4 per cent. This was one-third of the non-Indigenous rate of 7.3 per cent.[74] The number of Indigenous Australians actively engaged in small business indicates a declining trend since 1994.[75] The 2001 census estimated the proportion of Indigenous self-employed in the labour force to have increased to 4.8 per cent. The unexpected variance in these results would appear to be unnecessarily complicated census methodology used by the Australian Bureau of Statistics (ABS) in 1996.[76] The important statistic to understand is that in 2001 the statistical comparison of self-employment rates between Indigenous and non-Indigenous Australia decreased from 0.31 to 0.30 which supports the declining trend since 1994.[77] The sobering outcome of this literature is that 'Indigenous Australians remained three times less likely to be self-employed than other Australians'.[78]

At the 2001 Census there were 6089 Indigenous Australians aged 15 years and over who identified as self-employed. Of these, 2058 identified as employing other people, with 1845 in urban areas.[79] The premier survey in this area, the National Aboriginal and Torres Strait Islander Social Survey of 2002 (NATSISS), has no qualitative or quantitative data regarding Indigenous self-employment. This raises the important question: How is government policy informed if the basic building blocks of empirical data are not available? The problem of responsible reportage is further illustrated by the government-funded Indigenous Business Review (IBR), the report on support for Indigenous businesses. Its findings confirmed that there is no one central agency responsible for the collection and collation of data on Indigenous economic development.[80] Resultant bureaucratic misjudgements have played a part in the failure of some Indigenous community-based businesses. This is of concern because these failures inevitably reinforce negative stereotypes of Indigenous Australian entrepreneurs – including the popular belief that Aboriginal people cannot manage their own financial affairs.

A well-recorded example highlighting poor management by bureaucrats of a community-based organisation is the Warai pastoral enterprise on the Finniss River in the Northern Territory. The Warai pastoral enterprise received considerable funding from several government departments and agencies without adequate consultation and coordination between government and community stakeholders. No research or planning was undertaken to ensure the existence of the necessary financial management tools to run a business.[81] An extensive range of infrastructure was constructed for the community venture with little done to ensure its ongoing success through the provision of adequate financial management skills, working capital or marketing plans that set out target profit margins. This Aboriginal enterprise floundered and did not achieve its potential due to poor planning and lack of synchronisation of basic commercial business practices. The entrepreneurial capabilities of Indigenous individuals may have been evident; however, it was the cooperative nature of the business structure and the inability of government bureaucracy to interact with the participants that resulted in failure.

This brings us to another growing myth in Indigenous entrepreneurial practice. This is the espoused success stories of Aboriginal enterprise within the cooperative movement. One example used by government is the Cape York Partnerships (CYP), a network of interlinked locally controlled Aboriginal enterprises. The overall approach of CYP is founded on the premise that the Cape York community needs to take an entrepreneurial approach to meeting its social needs.[82] Among other activities, CYP has provided the impetus for the establishment of Indigenous Enterprise Partnerships (IEP), a non-profit organisation that channels philanthropic and corporate resources into Indigenous development.[83] As a social reform mechanism, CYP has potential, but many argue that considering the cooperative movement as an answer to economic reform is questionable as the shortcomings of community-centred commercial and economic development have been highlighted by the IBR. Community-based businesses often lack appropriate governance mechanisms, so that cultural demands often determine the use of funds rather than prudent financial management.[84]

Cultural demands within a community organisation can change the internal functioning of its business as it 'changes the incentive structure within a business and allows diffusion of responsibility over a business venture'.[85] Within a community business the lack of responsibility and direction is often at odds with the essential ingredients of any successful business – profit orientation and sound commercial management skills (including asset accumulation and maintenance). When social demands override profit requirements and responsibility is not defined, business failure is inevitable when liabilities exceed assets. It is on this basis that the defunct Aboriginal and Torres Strait Islander Commercial Development Corporation (CDC) was criticised for forming partnerships with Indigenous communities rather than individuals.[86]

In 1985 the Miller Report[87] identified important deficiencies in the administration of enterprise programs, yet almost two decades later the IBR confirmed that deficiencies in the management and administration of Indigenous business loan programs are still a matter of concern. The now defunct Aboriginal and Torres Strait Islander Commission's (ATSIC) implementation of business loan programs within the framework of overall economic development for communities was not successful, resulting in ad hoc and often unsuccessful business creation.[88]

It should be remembered that ATSIC was the dominating Indigenous business financier for over a decade and that the organisation had continual difficulty in achieving its goals. In 1991 the Royal Commission into Aboriginal Deaths in Custody criticised ATSIC's stringent commercial eligibility requirements; this resulted in the establishment of the Indigenous Business Incentive Program.[89] In contrast to the Royal Commission findings, the recent IBR report noted poor diligence by ATSIC staff in the monitoring of these loans.[90]

Thus, a frustrating picture emerges regarding Indigenous economic development through entrepreneurial activity. The cooperative or community-based business has not been a success, nor has it been well managed. What has worked is the creation of Indigenous Business Australia, an autonomous government body established initially as a joint venture partner in the upper end of the Indigenous entrepreneurial industry. It had a sound record of Indigenous business development. With the demise of ATSIC and changes in government policy it has grown to enormous bureaucratic size within a short period which will place strain on its ability to maintain core values and success. Where once it was a specialist and prudent investor/advisor it has now become a process centre: the one-stop shop Indigenous business provider.

The creation of the Indigenous Stock Exchange, which is basically a trading floor where ideas meet capital, has also been an innovative step in Indigenous economic development.[91] The primary goal is to support the development of 1000 new strong and sustainable Indigenous businesses across the country by 2008. The world's first mobile trading floor, it convenes within Indigenous communities to enable entrepreneurs to put forward ideas for businesses and investment. The concept was launched by Aboriginal entrepreneur Kevin Fong and the ISX has generated more than $200 000 for Aboriginal businesses. From over 600 nominations from 80 countries, the ISX was awarded a prestigious tech award for economic development at the Silicon Valley Tech Museum.

Decades of government programs, public sector goodwill and NGO assistance, coupled with the Indigenous Stock Exchange, has produced the critical mass necessary to start some Indigenous people in the direction of economic independence. These synergies have generated enterprises such as: Malabama Tours, the first Indigenous owned and operated tourist enterprise to provide a link with other Indigenous tours and walks in the region from Cairns to Cooktown; Northern Indigenous Pastoral Alliance (NIPA), which brings together Cape York and Kimberly pastoralists and is working on a franchise model to improve management practices; and Yaba Yabaju, which operates from Cooya Beach near Mossman and specialises in coastal habitat walks, interpretive talks, night spearing and fishing.[92]

There are numerous significant commercial accomplishments that point the way to a self-sufficient future for Australia's Indigenous people as confirmed in recent qualitative case study research.[93] (See also Part Four case analysis on pages 597–9). The future for Indigenous Australian entrepreneurial development, however, is still uncertain due to increasingly poor health and education statistics.

Indigenous Australians suffer a disproportionate burden of illness and social disadvantage compared with the general population, dying up to 20 years earlier than their non-Indigenous brothers and sisters. This is a gap which has not lessened in the last 10 years. This is worse than in Nigeria, Nepal and Bangladesh.[94]

Nevertheless, among Indigenous Australians there is hope as they look towards international developments in Indigenous entrepreneurship in New Zealand, Canada and some parts of the USA.

Māori entrepreneurs[95]

By contrast, the Indigenous people of New Zealand, the Māori, have rates of entrepreneurial activity that are high in global terms. Polynesian settlers arrived in Aotearoa (in *te reo*, or Māori language, 'Land of the Long White Cloud') around the 10th century. Aotearoa was visited briefly by Dutch navigator Abel Tasman in 1642. However, it was not until 1769 that British naval captain James Cook and his crew became the first Europeans to explore New Zealand's coastline thoroughly. The word Māori meant 'usual' or 'ordinary' as opposed to the 'different' European settlers. Before the arrival of Europeans, Māori, or Indigenous Polynesian inhabitants of New Zealand, had no name for themselves as a nation, only a number of tribal names. The original meaning of Pākehā, the settlers, was a person from England. With time, Pākehā became the word to describe fair-skinned people born in New Zealand. We use the word Pākehā here in the sense of the New Zealand Census as a European New Zealander.

Māori actually have a history of enterprise upon which to draw. The Māori Wars of the 1860s were fuelled not only by the settlers' hunger for land but also because Māori had become such successful entrepreneurs that they controlled a large share of the country's commerce. Māori were involved with export of produce to Australia[96] and various other countries, and to some degree Māori entrepreneurial abilities were the subject of envy by Pākehā. New Zealand's most distinguished anthropologist, Sir Raymond Firth, in his early work on Māori economics, confirms that Māori had an entrepreneurial streak. They return cunning with respect as this may increase one's *mana* (spirit or respect). Māori dignify labour and reprove idleness. As Firth said, 'The deep interest taken in work, the commendation of it in proverb and in song, as well as by public opinion, the close attention paid to quality, the administration of skill, the wide fame accorded to acknowledged experts and the preservation of their names in tribal memory – all this comprises a definite social attitude in favour of industry.[97]

Māori were also fervent adopters of technology. Best known is the Māori use of muskets to the great cost of the settler forces. Less well known is the history of Māori adaptation of European agriculture and shipping methods, as well as their rapid adoption of books and use of publishing.[98] Māori are so adept at technology that their rapid uptake spawned the Māori saying '*Ka pu te ruha ka hao te rangatahi*' (The old net lies in a heap while the new net goes fishing).

Why is all this important to New Zealand today? The Māori economy, though small, is 'robust and poised for continued expansion', says a recent report by the Institute of Economic Research (NZIER).[99] The Māori economy is concentrated in agriculture and fishing, but also in commercial and residential property investing, television, motion picture and radio services, education, health and tourism. But according to GEM research, Māori entrepreneurship has been hampered by general inadequacy or lack of business skills.[100]

Considerable effort has gone into studying the phenomenon of Māori entrepreneurship.[101] Māori, at 17.7 per cent of the adult population, were surpassed only by Thailand and Venezuela in terms of the adult population who are early-stage entrepreneurs. Māori statistically exceed the US and UK rates and were on par with the general New Zealand population figure of 17.6 per cent. Working back from the total population of Māori, there are currently 56 000 early-stage entrepreneurs of which 46 000 are opportunity entrepreneurs and 8000 are necessity entrepreneurs.

A source of strength within Māoridom relates to Māori culture and society itself, especially its extraordinary renaissance over the last 30 years. The development of a separate Māori education system, the burgeoning interest in Māori language and culture and a revision of Māori history from a Māori perspective are the most notable examples of this resurgence in identity, pride and culture. These strengths are complemented by government policies and programs that support Māori education and development and foster alliances between Māori, government, educators and business.

In terms of wider New Zealand social and cultural norms, the manifestation of attitudes including the Kiwi ingenuity, the 'number-8 wire' mentality, giving it a go, pulling together in a crisis and acceptance of innovation are seen as social strengths that enhance Māori entrepreneurship. The prevailing sense of pride in things Māori, the celebration of the *haka* – the Māori version of the national anthem at sporting events – and the growing use of Māori terms and place names are important acknowledgements of Māori culture for Māori people. These strengths are enhanced by tribal entrepreneurial success stories such as Ngai Tahu Corporation, Kaikoura Whale Watch, Whakatu Incorporation, Mangatu Incorporation, Paraninihi Ki Waitotara Trust, Federation of Māori Authorities, Tohu Wines and Mai FM, the most popular radio station in Auckland. Other entrepreneurial successes not linked to tribal entities include Carich International (IT education), Tamaki Tours (tourism), Wai Ata Productions (film and video production), Taylor Made (animation and graphics), Kaitaia Fire (condiments), Mana Media, the Green Juice Company (kiwi fruit products) and River Mill Bread (wheat products).

'LORD OF THE RINGS' INNOVATION

>>ENTREPRENEURSHIP IN PRACTICE

The *Lord of the Rings* film trilogy may have boosted New Zealand's reputation for innovation, but it reinforced what Kiwis – both Indigenous Māori as well as Pākehā (European New Zealanders) – already knew about themselves as being 'bloody innovative'. Values such as resourcefulness, inventiveness, hard work and respect have always been part of what defines Kiwis – from the cow-cocky (dairy farmer) to the modern Waikato biotechnologist. It is no accident that New Zealanders were the first to climb Mt Everest and to split the atom. Sir Edmund Hillary's 'We knocked the bastard off' and Sir Ernest Rutherford's 'We haven't the money so we must think' are part of Kiwi innovation lore.

European settlers developed a culture of innovation that stemmed from their remoteness from sources of tools and manufactured goods. In the 19th century they had only a few of the tools necessary to carry on their trades as farmers and foresters. They had to be innovative or starve. They took up the challenge by modifying and adapting what little equipment could be imported from their remote homelands on an eight-month journey across the globe by sea. The conversion of New Zealand bush into farms created the need for a great many fences. The preferred wire was known as 'Number 8 gauge', but it was also put to so many other uses that the 'Number 8 wire' mentality now represents Kiwi ingenuity, a quality that was born out of isolation and lack of infrastructure in New Zealand's early history.

Māori, New Zealand's Indigenous Polynesian inhabitants, also have a history of entrepreneurship and enterprise upon which to draw. The Māori Land Wars of 1860–66 were fuelled not only by the settlers' hunger for land but also because Māori had become such successful entrepreneurs that they controlled a large share of the commerce throughout the country. Māori exported to Australia and various other countries and to some degree Māori entrepreneurial abilities were the subject of envy by Pākehā. Māori were also fervent adopters of technology. Best known is the Māori use of the muskets to the great cost of the settler forces. Less well known is the history of Māori adaptation of European agriculture and shipping methods as well as their rapid adoption of books and use of publishing.

TABLE 4.4: WEB RESOURCES FOR CHAPTER 4

SOCIAL ENTREPRENEURSHIP	
AIESEC	www.aiesec.org
Center for the Advancement of Social Entrepreneurship	www.fuqua.duke.edu/centers/case
Kiva	www.kiva.org
Social Enterprise Alliance	www.se-alliance.org
Social Entrepreneurship Teaching Resources Handbook	www.universitynetwork.org/handbook
Social Innovation Conversations	http://sic.conversationsnetwork.org
Social Venture Network	www.svn.org
Students in Free Enterprise	www.sife.org
SustainAbility	www.sustainability.com/
TED: Ideas Worth Spreading	www.ted.com
The Institute for Social Entrepreneurs	www.socialent.org
The Schwab Foundation	www.schwabfound.org
University Network for Social Entrepreneurship	www.universitynetwork.org
BUSINESS ETHICS	
Association for Practical and Professional Ethics (United States)	www.indiana.edu/~appe
Australian Trinity College of Western Australia	www.trinity.wa.edu.au
Business for Social Responsibility (United States)	www.bsr.org
Centre for Applied Ethics (Hong Kong)	www.cae.hkbu.edu.hk
Center for Business Ethics (United States)	www.bentley.edu/cbe/
Center for Business Ethics (United States)	www.stthom.edu/cbes
Center for Ethics in Business (United States)	www.ethicsandbusiness.org
European Business Ethics Network (United Kingdom and Europe)	www.ebenuk.org
Famous Quotations on Business Ethics	www.valuequotes.net
Hong Kong Ethics Development Centre (Hong Kong)	www.icac.org.hk
Independent Commission Against Corruption (Hong Kong)	www.icac.org.hk
Institute of Business Ethics (United Kingdom)	www.ibe.org.uk
International Business Ethics Institute (United States)	www.business-ethics.org
International Society of Business, Economics and Ethics (United States)	www.isbee.org
Society for Business Ethics (United States)	www.societyforbusinessethics.org
Transparency International	www.transparency.org
World Bank Institute	www.worldbank.org/wbi
Zicklin Center for Business Ethics Research (United States)	www.zicklincenter.org
HUMAN RIGHTS AND BUSINESS	
Aim for Human Rights	www.aimforhumanrights.org
Business and Human Rights Resource Centre	www.business-humanrights.org
Business Leaders Initiative on Human Rights	www.blihr.org
Global Reporting Initiative	www.globalreporting.org
The Equator Principles	www.equator-principles.com
The Wolfsberg Group	www.wolfsberg-principles.com
United Nations Environment Programme Finance Initiative	www.unepfi.org/
United Nations Global Compact	www.unglobalcompact.org
Voluntary Principles on Security and Human Rights	www.voluntaryprinciples.org

Taken as a group, the initiatives are an example of the potential of Māori, tribal and urban, to foster entrepreneurship and develop and grow robust businesses.

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

SUMMARY

The global economic and climate crises make it essential to consider the role of ethics for entrepreneurs. Entrepreneurs around the world are some of the planet's best hopes to solve the big problems. They are also some of the greatest violators.

Ethics is a set of principles prescribing a behavioural code that explains right and wrong; it also may outline moral duty and obligations. Entrepreneurs face many ethical decisions, especially during the early stages of their new ventures. Some arrive at the 'greed is good' conclusion, while others consider the ethical consequences of their behaviours.

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

There is actually a dark side of entrepreneurship. Criminal entrepreneurs face some of the same start-up and growth dilemmas as ethical entrepreneurs.

It is also important for entrepreneurs to realise that many decisions are complex and that it can be difficult to deal with all of a decision's ethical considerations. Some of them may be overlooked and some may be sidestepped because the economic cost is too high. In the final analysis, ethics are sometimes judgement calls and what is unethical to one entrepreneur is viewed as ethical to another.

One of the greatest ethical threats to the planet today is environmental crime. This ranges from illegal logging and timber smuggling to wildlife smuggling, the black market in ozone-depleting substances and dumping of other forms of hazardous wastes and chemicals.

An ecopreneur combines the unrelenting drive and imagination of the entrepreneur with the stewardship of a conservator. Classic examples of ecopreneurship include The Body Shop and The Honey Bee Network.

Social entrepreneurs have a great many of the same characteristics as business entrepreneurs, but their underlying motivations are different. Social entrepreneurs are interested in the creation of social capital. Social enterprise is the term used for a market-based venture addressing social aims.

Entrepreneurs frequently have to confront corruption and bribery in many countries. In our region the level of corruption is near zero in New Zealand and Singapore, while countries such as Indonesia suffer from high levels of corruption.

The opportunity for entrepreneurs to exert ethical influence on their ventures creates a unique challenge of ethical leadership for all entrepreneurs. Despite the ever-present lack of clarity and direction in ethics, however, ethics will continue to be a major issue for entrepreneurs during the new century.

We examined the concept of disadvantage. Is it possible that disadvantaged people might actually become entrepreneurs more frequently than other people? These disadvantages range from cultural and social to geographic and physical. Disadvantaged entrepreneurs come in a rainbow of ethnicities, genders and cultures. In all nations with significant Indigenous populations, the slow growth of entrepreneurship and self-employment has been cause for concern.

KEY TERMS & CONCEPTS

absolutist ethics
bribery
corruption
disadvantaged entrepreneurs
discrimination
ecopreneur
ecopreneurship
entrepreneurial crime
entrepreneurial ecocide
entrepreneurial ethics
Indigenous entrepreneurs
Indigenous people
non-role acts
Ponzi schemes
psychological disequilibrium
relativist ethics
role assertion
role distortion
role failure
social entrepreneurship
social marginality
sub-prime mortgage crisis

REVIEW & DISCUSSION QUESTIONS

1. Using your own words and experiences, what do you mean when you use the term 'ethics'?
2. A small pharmaceutical firm has just received permission to market its new painkilling drug. Although the product has been tested for five years, management believes serious side effects may still result from its use and a warning to this effect is being printed on the label. How would you describe its actions from an ethical and legal standpoint? Use Table 4.1 to help you.
3. Marcia White, the leading salesperson for a small manufacturer, has been giving purchasing managers a kickback from her commissions in return for them buying more of the company's goods. The manufacturer has a strict rule against this practice. Using Table 4.1, how would you describe Marcia's behaviour? What would you suggest the company do about it?
4. Why do complex decisions often raise ethical considerations for the entrepreneur?
5. What are your opinions on the questions of greed and entrepreneurial crime?
6. Can you relate some environmental crimes that have occurred near you?
7. What are the types of ecopreneurial businesses?
8. What are the differences between business and social entrepreneurs that you know personally?
9. Do you believe social entrepreneurship to be a valuable option in modern-day civil society?
10. What is social marginality theory? Is it possible disadvantaged people can actually become more entrepreneurial than other people?
11. Identify the diversity of disadvantaged entrepreneurs around the world. Name some examples not mentioned in the text.
12. What are the barriers and restraints that disadvantaged entrepreneurs face?
13. What are the elements of a definition of Indigenous peoples?

EXPERIENTIAL EXERCISE:

EXERCISES IN ENTREPRENEURIAL ETHICS

- **Doing the right thing when no one's watching:** Divide into groups. Have one person present an ethical scenario in which there is no clear-cut right or wrong answer. Students can debate their positions and choose the most ethical resolutions to the scenarios.
- **Ethics symposium**: Create a panel discussion consisting of professors, business leaders and significant community leaders to discuss a recent ethics-related event. For comparison, field questions from the audience before and after the discussion in order to determine if their views have changed as a result of the symposium.
- **Small business social responsibility**: To help small business owners understand the importance of giving back to the community, even when a tangible or measurable benefit cannot be achieved, create a simple pamphlet that provides information on how to get involved, based on the needs of the community.

- **Whose lie is it anyway?** To help prepare for making ethical decisions when under pressure, create a series of if/then ethical scenarios with pre-determined decisions on note cards. Carry out an ethical skit, where the scenarios are changed on the spot (by choosing a note card) to make an ethical decision and have audience vote for the most ethical decision.
- **Current ethical event analysis**: To help students understand the thin line between right and wrong ethical decision making, organise an ethical duel where the class is divided into groups. Each group is presented with a current event in which a top executive acted legally but his ethics were questioned. Each group conducts research on the event and is prepared to present their views in a debate – pro versus con.
- **Ethical versus unethical advertising strategies**: To help consumers understand how to filter through complicated and misleading advertisements, develop a presentation that includes specific examples of over-promising and under-delivering products/services (for example, car industry gimmicks and credit card companies that target inappropriate markets such as high school students).

Source: These exercises are adapted from 'SIFE Project Ideas' available at http://ntusife.files.wordpress.com/2008/01/sife_project_ideas.pdf and http://www.sife.se/eng_sife.se/om_sife/pdf/SIFE_Project_Ideas.pdf

EXPERIENTIAL EXERCISE: KNOWING THE DIFFERENCE

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

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

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

CASE 4.1: THE BODY SHOP AND INDIGENOUS ENTREPRENEURS

Community Trade is The Body Shop's targeted purchasing program of accessories and natural ingredients from disadvantaged communities around the world. In this speech to the Australian Reconciliation Commission, Body Shop Director Barrie Thomas talks about how they are helping Indigenous entrepreneurs:

> Our Indigenous peoples are being called upon at an ever-increasing rate to feed the wheels of our so-called modern and progressive societies. Over the past centuries, Western economics

has stripped many Indigenous people of their lands, their traditions and their culture. In effect, economics has made Indigenous people visitors to their own country . . .

So how are we going to use economics to change the future, what are the alternatives and how do we all participate?

For a number of years, The Body Shop (TBS) worldwide has tackled the issue of inclusion of Indigenous people in economic prosperity with a program called 'Community Trade'. This program operates on the principle that through the development of trade links we can reverse some of the damage of the past and create a future that holds some promise for our most disadvantaged. We believe that primary sourcing of product in disadvantaged communities can assist in relieving the economic hardship of those communities. Rather than create dependency on charity, we prefer to provide sustainable trade, which assists communities to support themselves.

The program aims to change the way in which we engage with Indigenous people, by realigning the power of the players so that they become equal participants in the development of business and ultimately, communities. For example, we provide market information that allows Indigenous people to participate by at least enabling them to bid for manufacturing contracts.

We also develop credit terms that balance the economic equation. By providing partial payment up front, manufacturers can start production without having to borrow from banks, which often traps them in a cycle of poverty and indebtedness. We believe that it is more than just sourcing of ingredients that can bring about a change in the current exploitative situation, however. To create a truly economically participative situation, we need to come from the same perspective, we need to see a common vision of the future. To attain this, our program operates from principles that state:

- We will respect people's rights to control their resources, land and lives.
- We will respect all environments and trade in renewable natural materials.
- We will benefit the primary producer and treat trading partners with respect and dignity.
- We will create successful and sustainable trade links and encourage small-scale community economics which can be easily duplicated.
- We will pay special attention to those minority groups, women, disadvantaged people and businesses that are marginalised by their access to global markets.

Currently, TBS is working in conjunction with the Hope Vale community in Cape York, Australia on a venture to produce tea tree oil. This oil, in the first instance, will be used by TBS in its products and ultimately will be sold in the mainstream market. The venture is not really about tea tree oil, however. It is about developing an industry that supports the community, an industry that does not exploit the environment and, most importantly, an industry that comes from Indigenous wisdom.

Setting up industries in communities is not a mystery. It is not impossible, it just takes a reframing of priorities. It is deciding who really are the stakeholders in our overall business, not just from a pure economic framework, but from a framework of our real obligation as business, our obligation to create wealth for all. It is saying that the community which buys from us is as important as the people who work for us and as the people who receive the profit from us. They are not merely markets to be sold to, nor resources to exploit or passengers on our economic ship, but people who have as great a stake in our communities as we profess to have.

For a beginning, mechanisms need to be developed that seek to ensure that Indigenous people can become full and equal partners in any business that could be created in communities. There are limited options for Indigenous people to develop basic business skills that allow them to be successful and participate in the management of their own lands and resources. This situation is exacerbated by the fact that even those business courses that are available are presented by an unfamiliar culture using a system that devalues Indigenous wisdom. This situation must change. We must create learning environments that respect traditional wisdom as well as Western knowledge, environments that encourage Indigenous entrepreneurship and action while respecting culture. The foundations of economically self-sufficient Indigenous community will be laid through education and respect, not words and rhetoric.

Further to this challenge is the challenge for governments and business to establish trading ventures with Indigenous people, businesses that are not just resource industries but businesses that offer real skills development in communities, businesses that offer a career structure for the young that will help reverse the social disintegration and urban drift in rural Australia . . .

Successful business development in Indigenous communities means we will need to turn our eyes from the short-term financial balance sheet and look at the social balance sheet . . .

By creating sustainable business with Indigenous people that respects cultures, we will create a better Australia. The destiny of Aboriginal and non-Aboriginal Australia lies together. By developing joint ventures and working together we will understand each other at a deeper level. The development of businesses in Indigenous communities can assist in changing the current paradigm. I believe that through business we can assist Indigenous Australians to come from a position of host rather than visitor, of fellow journeyman not passenger, of brother not foe.

Source: Australian Reconciliation Convention, Speech by Mr Barrie Thomas, Director, The Body Shop, www.austlii.edu.au/au/other/IndigLRes/car/1997/3/book3/html/06shra34.htm

Questions

1. How difficult is it to develop enterprises in isolated areas?
2. Why do we say that economic participation is the building block to equal rights?
3. When Australians say that true reconciliation cannot be achieved without a high level of economic independence, what do they mean?
4. When developing and implementing policies for economic participation and development, how is it possible to guarantee that special features of Indigenous societies and cultures are identified?
5. How can we involve Indigenous peoples in all aspects of the development and implementation of policies and programs for stimulating economic development?
6. How is it possible to identify and prepare for the social costs that affect the communities involved?

CASE 4.2: A LIVING CULTURE, TAMAKI MĀORI VILLAGE

Often the values and needs of sustainable tourism sit uncomfortably with the requirements of commercially-driven tourism enterprises. The Tamaki Māori Village in Rotorua, New Zealand, bears testament to the fact that the two can exist and succeed symbiotically.

Founded by Māori brothers, Mike and Doug Tamaki, their driving vision of helping to preserve the Māori culture and add authenticity to the tourism experience has been fulfilled, as has their ancillary aim to develop and run a successful Māori tourism business. What makes this story even more remarkable is that success has not been achieved with aid from governments or outside funding, but rather it is a product of sheer hard work and inspiration of the two brothers, plus a little help from a Harley-Davidson motorcycle.

Rotorua is the geothermal capital of Aotearoa New Zealand. While other industries such as agriculture, retail and forestry have also flourished in the area, it is tourism that remains at the centre of the region's infrastructure. One-fifth of the city's working population is employed in the tourism industry, which must carefully balance a dynamic and contemporary attitude with a steadfast commitment to a 600-year-old cultural heritage.

Tourism in the region and throughout New Zealand has tended to reflect the ideologies of the period. By the 20th century Māori were being widely used as a marketing tool by Pākehā operators. Marketing and tourism products were often characterised by 'kitsch' and not altogether culturally appropriate depictions of Māori culture. The culture was portrayed, rather than experienced, with cultural groups brought to hotels in order to perform. This approach saw the development and perpetuation of a tongue-poking, poi-twirling, skirt-swinging cliché surrounding Māori and their culture.

It was against this background of Māori tourism stereotypes and limited Māori economic involvement in the industry that brothers Mike and Doug Tamaki developed Tamaki Tours and later the

Tamaki Māori Village. The driving vision of the brothers was to provide visitors with an authentic, deeper and more spiritual experience of Māori culture and to run a successful Māori business.

It is perhaps ironic, then, that the birth of the business that was to win New Zealand's top Māori tourism award began with the sale of an American cultural icon – a Harley-Davidson motorcycle. In the late 1980s Mike Tamaki had been driving tour buses around the region for a major tourism company. Mike's interactions with the tourists led him to believe that they wanted more than basic sightseeing; they longed for a fuller, more meaningful experience. They wanted to know who you were, the people, the places. He had unwittingly discovered a huge gap in the market and an opportunity to create more personalised tours, which included elements of culture and storytelling.

Mike approached his brother Doug, who was the proud owner of a classic Harley-Davidson. It took Mike three months of sweet-talking his brother to convince him to trade his beloved motorcycle for a minibus. The minibus, a 16-passenger affair, was hand-painted with signs, and brochures promoting the newly established 'Tamaki Tours' were printed. The Tamakis' personalised tours, laden with sights, story-telling, Māori culture and humour, began in September 1990. In their first week of business the brothers took five people on their tour; by the end of the year they had 5000 clients.

This success was a result of the Tamakis' vision, hard work and personal sacrifice. As Mike explains, although there were opportunities for them to get outside funding for the project, the fact that they built their business based on their own zeal and personal sacrifices made them all the more determined to make it succeed. 'There were possibilities for us to get government grants to kick-start an Indigenous business, but we didn't want to go down that track because we wanted to start our own business on the same level playing field as anybody else who was going to start a business. The Harley-Davidson was a sacrifice and from there on in there were many other sacrifices. We were always undercapitalised. We had dreams of getting bigger and bigger, but whenever we needed to spend money, we had no money left. So we learned to do business the real way, along the road of hard knocks.'

One of the Tamakis' tours was a three-day excursion into the Ureweras. This national park, known for its ruggedly beautiful forest, is about as far removed from civilisation as you can get. It was this tour that 'turned us inside out', says Mike. The brothers had hired a Tuhoe (a local Māori tribe) guide. 'He was a big guy, heavily tattooed, with dreadlocks and missing teeth. He had a huge smile and he loved the land and the people on the tour. As we got to the edge of the forest he would jump out and do a *karakia* (prayer). We went through the Urewera Forest and he completely reinterpreted everything. He spiritualised everything – the mountains, the trees, the forest, the sky, the land – and put the tourists into the environment. Once we finished this three-day tour we were on a whole different spiritual plane.'

The Urewera tours became a turning point for the company. Mike and Doug realised that they wanted an authentic, spiritualised Māori cultural experience to be the centrepiece of their business, rather than as an adjunct. The brothers took a step back and looked at the infrastructure of their company. They solicited outside help from a business manager and devised a three-year development plan. They perceived that there was a market opportunity for an authentic *hangi* (ground-oven cooked) meal and concert in a *marae* (traditional meeting place) setting. The philosophy behind this specialisation was twofold. First, there was a niche in the market and the brothers had received feedback from tourists indicating that the hotel-based concerts seemed staged and plastic. Second, the brothers wanted to get local *maraes* working again.

Mike and Doug then sought backing from local *iwi* (tribe) for access to a *marae* for their tour. After visiting a dozen *marae* in the area, speaking about their vision and ensuring that *marae* protocol would not be compromised, one site agreed to work with the brothers. As part of their new tour, the brothers brought busloads of tourists to the *marae* where they were fed a traditional hangi meal, entertained with live song and dance and given hands-on, participative insight into Māori culture.

However, the *marae* tour soon proved too successful. Because of the ever-burgeoning numbers of visitors it quickly became too taxing on the *marae*. The tour was running seven days a week and it soon began to overshadow and interfere with all the other activities in which the local *iwi* were involved. It was obvious to the brothers they would have to develop their own site for a *marae* experience. By coincidence, their bus broke down one day alongside a piece of land that appeared to be a perfect spot for such a development. It was in native forest and was the site of an ancient fortified *pa* (Māori village). The land was owned by a Māori trust that was enthusiastic about supporting the development.

It was never smooth sailing for the brothers. They were developing a product that represented a traditional and sacred culture and this meant that they had to be commercially aggressive and culturally sensitive. There was always going to be a degree of apprehension and tension associated with the Tamakis' vision of a commercial tourism enterprise, based in large measure on concerns that the culture could end up being compromised. For many years Māori had seen their culture bastardised in order to provide a clean, neat tourism industry package. Elders did not want to see similar misrepresentations in the Tamakis' business.

There are also many important and sacred protocols associated with the marae which must be observed and respected. Therefore, a consultative process was paramount, one where *iwi* could express their concerns and expectations and the Tamakis' could address and reconcile these. Six months of consultation with local *kaumatua* (elders) took place in order to ensure that the tourism development was culturally appropriate, while still being commercially viable.

In 1994 the Tamaki Māori Village began operations. By 1998, it had won both the Māori Tourism Award and New Zealand's Supreme Tourism Award. The awards bear testament to the development and popularity of a thriving Māori business. The village has also recently developed and opened a Tribal Arts and Crafts Market Place encompassing eight shops and a café where unique Indigenous arts and crafts are manufactured. The Market Place provides local Māori artists with the opportunity to own their own small business. In addition to employing Māori and providing the opportunity for local Māori artists to own their own businesses, the Village has other far-reaching benefits for both local Māori and Māori more generally. For example, the Village actively encourages the study of *Māoritanga* (the Māori culture). The Village also provides a vital opportunity for urban Māori, many of whom have been disenfranchised from their culture, to be reacquainted with its richness and warmth. By avoiding traditional stereotypes and settings, the Village authenticates Māori cultural tourism and gives it back the spirituality which is lacking when portrayed in a hotel setting. This authenticity is setting a benchmark for other tour operators, which, in turn, will break many of the Māori stereotypes that have been prevalent in the industry.

Source: 'A Living Culture, Tamaki Māori Village', http://cullin.org/cbt/index.cfm?section=chapter&number=11

Questions

1. How did the Tamaki brothers use their cultural heritage in starting their business? Do you think this was to their advantage when assuring success?
2. How does a policy of enterprise culture fit in with the success of the Tamaki brothers?
3. How did the Tamaki brothers manage to combine the need to be culturally sensitive and commercially aggressive? Do you think their solution was agreeable?

RECOMMENDED CASES FROM HARVARD BUSINESS SCHOOL ONLINE

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Circus Oz

Publication Date: 20 August 2006
Author(s): James Phills, Hilary Stockton
Product Number: 9-SI6-9A

Circus Oz was Australia's premier international circus, having performed in 26 countries on five continents. In early 2002 Circus Oz enjoyed its strongest financial position since its founding in 1977, making a profit and sitting on a surplus of AUD$1 169 313. Although in recent years the company had increased the percentage of revenue generated from the box office, more than 60 per cent of its funding still came from the Australia Council, its largest government sponsor. Linda Mickleborough, general manager of Circus Oz, was pondering how to respond to a recent offer by the Australia Council to fund a new position, director of development, at Circus Oz. The Australia Council was strongly encouraging the circus to hire development professionals to expand its funding from corporate donors. As an enticement, the council offered to underwrite the cost of the position for two years. Mickleborough had found the ideal candidate. The decision, however, was still a difficult one. Circus Oz had relatively flat salaries, reflecting deeply held egalitarian and democratic values. These values were central to the company's creative process, culture and aesthetic. The suggested salary of the development director position was more than two times the highest salary currently paid to any employee at Circus Oz. Such a large salary disparity might wreak havoc on the company's morale and culture.

Jamnalal Bajaj, Mahatma Gandhi and the Struggle for Indian Independence

Publication Date: 25 August 2006
Author(s): Geoffrey G. Jones, Kerry Herman, Pk Kothandaraman
Product Number: 9-807-028

This describes the role of a prominent Indian business leader in the campaign for independence before 1947 and his close relationship with the legendary Mahatma Gandhi. It provides the opportunity to consider the impact of colonialism on shaping Indian entrepreneurship and the role of the small Marwari group, originally from the Marwar region of Rajasthan, in creating many of India's leading business houses, including the Bajaj. The Bajaj, like other Marwari, were traders who after the First World War transitioned into manufacturing, including sugar manufacturing and steel rolling.

Social Enterprise: Private Initiatives for the Common Good

Publication date: 30 November 1994
Author(s): J. Gregory Dees
Product number: 395116

This presents a model for understanding how private social-purpose ventures (non-profit and for-profit) differ from traditional business firms in both their objectives and methods of operation. It identifies six dimensions that are useful for understanding the differences, and also discusses the role of social enterprise in society and current trends creating opportunities for social entrepreneurship.

Ashoka: Innovators for The Public

Publication date: 2006
Author(s): William F. Meehan III, Trabian Shorters
Product number: SM157

Founded in 1980 by Bill Drayton, Ashoka is a professional organisation that identifies and invests in leading social entrepreneurs globally. As defined by Ashoka, the social entrepreneur had the same makeup as a business entrepreneur – in mental attitude, vision, bias for action and skills – but the social entrepreneur sought to better the world in some way. Until 1997, Ashoka focused solely on locating and supporting social entrepreneurs in developing countries. Over the next three years, however, Ashoka entered a new stage requiring it to shed its trappings as a global development organisation. The new mission and hiring commitment attracted leading business entrepreneurs to Ashoka for the first time, triggering unprecedented organisational growth and allowing Ashoka to open for business in the US. This case addresses the challenges facing Ashoka in the US.

Muhammad Yunus and The Grameen Bank

Publication date: 2007
Author(s): Howard Husock
Product number: 1886.0

The Grameen Bank of Bangladesh created the model for large-scale 'microlending' in the developing world, in the process becoming an institution known and respected internationally for a creative and effective approach to poverty alleviation. Grameen's willingness to make extremely small loans at relatively modest rates of interest to borrowers without traditional forms of collateral has allowed it to reach nearly six million borrowers in Bangladesh – one of the world's poorest countries – and to serve as exemplar for other microlenders serving the poor throughout the world. This case tells the story of how Grameen grew from a small local experiment into a major force in Bangladesh serving more than 60 000 villages. It describes the stages of that growth from a small organisation staffed by volunteers to a sophisticated one with more than 17 000 employees. The case was conceived as one which establishes a template for the evolution of an organisation from one that is philanthropically and government supported into one that relies on operating income to sustain itself.

Creating Sustainable Local Enterprise Networks

Publication date: 2005
Author(s): David Wheeler, Kevin McKague, Jane Thomson, Rachel Davies, Jacqueline Medalye, Marina Prada
Product number: SMR184

The authors analysed 50 cases of successful sustainable enterprise in developing countries and developed a conceptual framework called the Sustainable Local Enterprise Network (SLEN) model. Successful sustainable enterprises in developing countries often involve informal networks that include businesses, not-for-profit organisations and local communities. These networks can lead to virtuous cycles of reinvestment in an area's financial, social, human and ecological capital. Successful SLENs require at least one business enterprise to ensure the network's financial sustainability and serve as its anchor; however, a cooperative or a profitable social enterprise launched by a nongovernmental organisation may play that anchor role. Although multinational corporations were sometimes part of the SLENs studied, entrepreneurs, non-profits and sustainable local businesses were more common. Concludes with recommendations for fostering the development of SLENs, such as setting up training programs in sustainable entrepreneurship in developing countries.

Bribery and Extortion in International Business

Publication date: 27 September 1999
Author(s): Louis T. Wells Jr
Product number: 700055

This case provides several examples of decisions involving bribery or other actions that could be considered as corrupt.

Answers to 'Knowing the Difference'

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

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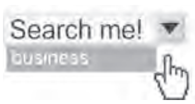
SEARCH ME!



bribery
corruption
discrimination
ethics
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social entrepreneurship
social marginality

ENTRPRENEURIAL CASE ANALYSIS

BUILDING A BETTER RAT TRAP: TECHNOLOGICAL INNOVATION, HUMAN CAPITAL AND THE IRULA

PART 1

Dr Siri Terjesen is Assistant Professor at Indiana University and Visiting Research Fellow at the Max Planck Institute of Economics in Jena, Germany.

Sethu Sethunarayanan, Director of the non-profit, non-government organisation (NGO) Center for Development of Disadvantaged People (CDDP), beamed as World Bank President James Wolfensohn presented him with the prestigious Global Development Marketplace grant to develop innovative technologies to alleviate poverty. At the podium, Sethu said:

> There are three million poor Irula Indigenous tribal people of untouchable status in India who make their income by catching rats in agricultural fields. They use a clay pot filled with burning straw to smoke these rats out of their burrows. Their mouths and hands touch the pot, and they are severely affected by heart, skin, eye and respiratory problems. We developed a new hand-operated steel rat trap which eliminates the health hazards completely and enables the Irula to double their income.

As Sethu returned to his seat in the World Bank auditorium, he thought about how this journey began, on a morning walk through impoverished Irula villages in Tamil Nadu, India.

INTRODUCTION On a sticky morning in January 2003, Sethu walked briskly, anxious to check on the progress of a new drinking water pump well installed in a remote Thiruvallar district village. Sethu wanted to make sure that the new pump was installed properly, so that the Irula people who live in the village would no longer have to bring water from several miles away. Sethu was pleased to see that the pump worked perfectly, but was exhausted from his two mile hike. He asked a lady villager for some water to drink. Sethu glanced down at a clay pot in front of the hut door and noticed a similar pot in front of most of the huts. Thinking he might be able to drink out of this pot, he picked it up, but noticed that, in addition to the top opening, there was a small hole at the base of the pot. He put the pot down and picked up a neighbor's pot which also had an extra hole.

> I asked, 'How will you carry water in the holed pot?' She replied with a sarcastic smile, 'This is not for carrying water, but for killing rats. My husband carries this pot when he goes rat catching. He looks for a rat burrow and places the pot at its entrance. He stuffs wet straw into the hole and lights it, creating smoke. On this little hole at the bottom, he places his mouth and blows air through, pushing the smoke out the other side of the pot and into the rat's burrow. The smoke traps the rat. Then my husband digs into the earth and gets the trapped rat. He brings it home and I cook it for dinner. But sometimes he also comes home with burned lips and hands from handling the pot when the straw is burning. He doesn't always catch a rat.

Sethu handed the pot back to the woman, but he did not stop thinking about the inefficiency of this pot and the resulting health problems. In 1998, then 38-year-old Sethu had established his own NGO, the Center for Development of Disadvantaged People (CDDP). CDDP is one of only a handful of NGOs recognised by both the UN and the World Bank. Its mission is, 'To develop those who are disadvantaged educationally, economically, socially and culturally through self-help and self-governing

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collective development activities'. CDDP's target areas are 80 villages in Andhra Pradesh India. The programs are aimed at helping women and children belonging to socially and economically weak sectors, unorganised agriculture labour, small and marginal farmers, youth, destitutes, orphans, physically challenged and other socially and economically disadvantaged people. CDDP has 23 employees and 56 volunteers.

THE IRULA An estimated three million Irula people live in India. Until recently, the Irula lived in forests and eked out an income by bartering or selling honey, wax and firewood to local villages in exchange for village products. They obtained food by hunting for vegetation and wild animals in the forests. The 1976 *Forest Protection Bill* made the Irula lifestyle illegal, forcing moves into villages of mud huts with straw roofs and dirt floors. Sethu described the situation:

> Irula are tribals and considered to be untouchables and unequal in society. For example, they are not allowed to use the wells of upper castes. They live in interior locations from which it is hard to reach towns and cities, and they do not interact with the community outside.

The Irula have a life expectancy of approximately 45 years. Only 5 per cent of Irula children attend school and adults are 99 per cent illiterate. Today, Irulas earn their income by performing physical labour for land owners. For example, men, widows and destitute women catch rats in agricultural fields. The farmers pay per rat and the rat catcher's average income varies from $15 to $30 per month. The rat may be the Irula's only source of meat and grains, usually consumed as one meal per day. In the past, some Irula people have starved.

BUILDING A BETTER RAT TRAP Back in the office, Sethu decided that there might be an opportunity to develop a better rat trap. He and a local engineer fashioned a steel cylinder and hand-crank to generate air for pushing smoke into the burrow, a door on the cylinder for straw and a wooden handle to eliminate direct contact with the hot areas of the trap. Sethu provided sample traps to 15 Irula rat catchers whom he met with regularly to get feedback. The rat catchers brought Sethu to the fields. He remembers:

> I asked the catcher, 'How do you find the rat'? He said: 'The rat keeps his house like my wife does – very tidy, including the area outside the door. So I know when I come across a burrow hole with a clean entrance, there is a rat inside.

Sethu watched as the rat catchers filled the steel trap with straw. The men located a hole on the bank between two fields, and two other holes about five feet away which they covered with dirt to prevent the rat's escape and to cause its suffocation. The lead rat catcher dug a larger entrance to the first hole, and put the trap's pipe inside. The other two men guarded the covered holes and watched as the lead rat catcher opened the trap's door, lit the straw and cranked the handle. The trap sputtered as smoke filtered down the hole, emerging from another hole in the earth which was then quickly covered. It became clear that if there was a rat inside the hole, it had been deprived of oxygen. The lead rat catcher then removed the trap and began to dig on the side of the hole, following the winding burrow. He reached down the hole and pulled out a dazed rat, stunned by smoke. The rat was then killed with a blow to its head. Sethu and the rat catchers were excited – the trap was a success! Sethu realised that he had identified a suitable technology for this opportunity and decided to seek funding for its commercialisation. Sethu applied for a grant from the annual World Bank Global Development Marketplace in December 2003 and received a grant for $98 500, enabling him to implement the project.

IMPLEMENTATION Sethu and CDDP volunteers began by visiting 170 Irula villages in order to identify the most needy individuals. The visits were conducted simultaneously in order to reach the target deadline, but the visits were not without their problems. As Sethu explained:

> We needed to take extra time to explain the project to the villagers. The Irula are especially sensitive to political matters, and at first they thought the CDDP volunteers were politicians … We encountered this problem in every new village.

The selection criteria were health and socioeconomic need, with priority given to those suffering health

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problems from the old pot fumigation method and whose entire income is based on rat catching. Destitute, deserted and widowed women were also a priority and comprised 15 per cent of beneficiaries.

A basic health check was completed for 1500 beneficiaries. In some cases, special tests for tuberculosis and diabetes, as well as ECG, X-ray and optometry exams were conducted. Treatment was begun for all affected villagers.

Sethu knew that he would need to work closely with the Irula to elicit interest in the new technology. Sethu explained:

> In the past, the Irulas have been given things by other NGOs and the government, but these things have basically been useless. So they do not like to get things for free. We tried to find out if the pot fumigation method was causing problems and to get them to see the link between the old method and their health troubles.

FACTORY ESTABLISHMENT A factory was established in a 60 square foot building. Based on 50 workers, eight hours a day, the factory has a monthly capacity of 400 traps, but can easily be expanded. Sethu calculated that each trap would cost $30 to produce, including $25 for raw materials and $5 for labour. In the event of a drop in demand for traps, the factory is equipped to make other steel items to be sold to farmers, including knives, sickles, ploughs, grill gates, chairs and benches.

Sethu opted to create new opportunities for young, unmarried women who were unemployed. Fifty young women were invited to work in the factory. The women organised themselves into the Tribal Women Technotrapper Producers Society and registered as a small industries cooperative. CDDP transferred whole ownership of the factory to the workers so that the women could control the profits. CDDP hired two technical people to provide three months of training in manufacturing, marketing and finance. The young Irula women, who did not have any business or manufacturing training, took great delight in their new roles. They were paid $35 to $70 a month – very high by village standards – and were able to provide for their siblings and parents.

PRODUCTION To make the trap, the girls first trace rectangular shapes on the sheet metal. A compass and chalk are then used to mark a 15-inch diameter circle. Next, a team of girls pulls a heavy handle to cut the metal and drills holes for smoke ventilation. The rectangle piece of steel is rolled through a machine to make it cylindrical. From here, two girls work together to weld the cylindrical rectangle to the circle. Finally, the door and hand crank are added.

WOMEN'S MICRO-CREDIT COLLECTIVES CDDP launched a number of women micro-credit funds, each comprised of 12 to 15 women. The fund enabled the women to obtain small loans for urgent household needs or to begin self-employment activities, reducing dependence on exploiting moneylenders. Each micro-credit group had a revolving fund collected from their monthly saving and also from the interest accrued from the loan. Each woman's initial contribution was $1 to $2. Fund availability ranged from $200 to $500 depending on each group's prerogative. The micro-credit groups were often used to purchase the new trap. Once a woman raised 50 per cent of the payment for the trap, she received the trap and paid the remaining half in loan instalments according to a timeline agreed by the group.

PROJECT EVALUATION An evaluation committee, composed of local World Bank employees, government officials and development experts, met with beneficiaries, staff and concerned communities to ascertain the impact of the project. The committee learned that many families are now able to send their children to school. Based on the evaluations, the World Bank considers CDDP's rat trap venture to be a success. Sethu explains:

> We estimated that the income of the tribal rat catchers would be doubled. To our surprise, income is more than tripled. There is great enthusiasm among the families. Another important unexpected positive development is that the rat catchers could use the trap for catching rabbits, foxes and other small animals which live in burrows. This fetches very high income for them.

CONCLUSION Sethu identified the following major challenges: factory expansion, NGO alliances, micro-credit developments, providing support for special projects, continuing to develop technology-based solutions, and fundraising. With over 100 million small farmers seeking the Irula rat catchers' help, the trap is in great demand. CDDP has taken orders for over 2000 devices. Sethu considered the factory expansion options,

> We could expand the factory to more than 50 employees, but then it would need to be registered under the *Big Industries Act* and we would incur enormous taxes and other bureaucratic problems. Instead, we could create a number of small factories across the villages. We would also reduce transportation costs and the local people would be employed. If the demand for traps ever falls, these small factories can produce steel products for farmers instead. We also need to figure out a way to lower our overall costs to make the traps so we can have more profit.

Another challenge is to determine the best loan structure that will enable the Irula to buy new traps and repay their loans. Relatedly, Sethu is eager to explore other possibilities with the micro-credit.

Finally CDDP would like to continue to devote resources towards special projects such as the release of children who are bonded labourers in other villages.

Sethu and his team continue to use technology to create innovative solutions for the poor, including a smokeless oven and a natural water purification system that uses materials, such as indigenous plants, which are easily found in impoverished areas. CDDP has received other international funding.

PROJECT EXPENSES 2004 (IN US$)

Materials and equipment: machinery and raw materials to make 1500 traps	$67 197
Training: making traps and other steel items to be sold to farmers	$9435
Health and self-help groups: identification and treatment of health problems, formation of micro-credit groups, societies and workshops	$7529
Personnel	$7053
General administration	$2930
Travel	$2300
Information dissemination	$2056
Total expenses	$98 500

DISCUSSION QUESTIONS

1. What makes Sethu's new trap an appropriate technology?
2. What are some examples of other societal problems and market failures that present an opportunity for entrepreneurs?
3. What characteristics of Sethu, CDDP and the Irula villagers enabled their success?
4. Why was micro-credit effective for the Irula village women?

Source: Siri Terjesen, 'Building a Better Rat Trap: Technological Innovation, Human Capital, and the Irula', *Entrepreneurship: Theory & Practice,* 31(6), November 2007: 953–63; Siri Terjesen, 'Note to Instructors: Building a Better Rat Trap', *Entrepreneurship: Theory & Practice,* 31(6), November 2007: 965–9

PART TWO: INITIATING ENTREPRENEURIAL VENTURES

CHAPTER

5

INNOVATION: THE CREATIVE PURSUIT OF IDEAS

Innovation is the combination of an inventive process and an entrepreneurial process to create new economic value for defined stakeholders.

Professor Kevin Hindle (Australia)[1]

Imagine a world in which all the things we make, use and consume provide nutrition for nature and industry, a world in which everything is so intelligently designed that human activity generates a delightful, restorative ecological footprint. Imagine having the choice, in every sphere of life – at home, on the job, travelling from place to place – to use goods and services that enhance the well-being of your community. Imagine those goods designed with only safe, healthful materials that can be either returned to the earth to replenish the soil or recovered by their manufacturers to be up-cycled into products of higher value, virtually eliminating the concept of waste. Think of packaging becoming food for the pea patch, automobiles designed for disassembly, and cost effective factories powered by the energy of the sun. Imagine high-tech buildings so in tune with the biosphere that they inhabit the landscape like native trees, making oxygen, sequestering carbon, fixing nitrogen, purifying water, providing habitat for thousands of species, accruing solar energy, building soil and changing with the seasons – while also generating remarkable productivity and providing beauty, comfort and delight. And then consider the many ways in which these changes, this rediscovery of our connection to life, could revitalize our cities, our economies and our nations, remaking the way we make things and transforming humanity's relation to the Earth.

William McDonough, *The Natural Advantage of Nations*[2]

chapter objectives

• 01
To explore the opportunity identification process

• 02
To define and illustrate the sources of innovation for entrepreneurs

• 03
To examine the role of creativity and to review the major components of the creative process: knowledge accumulation, incubation process, idea evaluation and implementation

• 04
To present ways of developing personal creativity: recognise relationships, develop a functional perspective, use your 'brains' and eliminate muddling mind-sets

• 05
To introduce the four major types of innovation: invention, extension, duplication and synthesis

• 06
To review some of the major misconceptions associated with innovation and to define the 10 principles of innovation.

As Thomas Edison famously said: 'Genius is one per cent inspiration and ninety-nine per cent perspiration'.[3] And proportions are important too. Often there is too much emphasis on the invention and no appreciation for how complex it is to commercialise it. Everyone has inspirations and ideas; it is the entrepreneur who puts in the huge amount of perspiration to take the invention to the marketplace.

Truthfully, the entrepreneur–inventor is very rare. There are only a few examples where the entrepreneur commercialises their own invention. Undaunted by several factory explosions, including one that took the life of his brother, Alfred Nobel is well known as the inventor and commercialiser of nitro-glycerine. American entrepreneur George Kodak invented and commercialised the Kodak camera to promote amateur photography on a large scale. Japanese serial entrepreneur Kiichiro Toyoda studied American manufacturing techniques by dismantling and reassembling imported motorcycles and automobiles. He went on to found Toyota. Chinese immigrant An Wang was a computer engineer who developed word processing and founded Wang Laboratories. Bill Gates helped developed DOS, which became Windows. Despite all these famous names most entrepreneurs rely on the inventions of others. Nicola Tesla, the inventor of motors and generators, died poor.

The reason is, as Hindle says, 'innovation is the combination of the creative process of invention and the entrepreneurial process of creating economic value'.[4] Or as Australian inventor–entrepreneur Katherine Livingston says, 'innovation means the process whereby new ideas are transformed, through economic activity, into a sustainable value-creating outcome'.[5]

OPPORTUNITY IDENTIFICATION: THE SEARCH FOR NEW IDEAS

Opportunity identification is central to the domain of entrepreneurship. As one researcher stated, 'at its core entrepreneurship revolves around the questions of why, when and how opportunities for the creation of goods and services in the future arise in an economy. Thus, opportunity recognition is the progenitor of both personal and societal wealth'.[6] It has been argued that understanding the opportunity identification process is one of the primary challenges within the domain of entrepreneurship research.[7] To give a better perspective of this entrepreneurial search, this chapter is devoted to examining the creative pursuit of ideas and the innovation process. These two major topics are keys to understanding opportunity and its development for entrepreneurs.

The first step for any entrepreneur is the identification of a good idea. However, the search for good ideas is never easy. Thus, we examine the sources that can be used in this search and how an entrepreneur can work toward the discovery of a good idea. The most important areas to be aware of are within the grasp of our own knowledge. Let us examine some of the key sources of innovative ideas.

Sources of innovative ideas

Potential entrepreneurs must always be alert to the opportunities that lie in the external and internal environments in which they live. This alertness will allow an entrepreneur to create an idea from what others simply cannot recognise. The following are some of the most effective sources of entrepreneurial opportunities.

- **Trends:** Trends signal shifts in the current paradigm (or thinking) of the major population. Observing trends closely will grant an entrepreneur the ability to recognise a potential opportunity. Trends need to be observed in society, technology, economy and government. Following are some examples of such trends:
  Societal trends: ageing demographics, health and fitness growth, senior living
  Technology trends: mobile (cellphone) technology, e-commerce, Internet advances

Economic trends: higher disposable income, dual wage-earner families, performance pressures

Government trends: increased regulations, petroleum prices, terrorism.

- **Unexpected occurrences:** These are successes or failures that, because they were unanticipated or unplanned, often end up proving to be a major innovative surprise to the firm. For example, Alexander Fleming was surprised to note that a contamination of a bacterial plate culture suppressed the growth of his bacteria. He identified the contamination as penicillin mould. Later, Australian scientist Howard Florey drew on Fleming's observation to create industrial-scale manufacture of penicillin.
- **Incongruities:** These occur whenever a difference exists between expectations and reality. Innovation is the creation of solutions to incongruities. Solving the problem of how to fly in a vacuum gave us rockets and satellites. Switching electrons through insulators gave us transistors, microchips and then Silicon Valley and the digital age.
- **Process needs:** For example, process gaps or bottlenecks. These occur when an answer to a particular need is required. Venture capitalists often refer to these as '**pain**' that exists in the marketplace. The entrepreneur must recognise an innovation solution, or '**painkiller**'. Examples include the creation of new medical devices, health foods, pharmaceuticals, time-saving devices and eco-sustainable green manufacturing.
- **Industry and market changes:** Continual shifts in the marketplace occur, caused by developments such as consumer attitudes, advancements in technology, industry growth and the like. Industries and markets are always undergoing changes in structure, design, or definition. An example is found in the healthcare industry where hospital care has undergone radical change and where home healthcare and preventive medicine have replaced hospitalisation and surgery as primary focus areas. The entrepreneur needs to be aware of and seize these emerging opportunities.
- **Demographics:** These arise from trend changes in population, education, income changes, age, occupations, geographic locations and similar factors. Demographic shifts are important and often provide new entrepreneurial opportunities. For example, as the average population age in Australia's Gold Coast has increased (due largely to the influx of retirees), land development, recreational and healthcare industries all have profited.
- **Perceptual changes:** These changes occur in people's interpretation of facts and concepts. They are intangible yet meaningful. Perception can cause major shifts in ideas to take place. The fitness fad, caused by the perceived need to be healthy and physically fit, has created a demand for both health foods and health facilities throughout the country. Another example is people's desire to better use their personal time. As a result, the travel industry has capitalised on the consumers' current need to see the world while they are young and healthy and time-share condominiums and travel clubs have increased.
- **Knowledge-based concepts:** These are the basis for the creation or development of something brand new. Inventions are knowledge-based; they are the product of new thinking, new methods and new knowledge. Such innovations often require the longest time period between initiation and market implementation because of the need for testing and modification. For example, today's cellphone technology has advanced to transform the end product into not just a phone service but a camera, Internet access resource, and music provider. This has revolutionised the way we use different technologies today. These concepts were not thought possible five years ago.

Some examples of these innovation sources are presented in Table 5.1.

TABLE 5.1: SOURCES OF INNOVATION

SOURCE	EXAMPLES
Unexpected occurrences	Unexpected success: Viagra, Apple Computer Unexpected failure: 9/11 terrorist attack, 2008 global financial crisis
Incongruities	Overnight package delivery
Process needs	Sugar-free products Caffeine-free coffee Microwave ovens
Industry and market changes	Healthcare industry – changing to home healthcare
Demographic changes	Retirement communities for older people
Perceptual changes	Exercise (aerobics) and the growing concern for fitness
Knowledge-based concepts	Mobile (cellphone) technology, pharmaceutical industry, robotics

TOP INVENTIONS IN OUR REGION

>>ENTREPRENEURSHIP IN PRACTICE

- **Lawn-mower**: Australian Mervyn Victor Richardson developed the Victa rotary lawn-mower in August 1952. It was not the first rotary lawn-mower ever developed, but it was cheaper, lighter and easier to use than the mowers that came before.
- **Incat Catamarans**: During the 1990s, large catamaran ferries made of aluminium started operating on ferry routes around the world. These ferries, first made by Incat in Hobart, Tasmania, operated at twice the speed of conventional ferries and had very short turnaround times, allowing operators to provide twice as many trips as before and dramatically reduce travel times for passengers.
- **Australian tea tree oil**: The Aboriginal Bunjulung people of the NSW north coast use it to take the sting out of cuts and insect bites and to successfully treat bacterial, viral and fungal infections. The tea tree industry has developed dramatically from one relying on harvesting of naturally occurring plants to one characterised by highly mechanised intensive plantations. Australia leads the world in the supply of high-quality tea tree oil and associated products.
- **Hills Hoist**: The Australian Hills Hoist is a rotary clothes line fitted with a hoist operated by a crown and pinion winding mechanism which allows the frame to be raised and lowered. It was developed and marketed by Lance Hill in 1945 after he returned from the Second World War.
- **Cochlear – the bionic ear**: The Australian bionic ear is the result of pioneering research commenced by Professor Graeme Clark in the late 1960s at the University of Melbourne Department of Otolaryngology. The device analyses the complex speech signal and presents it as electrical stimulation to the hearing nerve so that speech can be understood.
- **Stump jump plough**: The South Australian stump jump plough was designed to allow the farmers to jump their equipment over stumps in their way thereby protecting their machinery and avoiding the cost of having to remove each stump.
- **Plastic banknotes**: Australia was the first country to have all polymer banknotes, but the rest of the world is starting to follow our lead. Note Printing Australia has produced banknotes for Thailand, Indonesia, Papua New Guinea, Kuwait, Western Samoa, Singapore, Brunei, Sri Lanka and New Zealand.
- **Woomera**: Hunters all over the world have used spears but the 'woomera', a type of spear thrower, is a unique Aboriginal invention. A woomera is a simple lever that acts to increase the speed at which a spear is thrown and thus increase the distance it travels.
- **Bungy jumping**: A.J. Hackett spent two years working with the University of Auckland developing a special cord made up entirely of individual rubber strands which, when attached to

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the ankles, could be used to bungy jump from a fixed platform. They originally got the idea from watching native tribes in Papua New Guinea who used forest vines to leap from manmade towers, an initiation rite often with tragic consequences.

- **Seismic isolators**: No one else in the world had thought of it before New Zealand engineer Bill Robinson. Today many prominent buildings around the world are made safe from earthquakes by earthquake bearings that can move sideways as well as up and down.
- **Flight**: It was New Zealand's Richard Pearse, not the Wright Brothers, who was first to fly. The quintessential 'mad scientist' inventor, he didn't realise the historic importance of the event and so didn't bother to have any photographs taken of his machine flying, although there is extensive evidence from witnesses describing his flights eight months before the Wright Brothers. What distinguished the Wright Brothers was sustained controlled flight and their focus on building a business out of this invention.
- **X-ray crystallography**: Father and son, Sir William Henry Bragg and Sir William Lawrence Bragg of Adelaide, shared the 1915 Nobel Prize for their studies of X-ray spectra crystal structure. This tool allowed many different types of crystals to be analysed.
- **Black box flight recorder**: The black box was invented in 1953 by Australian David Warren. The box is now standard equipment in large aircraft all over the world.
- **Refrigeration**: Making ice was invented in 1851 by James Harrison in Geelong, Victoria. It was invented because cooling was needed to stop food becoming spoilt while it was being transported within Australia and to other countries.
- **Penicillin**: Australian scientist Howard Florey transformed penicillin, first observed by Scotsman Alexander Fleming, from an interesting observation into a life-saving antibiotic medicine.
- **Microsurgery**: Earl Owen graduated as a surgeon from Sydney University. He convinced Zeiss Optics to develop a range of equipment that made surgery possible on a tiny scale.

Sources: For Australia: The Science and Technology Centre, Canberra, Australia; the Powerhouse Museum in Sydney; Paul Holper & Simon Torok, *Australian Inventions*, ABC Books for the Australian Broadcasting Corporation; William D. Ferris, 'Australia Chooses: Venture Capital and a Future Australia', *Australian Journal of Management*, 26, 2001: 45. For New Zealand: New Zealand Inventors Trust, www.inventors.co.nz.; also United States Patent and Trademark Office.

TABLE 5.2: SOME IMPORTANT INNOVATIONS BY SMALL FIRMS IN THE 20TH CENTURY

Aeroplane	Electronic spreadsheet	Microprocessor
Air conditioning	Freewing aircraft	Nuclear magnetic resonance scanner
Air passenger service	FM radio	Optical scanner
Articulated tractor chassis	Front-end loader	Oral contraceptives
Assembly line	Geodesic dome	Outboard engine
Audio tape recorder	Gyrocompass	Overnight national delivery
Bakelite	Heart valve	Pacemaker
Biomagnetic imaging	Heat sensor	Personal computer
Biosynthetic insulin	Helicopter	Photo typesetting
Catalytic petroleum cracking	High-resolution CAT scanner	Polaroid camera
Cellophane artificial skin	High-resolution digital x-ray	Portable computer
Computerised blood pressure controller	High-resolution x-ray microscope	Prefabricated housing
Continuous casting	Human growth hormone	Prestressed concrete
Cotton picker	Hydraulic brake	Pressure sensitive tape
Defibrillator	Integrated circuit	Programmable computer
DNA fingerprinting	Kidney stone laser	Quick-frozen food
Double-knit fabric	Large computer	Reading machine
	Link trainer	Rotary oil drilling bit

Safety razor	Strain gauge	Variable output transformer
Six-axis robot arm	Strobe lights	Vascular lesion laser
Soft contact lens	Supercomputer	Xerography
Solid fuel rocket engine	Two-armed mobile robot	X-ray telescope
Stereoscopic map scanner	Vacuum tube	Zipper

Source: US Small Business Administration, 'Small Firms: Why Market-Driven Innovation Can't Get Along Without Them', www.sba.gov/advo/research/sbe_05_ch08.pdf

INNOVATION AND DISRUPTIVE TECHNOLOGY One controversial yet powerful theory of innovation is disruptive technology, coined by Christensen in his 1997 book *The Innovator's Dilemma*.[8] A disruptive technology is usually a lower performance or less expensive product or process that gains a foothold in the low end, less demanding part of an existing market and then successively moves upmarket through performance improvements until finally displacing the market incumbents (see Table 5.3). Disruptive technologies are usually introduced to the market by small start-up enterprises.

Not all disruptive technologies are of lower performance. There are several examples where the disruptive technology outperforms the existing technology but is not adapted by existing majors in the market. These occur in industries with a high capitalisation sunk into the older technology (for example, vertically integrated steel mills and cargo ships and stevedores).

TABLE 5.3: EXAMPLES OF DISRUPTIVE TECHNOLOGIES

DISRUPTIVE TECHNOLOGY	DISPLACED TECHNOLOGY
Printing press	Manuscripts, scriptoria
Railways	Canals
Automobiles	Railways
Digital cameras	Photographic film
Mass-market mobile telephony	Fixed-line telephony
Boutique steel mills	Vertically integrated steel mills
Minicomputers	Mainframe computers
Personal computers	Minicomputers
Desktop publishing	Phototypesetting and manual paste-up
Flash drives	Floppy disk drives
Container ships and containerisation	Cargo ships and stevedores

ENTREPRENEURIAL IMAGINATION AND CREATIVITY Entrepreneurs blend imaginative and creative thinking with a systematic, logical process ability. This combination is a key to successful innovation. In addition, potential entrepreneurs are always looking for unique opportunities to fill needs or wants. They sense economic potential in business problems by continually asking 'What if … ?' or 'Why not … ?' They develop an ability to see, recognise and create opportunity where others only find problems. It has been said that the first rule for developing entrepreneurial vision is to recognise that problems are to solutions what demand is to supply. Applying this rule means an entrepreneur will analyse a problem from every possible angle: What is the problem? Whom does it affect? How does it affect them? What costs are involved? Can it be solved? Would the marketplace pay for a solution? This is the type of analysis that blends creative thinking with systematic analysis.[9]

THE ROLE OF CREATIVE THINKING It is important to recognise the role of creative thinking in the innovation process. **Creativity** is the generation of ideas that results in the improved efficiency or effectiveness of a system.[10]

Not only is creativity of interest to scientific researchers, but it also has become a compelling topic in the popular media. Richard Florida is an academic whose field is regional economic development. He says: 'Human creativity [is] the key factor in our economy and society . . . we now have an economy powered by human creativity. Creativity . . . is now the *decisive* source of competitive advantage'.[11]

Two important aspects of creativity exist: process and people. The process is goal-oriented; it is designed to attain a solution to a problem. The people are the resources that determine the solution. The process remains the same, but the approach that the people use will vary. For example, sometimes they will adapt a solution and at other times they will innovate a solution.[12] Table 5.4 compares these two approaches.

TABLE 5.4: TWO APPROACHES TO CREATIVE PROBLEM SOLVING

ADAPTOR	INNOVATOR
Employs a disciplined, precise, methodical approach	Approaches tasks from unusual angles
Is concerned with solving, rather than finding, problems	Discovers problems and avenues of solutions
Attempts to refine current practices	Questions basic assumptions related to current practices
Tends to be means oriented	Has little regard for means; is more interested in ends
Is capable of extended detail work	Has little tolerance for routine work
Is sensitive to group cohesion and cooperation	Has little or no need for consensus; often is insensitive to others

Source: Michael Kirton, 'Adaptors and innovators: A description and measure', *Journal of Applied Psychology*, October 1976: 623. Copyright 1976 by The American Psychological Association

The nature of the creative process

One's creative potential is something that can be developed and improved.[13] Everyone is creative to some degree. However, as is the case with many abilities and talents (for example, athletic or artistic), some individuals have a greater aptitude for creativity than others. Also, some people have been raised and educated in an environment that encouraged them to develop their creativity. They have been taught to think and act creatively. For others the process is more difficult because they have not been positively reinforced and, if they are to be creative, they must learn how to formally implement the creative process.[14]

Many people incorrectly believe that only a genius can be creative.[15] Most people also assume some people are born creative and others are not, or only the gifted or highly intelligent person is capable of generating creative ideas and insights. Yet, the real barriers to creative thinking are sometimes the inadvertent 'killer phrases' we use in our communications. Table 5.5 lists 15 'idea stoppers' that we use. People may not intentionally stop a creative idea, but these simple negative phrases prohibit people from thinking any further.[16]

Creativity is not some mysterious and rare talent reserved for a select few. It is a distinct way of looking at the world that is often illogical. The creative process involves seeing relationships among things others have not seen (for example, the use of USB flash drives or memory sticks to store and transfer data between computers).[17]

TABLE 5.5: THE MOST COMMON IDEA STOPPERS

1	'Naah.'
2	'Can't' (said with a shake of the head and an air of finality).
3	'That's the dumbest thing I've ever heard.'
4	'Yeah, but if you did that . . .' (poses an extreme or unlikely disaster case).
5	'We already tried that – years ago.'
6	'We've done all right so far; why do we need that?'
7	'I don't see anything wrong with the way we're doing it now.'
8	'That doesn't sound too practical.'
9	'We've never done anything like that before.'
10	'Let's get back to reality.'
11	'We've got deadlines to meet – we don't have time to consider that.'
12	'It's not in the budget.'
13	'Are you kidding?'
14	'Let's not go off on a tangent.'
15	'Where do you get these weird ideas?'

Source: Adapted from Angela M. Biondi (ed.), *The Creative Process*, The Creative Education Foundation, 1986

Developing the entrepreneurial capacity

Phase 1: Background or knowledge accumulation

Successful creations are generally preceded by investigation and information gathering. This usually involves extensive reading, conversations with others working in the field, attendance at professional meetings and workshops and a general absorption of information relative to the problem or issue under study. Additional investigation in both related and unrelated fields is sometimes involved. This exploration provides the individual with a variety of perspectives on the problem and it is particularly important to the entrepreneur, who needs a basic understanding of all aspects of the development of a new product, service, or business venture.

People practise the creative search for background knowledge in several ways. Some of the most helpful are: (1) read in a variety of fields; (2) join professional groups and associations; (3) attend professional meetings and seminars; (4) travel to new places; (5) talk to anyone and everyone about your subject; (6) scan magazines, newspapers and journals for articles related to the subject; (7) develop a subject library for future reference; (8) carry a small notebook and record useful information; and (9) devote time to pursue natural curiosities.[18]

Phase 2: The mind incubation process

Creative individuals allow their subconscious to mull over the tremendous amounts of information they gather during the preparation phase. This incubation process often occurs while they are engaged in activities totally unrelated to the subject or problem. It happens even when they are sleeping. This accounts for the advice frequently given to a person who is frustrated by what appears to be an unsolvable problem: 'Why don't you sleep on it?'[19] Getting away from a problem and letting the subconscious mind work on it allows creativity to spring forth. Some of the most helpful steps to induce incubation are: (1) engage in routine, 'mindless' activities (cutting the grass, painting the house); (2) exercise regularly; (3) play (sports, board games, puzzles); (4) think about the project or problem before falling asleep; (5) meditate or practise self-hypnosis; and (6) sit back and relax on a regular basis.[20]

Phase 3: The idea experience

This phase of the creative process is often the most exciting. It is when the idea or solution the individual is seeking is discovered. Sometimes referred to as the **eureka factor**, this phase is also the one the average person incorrectly perceives as the only component of creativity.[21]

As with the incubation process, new and innovative ideas often emerge while the person is busy doing something unrelated to the enterprise, venture, or investigation (for example, taking a shower, driving on a highway, leafing through a newspaper).[22] Sometimes the idea appears as a bolt out of the blue. In most cases, however, the answer comes to the individual incrementally. Slowly but surely, the person begins to formulate the solution. Because it is often difficult to determine when the incubation process ends and the idea experience phase begins, many people are unaware of moving from phase 2 to phase 3.

Here are some ways to speed up the idea experience: (1) daydream and fantasise about your project; (2) practise your hobbies; (3) work in a leisurely environment (for example, at home instead of the office); (4) put the problem on the back burner; (5) keep a notebook at your bedside to record late-night or early-morning ideas; and (6) take breaks while working.[23]

Phase 4: Evaluation and implementation

This is the most difficult step of a creative endeavour and requires a great deal of courage, self-discipline and perseverance. Successful entrepreneurs can identify ideas that are workable and that they have the skills to implement. More important, they do not give up when they run into temporary obstacles.[24] Often they will fail several times before they successfully develop their best ideas. In some cases entrepreneurs will take the idea in an entirely different direction or will discover a new and more workable idea while struggling to implement the original idea.

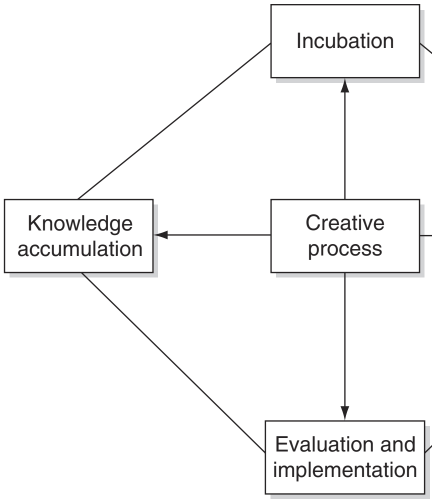
Another important part of this phase is the reworking of ideas to put them into final form. Because frequently an idea emerges from phase 3 in rough form, it needs to be modified or tested to put it in final shape. Some of the most useful suggestions for carrying out this phase are: (1) increase your energy level with proper exercise, diet and rest; (2) educate yourself in the business planning process and all facets of business; (3) test your ideas with knowledgeable people; (4) take notice of your intuitive hunches and feelings; (5) educate yourself in the selling process; (6) learn about organisational policies and practices; (7) seek advice from others (for example, friends, experts); and (8) view the problems you encounter while implementing your ideas as challenges to be overcome.[25]

Figure 5.1 illustrates the four phases of a creative thinking process. If a person encounters a major problem while moving through the process it is sometimes helpful to go back to a previous phase and try again. For example, if an individual is unable to formulate an idea or solution (phase 3), a return to phase 1 often helps. By immersing themselves in the data, entrepreneurs allow the unconscious mind to begin anew processing the data, establishing cause/effect relationships and formulating potential solutions.

Developing your creativity

You can do several things to improve your own creative talents. Becoming aware of some of the habits and mental blocks that stifle creativity is one of the most helpful.[26] Of course, as with most processes, your development will be more effective if you regularly practise exercises designed to increase your creative abilities. The following section is designed to improve your awareness of some of the thought habits that limit your creativity and to assist you in developing a personalised creativity improvement program.

FIGURE 5.1: A CREATIVE THINKING PROCESS



Lateral thinking

One of the difficulties in using the four-step creative process is the reliance on bright ideas emerging from phase 2, the mind incubation process. In recent years, creativity researchers have devised specific techniques to 'forcibly' generate novel ideas. Among the best-known approaches are the *lateral thinking* approaches devised by de Bono. Lateral thinking is concerned with generation of new ideas. It is also concerned with 'breaking out of the concept prisons of old ideas'.[27] Lateral thinking is not a substitute for vertical thinking. Both are required – they are complementary: lateral thinking is generative, vertical thinking is selective. For instance, during brainstorming meetings, you encourage lateral thinking throughout the first session to generate as many creative solutions as possible and vertical thinking during the second session to select the feasible ideas.

In traditional vertical thinking (logic or mathematics), you move forward by sequential steps, each of which must be justified. You select out of only what is relevant. You must be right at each stage in order to achieve a correct solution.[28]

In lateral thinking, you may deliberately seek out irrelevant information – you use information not for its own sake but for its effect. You may have to be wrong at some stage in order to achieve an innovative and correct solution (see Table 5.6).

TABLE 5.6: LATERAL THINKING VERSUS VERTICAL THINKING

LATERAL THINKING	VERTICAL THINKING
Changes	Chooses
Looks for what is different	Looks for what is right
Makes deliberate jumps	One thing must follow directly from another
Welcomes chance intrusions	Concentrates on relevance
Explores the least likely directions	Moves in the most likely directions

Thinking outside the box

Thinking outside the box is never easy, nor is it merely a reflection of mental brightness. To leave your psychological comfort zone and explore 'solutions in the unknown world on the outside requires large measures of mental agility, boldness and creativity – and/or a leader who makes life in the old box so uncomfortable that getting out is the only option. The future rests in those willing and able to do so'.[29]

>>ENTREPRENEURIAL EDGE

SINGAPOREAN ENTREPRENEUR 'ABDUCTED BY ALIENS'

Examining the evidence, it is possible to conclude that Sim Wong Hoo was at one time abducted by aliens. The Singaporean exudes an otherworldly openness of mind seemingly at odds with buttoned-down Singapore. He taught himself to program a computer. His personal net worth exceeds $400 million, yet he plays musical instruments favoured by down-and-out street buskers – the accordion and the harmonica (as well as the piano). He responds to unsolicited faxes from students who want his opinion on their science projects. He once wrote an elegant algorithm for piano software that automatically chords left-hand accompaniment to tunes plunked out with the right hand. Then he called it the 'Keytar'.

Being creative was Sim Wong Hoo's hobby. The hobby turned him into a taker of risks and maker of contrarian moves. His exceptional qualities led to his being described as the 'quintessential entrepreneur of Singapore'. In 1981, after 'a moment of self-revelation under a starry night sky on an offshore rig', Sim felt he needed a goal – he wanted to make $1 million in five years. First Sim developed a unique microcomputer. Sound cards came next and this ushered in a whole new industry. In 1981, with an initial capital of $6000 Sim Wong Hoo founded Creative Technology. The founding of the company was one step towards realising Sim's vision of building a personal computer that could talk, sing and play music, besides crunching numbers.

Yet Sim is an atypical offspring of Singapore's regimented educational system. He did not follow a prescribed career trajectory, working instead as a teacher and as an engineer in a Japanese electronics firm, then on an oil drilling rig in the South China Sea. The 10th of 12 children born to a chicken-egg vendor, he grew up in the kampongs (native Malaysian villages). With no money for toys, he played with ants and improvised board games to amuse himself – an activity he says helped to form his capacity for innovation and his tendency to colour outside the lines.

Leading Creative Technology – or any business, for that matter – is all about managing chaos, Sim says. 'You have to balance chaos with structure. Because of chaos, you can create mutation. Because of mutation we survive, we evolve as a species. If you are very structured, you can't move. If you are all chaos, you crash. This balance is important. It allows variety'.

He believed that, 'Chaos is the nature of all things . . . [and] provides the environment for creativity'. Therefore, chaos is the mother of creativity. Chaotic environments generate many new ideas (like brainstorming sessions) but you need to reign in the chaos to convert ideas into actions, Sim explained. In stressing the importance of creativity, Sim mentioned that creativity is needed for survival when meeting the next evolution or disruptive change. However, creativity must be controlled and 'put into boxes' because too much chaos can collapse a system.

He also introduced his own 'creative oxymoron' which is 'teaching-creativity'. 'We should make rules to teach our people to be creative and entrepreneurial', said Sim in relation to today's obedient Singaporeans. 'We spend enormous energy and money to teach our kids not to be creative', he says, joking about the lack of creativity among Singaporeans.

His recently published book, *Chaotic Thoughts from the Last Millennium,* contains a chapter entitled 'Uses for Saliva' (use no. 7: to ease fungi-related body itches). 'If I had the time', Sim muses, 'I'd like to concentrate on being an inventor'. If he had lots of time, Sim would probably spend it trying to produce a warp drive, a time machine, or Flubber.

Sources: Adapted from Alexandra A. Seno, 'Creative's Genius' *Asiaweek*, 29 September 2000; V. Bala Kiran and N.N. Rajshekar, 'Sim Wong Hoo: The Nimble Entrepreneur', Hyderabad: ICFAI Business School Case Development Centre, 2004; Andrea Lau, Eunice Tan and Wai XiaoWen, 'Forum on Creativity in the Arts, Science and Technology in Singapore 2002', www.fineartforum.org

Here are some tips for challenging assumptions:

- understand the problem – recognise that you and everyone else have ingrained assumptions about every situation
- play a child – ask plenty of basic 'why?' and 'why not?' questions in order to discover and challenge those assumptions
- play an external observer – pretend you are a complete outsider and ask questions such as: 'Why do you do it this way at all?'
- disassemble the problem – reduce a situation to its simplest components in order to take it out of your environment
- reframe – consider an issue from many different angles; restate a problem in different terms
- imagine the opposite – consider what the experts and professionals advise and then consider doing the opposite.[30]

Recognising relationships

Many inventions and innovations are a result of the inventor seeing new and different relationships among objects, processes, materials, technologies and people.[31] Examples range widely and include: (1) bio-degradable packaging materials made out of starch; (2) combining combustion engine technology with the wheel to create the automobile; and (3) using a winged keel on an Australian yacht to break the then longest winning streak in modern sports and wrest the America's Cup away from the Americans for the first time in 132 years.

If you wish to improve your creativity it helps to look for different or unorthodox relationships among the elements and people around you. This activity involves *perceiving in a relational mode*. You can develop this talent by viewing things and people as existing in a complementary or **appositional relationship** with other things and people. Simply stated, things and people exist in the world in relation to other things and people. Creative people seem to be intuitively aware of this phenomenon and have developed a talent for recognising new and different relationships. These relationships often lead to visions that result in new ideas, products and services.[32] In order to develop the ability to recognise new relationships, you must practise perceiving in a relational mode. The following exercise helps with this development.

CREATIVE EXERCISES Analyse and elaborate on how the following pairs relate to each other in a complementary way: nut and bolt, husband and wife, chocolate cake and vanilla ice cream, grass clippings and tomato plants, athlete and coach, humanity and water, winning and losing, television and overhead projectors and managers and production workers.

Developing a functional perspective

If expanded, the principle of perceiving in a relational mode helps develop a **functional perspective** towards things and people. A creative person tends to view things and people in terms of how they can satisfy their needs and help complete a project. For example, the homemaker who cannot find a screwdriver often will use a butter knife to tighten a loose screw. Or the cereal manufacturer will add fruit to its product to create a new product line that appeals to a health-conscious market.

If you wish to become more innovative and creative, you need to visualise yourself in complementary relationships to the things and people of the world. You must learn to look at them in terms of how they complement you in your attempts to satisfy your own needs and to complete your projects. You must begin to look at things and people in non-conventional ways and from different perspectives.[33] The following exercise is designed to help you develop a functional perspective.

Think of and write down all the functions you can imagine for the following items:

- an egotistical staff member
- a large pebble
- a fallen tree branch

>>ENTREPRENEURSHIP IN PRACTICE

OPPORTUNITY TRENDS

She doesn't use a crystal ball, but futurist Faith Popcorn can see some of the major trends that sway consumer buying decisions. Popcorn believes that those who understand the future will make fewer mistakes and become more successful. By spotting the trends that will shape marketplaces, she hopes to help entrepreneurs start and grow their businesses. She reaches those entrepreneurs through her marketing consulting firm, BrainReserve. How well does Popcorn predict the trends of tomorrow? According to her, she hasn't been wrong about a trend yet.

Popcorn states that, as a marketer, she finds trend knowledge invaluable. In her book, *Clicking*, she identified some of the most influential trends driving the marketplace. These are not fads – they are big, sweeping consumer movements that savvy entrepreneurs see as opportunities for big profits. Since her book was published, she has provided a yearly set of predictions regarding consumer trends. The following are her predicted trends for the 21st century.

>> **Cocooning**: The desire to shelter ourselves from the harsh realities of the outside world.

>> **Fantasy adventure**: The need for the new and unconventional. We seek out ways to escape from our problems and experiment with our desires.

>> **Skin deeper**: According to Popcorn, our material focus has left us emotionally starving. Due to increasing work hours and more emphasis on virtual relationships, we will increasingly want physical contact.

>> **Brain fitness**: According to Popcorn, a mental fitness boom is on the horizon. The focus on mental agility will parallel the need to prolong physical fitness and youthful appearance.

>> **Secondhand nostalgia**: Due to the stresses and concerns of life, we will seek out safe places that allow for a retreat. We will also trend toward activities that were popular during safe times, such as the 1950s.

>> **America's next top surgery**: The rage of reality surgery shows and the increased medical advancements will cause an obsession with risky surgeries. Also, playing to the Fantasy Adventure trend, people will be motivated to try new surgeries to cure illnesses and improve appearance.

>> **No olds barred**: The enormous baby boomer market is ageing into its 60s and 70s. These boomers view themselves as young and will demand products to meet their needs but not be labelled as products for the elderly. Popcorn suggests that one such outcome could be larger, easier to read dials in luxury automobiles (such as BMW or Infinity).

>> **ExpertEASE**: Given the availability of information on the Internet, expertise takes on a new meaning. According to Popcorn, 'Expertise is no longer earned through years of training; all it takes is a little research'. She claims that we have lost the preferred taste for actual experience and have replaced it with virtual experiences.

>> **Debug–rebug**: In the past, we have focused on removing bad organisms from the environment. Recently, biologists have identified that some organisms can be beneficial and improve health. Popcorn suggests that spas and healthcare entities will offer 'designer' treatments of advantageous organisms.

>> **Mood tuning**: According to Popcorn, we now expect that the things we buy will adjust our feelings. We will seek out biologically enhanced purchases that will cause us to feel more confident, sexy, or whatever the situation dictates.

Source: Adapted from 'Faith Popcorn's Predictions for 2006', *Arizona Reporter*, http://managecamp.typepad.com/brand_managecamp_weblog/files/faith_popcorn_2006_predictions.pdf, accessed 10 October 2006

- a chair
- a computer 'whiz kid'
- an obsessively organised employee
- the office gossip
- an old hubcap
- a new secretary
- an empty roll of masking tape
- a yardstick
- an old coat hanger
- the tight-fisted co-worker
- this exercise.

Going with the flow

Mihaly Csikszentmihalyi[34] is best known for his best-selling 1990 book, *Flow – The Psychology of Optimal Experience*. He defined and explored the concept of 'flow' – as in 'getting in the flow' – as our experience of optimal fulfilment and engagement. Flow, whether in creative arts, athletic competition, engaging work, or spiritual practice, is a deep and uniquely human motivation to excel, exceed and triumph over limitation. The flow experience is when a person is completely involved in what they are doing, when the concentration is very high, when the person knows moment by moment what the next steps should be (if you are playing tennis, you know where you want the ball to go; if you are playing a musical instrument you know what notes you want to play, every millisecond, almost). He describes flow as:

> . . . being completely involved in an activity for its own sake. The ego falls away. Time flies. Every action, movement and thought follows inevitably from the previous one, like playing jazz. Your whole being is involved and you're using your skills to the utmost.[35]

Csikszentmihalyi described six components of 'flow':

- You know at any time without thinking what you must do.
- Even under highly demanding circumstances you still feel in control.
- You glide from one event to another as if by some inner logic.
- You concentrate like you breathe – without effort or thought; you filter out distractions.
- You forget about time – hours fly by like minutes.
- Your self melts into your activity and you lose self-consciousness.

Using your brains

Ever since split-brain studies were conducted in the 1950s and 1960s, experts on creativity, innovation and self-development have emphasised the importance of developing the skills associated with both hemispheres of the brain.[36]

The **right brain** hemisphere helps an individual understand analogies, imagine things and synthesise information. The **left brain** hemisphere helps the person analyse, verbalise and use rational approaches to problem solving. Although the two brain hemispheres (right and left) process information differently and are responsible for different brain activities and skills (see Table 5.7), they are integrated through a group of connecting nerve fibres called the *corpus callosum*. Because of this connection and the nature of the relationship between the activities of each hemisphere, each hemisphere should be viewed as existing and functioning in a complementary relationship with the other hemisphere.[37]

The creative process involves logical and analytical thinking in the knowledge accumulation, evaluation and implementation stages. In addition, it calls for imagination, intuition, analogy conceptualisation and synthesising in the incubation and idea-creation stages. So to become more creative it is necessary to practise and develop both right- and left-hemisphere skills.

TABLE 5.7: PROCESSES ASSOCIATED WITH THE TWO BRAIN HEMISPHERES

LEFT HEMISPHERE	RIGHT HEMISPHERE
Verbal	Non-verbal
Analytical	Synthesising
Abstract	Seeing analogies
Rational	Non-rational
Logical	Spatial
Linear	Intuitive
	Imaginative

Source: Betty Edwards, *Drawing on the Right Side of the Brain*, Los Angeles: Tarcher, 1979

TABLE 5.8: WAYS TO DEVELOP LEFT- AND RIGHT-HEMISPHERE SKILLS

LEFT-HEMISPHERE SKILLS	RIGHT-HEMISPHERE SKILLS
1 *Step-by-step planning of your work and life activities*	1 *Using metaphors and analogies to describe things and people in your conversations and writing*
2 *Reading ancient, medieval and scholastic philosophy, legal cases and books on logic*	2 *Taking off your watch when you are not working*
3 *Establishing timetables for all of your activities*	3 *Suspending your initial judgement of ideas, new acquaintances, movies, TV programs and so on*
4 *Using and working with a computer program*	4 *Recording your hunches, feelings and intuitions and calculating their accuracy*
	5 *Detailed fantasising and visualising things and situations in the future*
	6 *Drawing faces, caricatures and landscapes*

INNOVATION AND THE ENTREPRENEUR

Innovation is a key function in the entrepreneurial process. Researchers and authors in the field of entrepreneurship agree, for the most part, with the renowned consultant and author, Peter R. Drucker, about the concept of innovation: 'Innovation is the specific function of entrepreneurship . . . It is the means by which the entrepreneur either creates new wealth-producing resources or endows existing resources with enhanced potential for creating wealth.'[38]

Innovation is the process by which entrepreneurs convert opportunities (ideas) into marketable solutions. It is the means by which they become catalysts for change.[39] We demonstrated in the earlier parts of this chapter that the innovation process starts with a good idea. The origin of an idea is important and the role of creative thinking may be vital to that development.[40] A major difference exists between an idea that arises from mere speculation and one that is the product of extended thinking, research, experience and work. More important, a prospective entrepreneur must have the desire to bring a good idea through the development stages. Thus, innovation is a combination of the vision to create a good idea and the perseverance and dedication to remain with the concept through implementation.

DEVELOPING CREATIVITY

>>ENTREPRENEURSHIP **IN PRACTICE**

What colour is the sky when you dream? Do you consider yourself to be creative? Creativity has been defined as having the quality or power of creating. People are innately creative. Really. Let your creativity out of the playpen! Millions of dollars have been made from creative endeavours that are truly simple. You can make them too if you use some of these methods to boost your creativity.

- **Brainstorm**: This is the old-school way to drum up creative ideas and solve problems, but it is still by far the best. The corporate world was woken up when Alex Osborn introduced this concept in the 1950s. Established rules were easy to follow:
  - shout out or write down every solution that comes to mind
  - off-the-wall ideas are welcome
  - criticise nothing
  - organise later
  - build on every idea – even when it seems foolish or fanciful.
- **Opposites attract**: Here's an interesting concept: synectics. Similar to the word itself, synectics involves putting two nonsensical things together to see what happens. Examples: Imagine a restaurant with no waiters, tables, or silverware. It's McDonald's. Imagine a bookstore with no books – and no store. Isn't that Amazon.com? U-Haul: Moving trucks with no movers. Don't hesitate to explore that which is strange!
- **THINKubate**: Gerald Haman created the 'THINKubator' – a playground where businesspeople, entrepreneurs and the like can go to escape the humdrum environment of offices and 'can't doers'. The playground houses comfortable seating, toys and fun pictures and overall offers an environment that favours brain stimulation and idea creation. It must work, because Haman has developed numerous products for Procter & Gamble.
- **Trigger great ideas**: Triggers are everyday items that can be used to stimulate the brain: abstract photos, inspiring quotes, uncompleted ideas, tips and so on. Place trigger items in various places you look or visit often – the refrigerator door, your dashboard, your phone. You never know when a connection will be made.
- **Connect**: Every person you meet or place you visit might be an opportunity waiting to happen. The key is to be prepared for that opportunity when it arises. Creativity consultant Jordan Ayan suggests building up your CORE: curiosity, openness, risk and energy. These traits can be enhanced by reading up on trends, attending trade shows, browsing and trying new things. Spotting open windows isn't necessarily easy, but increasing the number of windows can be.
- **Always celebrate failure**: Try and try again. What doesn't kill you only makes you stronger. Dare to be great! Get the idea? Don't suffer from insanity! Enjoy every minute of it!
- **Make 'em laugh**: Humour is a great way to relieve stress. Use it in your creative endeavours. Can you imagine Dennis the Menace helping you build your prototype? How about letting the Monty Python writers co-author your business plan? Let Urkel, or even your youngest relative, in on your invention. Humour and laughter certainly encourage creativity.
- **Sweat it**: Yes! Sweat it out! Exercise gets the creative juices – endorphins – flowing. Let the mind wander while you're jogging, or ride the exercise bike while reading the year-end reports. Just be sure to keep a notepad handy to jot down all of the great ideas!
- **Remember your wildest dreams**: Has anyone ever replied to you with this statement: 'In your dreams!' Well, go figure! Dreams are a great place to start when it comes to unleashing creativity. Elias Howe once had a dream in which cannibals were piercing his flesh with spears. Thus the sewing machine was invented. Don't ignore daydreams or spur-of-the-moment ideas, either. Your subconscious could be trying to tell you something.

Source: Adapted from Nick D. Alto, 'Think Big', *Business Start Ups*, January 2000: 61–5

THE INNOVATION PROCESS Most innovations result from a conscious, purposeful search for new opportunities.[41] This process begins with the analysis of the sources of new opportunities. Drucker has noted that because innovation is both conceptual and perceptual, would-be innovators must go out and look, ask and listen. Successful innovators use both the right and left sides of their brains. They look at figures. They look at people. They analytically work out what the innovation has to be to satisfy the opportunity. Then they go out and look at potential product users to study their expectations, values and needs.[42]

Most successful innovations are simple and focused. They are directed towards a specific, clear and carefully designed application. In the process they create new customers and new markets. Wireless Internet is an example. Why should one be tied down to a desk when computing should be ubiquitous?

Types of innovation

Four basic types of innovation exist (see Table 5.9). These extend from the totally new to modifications of existing products or services. In order of originality the four types are:

- **invention** – the creation of a new product, service, or process, often one that is novel or untried; such concepts tend to be revolutionary
- **extension** – the expansion of a product, service, or process already in existence; such concepts make a different application of a current idea
- **duplication** – the replication of an already existing product, service, or process; the duplication effort, however, is not simply copying but adding the entrepreneur's own creative touch to enhance or improve the concept to beat the competition
- **synthesis** – the combination of existing concepts and factors into a new formulation; this involves taking ideas or items already invented and finding a way so together they form a new application.[43]

The major misconceptions of innovation

The entire concept of innovation conjures up many thoughts and misconceptions; it seems that everyone has an opinion as to what innovation entails. In this section, we outline some

TABLE 5.9: INNOVATION IN ACTION

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

of the commonly accepted innovation misconceptions and provide reasons why these are misconceptions and not facts.[44]

- **Innovation is planned and predictable**. This statement is based on the, old concept that innovation should be left to the research and development (R&D) department under a planned format. In truth, innovation is unpredictable and may be introduced by anyone.
- **Technical specifications must be thoroughly prepared**. This statement comes from the engineering arena, which drafts complete plans before moving on. Thorough preparation is good, but it sometimes takes too long. Quite often, it is more important to use a try/test/revise approach.
- **Innovation relies on dreams and blue-sky ideas**. As we have demonstrated in this chapter, the creative process is extremely important to recognising innovative ideas. However, accomplished innovators are very practical people and create from opportunities grounded in reality not daydreams.
- **Big projects will develop better innovations than smaller ones**. This statement has been proven false time and again. Larger firms are now encouraging their people to work in smaller groups where it often is easier to generate creative ideas.
- **Technology is the driving force of innovation success**. Technology is certainly one source for innovation, but it is not the only one. As we outlined earlier in this chapter, numerous sources exist for innovative ideas; technology is certainly a driving factor in many innovations, but it is not the only success factor. Moreover, the customer or market is the driving force behind any innovation. Market-driven or customer-based innovations have the highest probability of success.

Principles of innovation

Potential entrepreneurs need to realise innovation principles exist. These principles can be learned and, when combined with opportunity, can enable individuals to innovate. The major motivation principles follow:

- **Be action oriented**: Innovators always must be active and searching for new ideas, opportunities, or sources of innovation.
- **Make the product, process, or service simple and understandable**: People must readily understand how the innovation works.
- **Make the product, process, or service customer-based**: Innovators always must keep the customer in mind. The more an innovator has the end-user in mind, the greater the chance the concept will be accepted and used.
- **Start small**: Innovators should not attempt a project or development on a grandiose scale. They should begin small and then build and develop, allowing for planned growth and proper expansion in the right manner and at the right time.
- **Aim high**: Innovators should aim high for success by seeking a niche in the marketplace.
- **Try/test/revise**: Innovators always should follow the rule of try, test and revise. This helps work out any flaws in the product, process, or service.
- **Learn from failures**: Innovation does not guarantee success. More important, failures often give rise to innovations.[45]
- **Follow a milestone schedule**: Every innovator should follow a schedule that indicates milestone accomplishments. Although the project may run ahead or behind schedule, it is still important to have the schedule in order to plan and evaluate the project.
- **Reward heroic activity**: This principle applies more to those involved in seeking and motivating others to innovate. Innovative activity should be rewarded and given the proper amount of respect. This also means tolerating and, to a limited degree, accepting

failures as a means of accomplishing innovation. Innovative work must be seen as heroic activity that will reveal new horizons for the enterprise.

- **Work, work, work**: This is a simple but accurate exhortation with which to conclude the innovation principles. It takes work – not genius or mystery – to innovate successfully.[46]

INNOVATION IN THE ERA OF CLIMATE CHANGE We have talked about the basic types of innovation (see Table 5.9). In essence, extension, duplication and synthesis come from technologies that we already have. The history of technology is one story after another of inventions getting smaller, smarter and cheaper. It comes from making little improvements on existing technology.

The other type of innovation is pure invention, creating new processes that are revolutionary. Governments often put most of our attention and funding into this second type of innovation – breakthrough innovation – while ignoring the steady advances that are hiding in plain sight. Good examples are the myriad wind and solar technologies that are already cost-effective. Amazingly, we still haven't seen the commercial introduction of hydrogen fuel cells 160 years after they were invented. As Friedman says:

> . . . that is why we need to be constantly trying to invent new forms of abundant, clean, reliable, and cheap electrons and constantly trying to make the technologies that already exist today for producing clean electrons – solar photovoltaic, wind, solar thermal, and geothermal – more abundant, reliable, and cheap.[47]

Ultimately the green revolution is going to be solved by engineers who break down the barriers to the market and who commercialise existing technologies. As we have written above, it is usually not the entrepreneur himself or herself who invents the innovation, but it is the entrepreneur who does the hard yards, who puts in the 99 per cent perspiration to take that inspiration to the market. We don't need a massive Manhattan Project for clean technology; we need a market for clean energy. We need innovators to team up with entrepreneurs to produce and market all sorts of breakthroughs by creating demand. Only entrepreneurs can take this much innovation to the marketplace. Only entrepreneurs can generate and allocate enough capital fast enough to commercialise them.

But climate change does present a dilemma. How can entrepreneurs continue to encourage consumption while simultaneously discouraging and warning about its perils? Milker gives some guidelines:

- A manufacturer developing a new product should consider whether their product will offset a consumer's general consumption needs and potentially decrease the consumer's environmental impact. Examples could be shoes made from recycled materials, products with a lifetime warranty, or a product which is made of completely bio-degradable materials. Digital examples could be creating digital goods (MP3s or audio books), services which replace traditional paper (craigslist versus yellow pages) and services promoting reuse and sale of used goods.
- In its product planning a business should include methods of manufacturing and distribution which ensure a minimal environmental impact. This can be accomplished by using direct-to-consumer shipping whenever possible, by creating products for a local market which utilise local resources and by sourcing manufacturing materials locally.
- Businesses should consider creating products with significantly longer life spans. While this is impractical for many products, it is also a great design challenge for entrepreneurs. By creating products, which can be upgraded, retro-fitted, or are simply

indestructible, we can communicate to consumers the inherent environmental and cost benefits of purchasing a product which will last a generation.

- Entrepreneurs should find ways to package products which are sustainable by utilising recycled and bio-degradable materials for packaging while minimising packaging as much as possible.
- Entrepreneurs should adopt marketing and promotional standards which are less impactful to the environment by using digital and word-of-mouth promotion. Build your brand by promoting your sustainable practices and you can stand apart. Create incentives for consumers to purchase your products which go beyond price and features, but provide value through longevity and re-usability.[48]

Cradle-to-cradle design

The challenge for entrepreneurs of the new century is how to create and sell products and services that comply with economic, social and ecological sustainability. Although it may be new to entrepreneurs, **sustainable design** and innovation is already very present within architecture, landscape architecture, urban design, urban planning, engineering, graphic design, industrial design, interior design and fashion design.

Cradle-to-cradle design is a philosophy of innovation based upon the cyclical flows of the earth. In the natural worlds, one organism's waste becomes the next organism's nourishment. In the same way, cradle-to-cradle products virtually eliminate waste and provide the 'nutrients' for both nature and for the next products of industry. Every action – be it commercial, lifestyle, educational or governmental – ought to have a net positive effect on the environment. Cradle-to-cradle was first developed by Michael Braungart and William McDonough.[49] They conceived products, such as biodegradable fabrics, that would be used and then be returned to nature and food for the next product forming a closed loop. McDonough challenges us in the epigraph at the beginning of this chapter to 'imagine a world in which everything is so intelligently designed that human activity generates a delightful, restorative ecological footprint' (see also Chapter 3, pages 89 and 91).

CRADLE-TO-CRADLE IN THE CRADLE IN AUSTRALIA

>>ENTREPRENEURIAL EDGE

A husband and wife team from Australia have developed innovative nappies known as gDiapers. Jason and Kim Graham-Nye discovered flushable nappies while living in Sydney. The pair quickly snapped up the rights to make and market the product outside of Australia and New Zealand.

When the nappy needs to be changed, the liner snaps out of the pants and the pad can be pushed out into the toilet. A new flushable pad goes back into the liner, and the next nappy is ready to go. The world's first flushable and compostable nappy, developed in Tasmania, is currently being launched in the US market after gaining financial backing from two Australian and three US business angels.

Disposable nappies, with 20 billion thrown away each year, are the third largest contributor to landfills (that's 50 million disposable nappies per day.) The plastic contained in these nappies takes up to 500 years to decompose. Additionally, most of these nappies contain untreated human waste that can leach into the water table. For the Graham-Nyes, disposables were out. Cloth used too much water for the water conscious couple living in drought-stricken Australia. And then they found it. A company in Tasmania made flushable nappies. They were delighted to find them in their own backyard – well, just a small shipping charge away – and placed an order immediately. The idea went over big with family and friends.

Sources: Victor Bivell, 'Flushable Tasmanian Nappy Hits US Soil', *Eco-Investor*, December 2005: 16, www.ecoinvestor.com.au/Editions/Eco_Investor_December_2005.pdf; gDiapers Media Kit, www.gdiapers.com/fair-dinkum/newsroom/media-kit

>>ENTREPRENEURIAL EDGE

ASIA–PACIFIC EXAMPLES OF SUSTAINABLE INNOVATION

- **Australian design for sustainability**: Rein Plastics is an Australian company that designs and produces innovative quality plastic products in the waste, wastewater and agricultural products sector for the Australian and international markets. In 1990 the company developed a line of organic waste recycling products including compost bins and worm farms from 100 per cent post-consumer plastic. The products allow households to compost their organic waste, reducing their contribution to the waste stream, while producing hygienic, odourless solid and liquid fertiliser. The products themselves can be recycled at the end of their useful lives.
- **Indian bagasse paper**: Indian scientists have developed a cost-effective quality photocopy paper made from 75 per cent bagasse (sugar cane waste) and 25 per cent plantation eucalypt fibre. The process uses 90 per cent less chlorine than is used to make normal paper. Most of the energy used by the mill is generated via its own wind-farm. Effluent is reprocessed into water and then used to irrigate the cane-fields, with the sludge also being treated and returned to the land as compost.
- **Zero waste in New Zealand**: The Warehouse Ltd, New Zealand's largest mixed retailer, has an annual turnover of NZ$1 billion. In 1999 it declared a national corporate goal of zero waste. To minimise the waste generated in stores, the company's buyers have been given a radical packaging reduction target in their terms of trade document. This means that the Warehouse's buyers and suppliers have to work together to address packaging issues.
- **Micro-credit**: Micro-enterprise schemes are emerging all over the world as a successful way to help poor entrepreneurs to help themselves. The idea emerged in the 1970s, when the Grameen Bank in rural Bangladesh began lending small sums of money to the landless poor. Almost everyone repaid the loans and the scheme was so successful that a few years later it had over a million borrowers. Most of its clients are women who form groups of about 25 to receive small business loans and mentoring. They co-guarantee each other's loans and since almost all their businesses succeed their repayment rates are excellent at over 90 per cent.
- **Village payphones**: The Grameen Bank's scope has broadened to address the myriad of factors that make poverty cycles so hard to break. One such factor is the lack of access to resources, technology and information as well as credit. To address this, the Grameen Bank has established several subsidiaries such as Grameen Telecom (GI), a wholly owned subsidiary. GT has been established to provide cellular village telephone services in urban and rural areas. The new phones are also leading to increased profits and business for those communities that have had them installed.
- **India's wireless Internet access**: New technology from India has created a low-cost Internet access system that doesn't require a modem, eliminates the need for expensive copper lines and is faster and much cheaper than using telephone lines. The technology is a significant advance and has been implemented in many countries.
- **Cheap Internet access – The Simputer**: The Internet and computers are too expensive for the vast majority of people in developing countries. In response to this problem, Indian scientists have created a hand-held device, costing less than US$200, with multiple connectivity options based on free Linux software. It is portable and can therefore easily be shared within communities.

Source: Adapted from Alan Atkisson, Amory B. Lovins, Hunter Lovins, Michael Fairbanks and William McDonough, *The Natural Advantage of Nations: Business Opportunities, Innovation and Governance in the 21st Century,* Earthscan, 2005: 92–3, 103, 106

Social innovations

We have seen a huge increase in innovations created by social ventures. Dedicated non-profits as well as hybrid businesses have all been creative in the **social innovation** sphere.

Researchers at Stanford University have defined social innovation as 'a novel solution to a social problem that is more effective, more efficient, more sustainable, or more just than existing solutions and for which the value created accrues primarily to society as a whole rather than to private individuals'.[50] Yet they maintain that social innovations are products of the times, of a particular period in history. Today private businesses are being force to consider the social impact of their conduct in society. There is now a cross-fertilisation between the non-profit, governmental and private sectors that is propelling social innovation. These Stanford researchers list some recent social innovations:

- **Community-centred planning**: a process that enlists the knowledge and resources of local residents to help craft solutions appropriate to local needs. Allowing people to create and implement their own plans for the community helps lead to sustainable development.
- **Emissions trading**: a pollution control program that uses economic incentives to reduce emissions. A cap is set on the total amount of a certain pollutant that can be emitted, and permits to pollute are issued to all participating businesses. Those with higher emissions can buy credits from businesses that have reduced their emissions. Over time the cap is reduced.
- **Fair trade**: an organised movement that establishes high trade standards for coffee, cocoa, sugar and other products. By certifying traders who pay producers a living wage and meet other social and environmental standards, the fair-trade movement improves farmers' lives and promotes environmental sustainability.
- **Habitat conservation**: an agreement that creates economic incentives for wildlife conservation by allowing development in the habitat of an endangered species if the property owner protects endangered species in another location.
- **International labour standards**: legally binding standards that protect workers' rights to freedom, equity, security and human dignity. The standards were developed by the International Labour Organization, governments, employees, and workers and are enforced by member countries.
- **Microfinance**: financial institutions that provide services such as banking, lending and insurance to the poor and disadvantaged who otherwise have no access to these services. By saving money, getting loans and having insurance, the poor can improve their lives and even rise out of poverty.
- **Socially responsible investing**: an investment strategy that attempts to maximise both financial and social returns. Investors generally favour businesses and other organisations whose practices support environmental sustainability, human rights and consumer protection.
- **Supported employment**: programs that help disabled or otherwise disadvantaged workers find and retain good jobs. Services include job coaches, transportation, assistive technology, specialised job training and individually tailored supervision.

SUMMARY

This chapter examined the importance of creativity and innovation to the entrepreneur. Opportunity identification was discussed in relation to the knowledge and learning needed to recognise a good idea. The sources of innovative ideas were outlined and examined. The creativity process was described and ways of developing creativity were presented.

Exercises and suggestions were included to help the reader increase the development of their creativity. The nature of the creative climate also was presented. Various Asia–Pacific inventions and innovations were described and interesting case studies included.

The four basic types of innovation – invention, extension, duplication and synthesis – were explained and the sources of innovation were outlined and examined. The chapter reviewed the misconceptions commonly associated with innovation, presented the major innovation principles and discussed financial support for innovation.

One dilemma facing entrepreneurs in the era of climate change is how to encourage the right kind of consumption. We finished the chapter by introducing and describing the field of social innovations.

KEY TERMS & CONCEPTS

appositional relationship
creative process
creativity
duplication
eureka factor
extension
functional perspective
incongruities
innovation
invention
left brain
muddling mind-sets
opportunity identification
pain and painkiller
probability thinking
right brain
stereotyping
synthesis

REVIEW & DISCUSSION QUESTIONS

1. Describe opportunity identification for the entrepreneur.
2. How are prior knowledge and learning important to the recognition of opportunities?
3. What are four major types of innovative ideas? Explain and give an example of each.
4. What is the difference between an adaptor and an innovator?
5. What are four major components in the creative process?
6. What are the four steps involved in developing personal creativity?
7. In your own words, state what is meant by the term innovation.
8. What are the four major types of innovation?
9. Briefly describe each of the five major misconceptions commonly associated with innovation.
10. Identify and describe five of the innovation principles.
11. What is the dilemma facing entrepreneurs in the era of climate change? What are some examples of this?
12. What is a social innovation and what are some examples in your community?

EXPERIENTIAL EXERCISE: TOP 10 THINGS YOU CAN DO WITH DUCT TAPE

Here's an exercise (inspired by www.ducttapefashion.com and the Duct Tape Page [www.thorssell.net/duct.html]) where you can apply some of the things we have been learning about creativity and innovation.

Duct tape is a strong, fabric-based, multi-purpose adhesive tape that can be used for just about anything. It has been said that 'duct tape holds the world together'. Here are the top 10 things you can do with it. Your task is to think of as many other uses as you can.

- patch pipes under the house
- cover the annoying 'check engine' light that won't go out
- use as a band-aid
- tape all the holes in the computer case shut so the fan noise isn't so annoying
- tape an annoying person's mouth shut
- repair eyeglass frames
- patch a broken cigarette
- hand-cuff the kids as an emergency baby sitter
- be sure the toilet seat never stays up (duct tape it down)
- get dried cat puke out of carpeting.

EXPERIENTIAL EXERCISE: DEVELOPING YOUR PERSONAL CREATIVITY

This exercise is designed to help you develop your personal creativity. To enhance your creativity, you should make improvements in the following areas:

1. **personal development** – self-discipline, self-awareness, self-confidence, improvement in energy level etc.
2. **problem-solving skills** – problem recognition etc.

3 **mental fluency** – quantity of thoughts/ideas etc.
4 **mental flexibility** – switching gears/approaches etc.
5 **originality** – unusual thoughts and ideas etc.

It is best to start small and work on a few things at a time. Follow the step-by-step approach listed next. Use the accompanying worksheet to help you design a personal creativity program.

1. Choose one of the five areas for improvement listed (for example, mental fluency).
2. Establish a specific objective for this area (for example, to increase your ability to generate logical and intuitive solutions to problems at work).
3. Decide how much time you will give to this program (for example, three hours per week).
4. Decide how long you will work in this area (for example, one month, two months).
5. Decide what actions you will take and what exercises you will perform to improve in this area (for example, sentence-creation exercises, usage ideas, meditation, suspension of initial judgements).
6. Set up an outline of your program (that is, day of week, time of day, place and what you will do during this time).
7. Review your program after completion and write a similar program for another one of the five areas for improvement.

PERSONAL CREATIVITY PROGRAM WORKSHEET				
Area of improvement				
Specific objective				
Number of hours per week				
Duration of program				
Actions/exercises				
Outline of program				
Day of the week				
Time of day				
Place				
Actions that day				

CASE 5.1: INTERFACE ASIA–PACIFIC

Interface Ltd, a carpet company, has emerged as perhaps the most cited example of a sustainable company in the world. It has replaced petrochemical fibres with corn-based biomass that is certified climate-neutral and the carpet tiles can be returned to Interface for the next customer (see also Case 3.1, pages 100–1 and Table 13.7, page 497).

It wasn't always the case. In the mid-nineties, their factories and suppliers consumed around 1.2 billion pounds of material. The company's technology [was] plundering the earth. Rob Coombs, Asia–Pacific President of Interface, summarises what has driven the company in our region:

> The business world is slowly coming to the realisation that it needs to develop practices sympathetic with the natural environment in which it operates. The slumbering giant is beginning to understand that there are also a range of stakeholders affected by business practices and that there is a social contract that needs to be rethought and redeveloped. This awakening brings with

it many pressures; the need to rethink age-old values and approaches to problems, the need to find solutions to previously unapproached technical barriers, and the need to create a new set of decision making criteria.

For Interface in the Asia–Pacific region, the evolution of sustainable business practice has created another challenge: How to play an important part in the process of becoming a sustainable business within a large organisation at the leading edge of the debate? How to support the position for which the company is known globally and how to live up to the position on a local basis?

With a vision to become sustainable and then restorative through the power of its influence by 2020, Interface has already established a clear measure of business success. It is moving towards this goal through the adoption of a strategy on seven fronts: eliminating waste, using only renewable energy sources, creating only benign emissions, closing the product loop, energy efficient transport, energising people and changing the nature of commerce itself.

Asia–Pacific represents 5 per cent of global Interface revenues and although the region is seen as a growth engine for the business, the relatively small scale of the division creates a series of challenges around the move to sustainability. How has Asia–Pacific embraced the philosophy and what has it done to support it? What are the challenges faced by a small division of a leading force in sustainable business development?

For example, Japan has embraced, by necessity, the concept of recycling as a noble activity and it is promoted by government and within the business community. Thus, Interface is engaged in a wide range of activity in Japan around this issue, while discussion around renewable energy receives much less attention.

The two countries across the region that appear most engaged are Japan and Australia. In most other countries, sustainability remains a very low priority and Interface operates with less external stimulus. The stimulus from customers for more sustainable solutions is the greatest driver we have. With this less evident, Interface operates in a vacuum. In both our Australian and Thailand manufacturing facilities, Interface has reduced dramatically all forms of process and material waste. In Australia, for example, waste per unit of production has reduced by 90 per cent since 1996, an achievement that has both funded other sustainability projects and helped to deliver greatly improved business performance. The waste effort has been driven in both facilities by people working in teams at operator level with strong supervisor leadership. It is very much a grassroots program to reduce the company's environmental footprint. Equally, regional success in reducing harmful emissions has been encouraging. Since 1999 our annual greenhouse gas emissions have reduced from approximately 1650 metric tons of CO_2 to 1450 metric tons, while at the same time we have increased our production throughput by 35 per cent. The source of these emissions is electricity production 63 per cent (indirect contribution) and the burning of natural gas 37 per cent (direct production). We have reduced and rationalised the use of solvents at our production facilities and even gone to the extent of identifying new cleaners with less solvent emissions for our Carpet Spot Cleaning Kits, admittedly a small component, but significant in the message we are trying to put out into the marketplace. In the short term we are evaluating the sale and use of 'climate neutral' products and services.

Source: Adapted from Alan Atkisson, Amory B. Lovins, Hunter Lovins, Michael Fairbanks and William McDonough, *The Natural Advantage of Nations: Business Opportunities, Innovation and Governance in the 21st Century*, Earthscan, 2005: 79–81, available at www.naturaledgeproject.net/NAON1Chapter6.1.aspx

Questions

1. How does Interface demonstrate that competitive advantage and sustainability are not mutually exclusive?
2. What system of complementary activities contribute to Interface's competitiveness?
3. Which other Asia–Pacific countries would be the next candidates for Interface's sales team?

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RECOMMENDED CASES FROM HARVARD BUSINESS SCHOOL ONLINE

Cradle-to-Cradle Design at Herman Miller: Moving Toward Environmental Sustainability

Published: 2007
Reference: 9-607-003

Herman Miller decided to implement the cradle-to-cradle (C2C) design protocol during the design of its mid-level office chair, Mirra. The C2C protocol was a set of environmentally friendly product development guidelines.

Creativity is not Enough

Publication date: 1 August 2002
Author(s): Theodore Levitt
Product number: R0208K

Creativity is often touted as a miraculous road to organisational growth and affluence. But creative new ideas can hinder rather than help a company if they are put forward irresponsibly. In this classic HBR article from 1963, the author, a professor emeritus at Harvard Business School and a former HBR editor, offers suggestions for the person with a great new idea.

Creativity: A Key Link to Entrepreneurial Behaviour

Publication Date: 15 September 2007
Author(s): Stephen Ko, John Butler
Product Number: BH244

While entrepreneurial creativity is a desired behaviour in most firms, it is difficult to understand both how this complex phenomenon occurs and how to increase its rate of occurrence. Understanding and increasing managerial creativity is important not only in developed economies but also in developing economies, where the research discussed herein was conducted. The authors argue that a solid knowledge base, a well-developed social network and a strong focus on identifying opportunities are all necessary inputs toward entrepreneurial behaviour. High-tech entrepreneurs interviewed in Hong Kong, however, indicated that creativity also plays a critical role in the entrepreneurial process. Attesting to this, they credited their competence with their being able to make the associations and bisociations needed to develop new products, leading to their entrepreneurial success.

Iqbal Quadir, Gonofone and the Creation of Grameenphone (Bangladesh)

Publication Date: 12 March 2007
Author(s): Daniel J. Isenberg, David Lane, Carin-Isabel Knoop
Product Number: 9-807-099

As the smallest of four partners in a unique wireless telephony venture in Bangladesh that he initiated and helped grow, Iqbal Quadir is trying to acquire a larger stake in the venture when one of the partners wants to sell his shares. However, Quadir faces stiff resistance from the other two partners, who also want to acquire the shares.

Interface's Evergreen Services Agreement

Publication Date: 25 February 2003
Author(s): Rogelio Oliva, James Quinn
Product Number: 603112

In an attempt to reduce its ecological footprint, Interface Americas, a leading manufacturer of commercial carpet tile, has launched the Evergreen Services Agreement (ESA) – a lease agreement that provides would-be carpet purchasers with comprehensive floor-covering services (colour, texture, warmth, beauty, acoustics and safety). Under ESA, Interface retains ownership of all carpet material, thereby ensuring proper recycling. Despite active media attention and a lot of interested calls from potential buyers, Interface is having difficulty selling ESA. CEO Dan Hendrix is at a crossroad and must decide whether to continue support for ESA or to focus on other initiatives. This case, grounded in a failed negotiation with the University of Texas, Houston, details a discussion of the difficulties of structuring a long-term lease agreement, defining a new service value proposition for the customer and developing a sustainable business model for product-related services.

Scorched Earth: Will Environmental Risks in China Overwhelm its Opportunities?

Publication Date: 1 June 2007
Author(s): Elizabeth Economy, Kenneth Lieberthal
Product Number: R0706F

Of all the risks of doing business in China, the greatest is the threat posed by environmental degradation. And yet it's barely discussed in corporate boardrooms. This is a serious mistake. Multinationals may be more concerned with intellectual property rights violations, corruption and potential political instability, but the Chinese government, NGOs and the Chinese press have been focused squarely on the country's energy shortages, soil erosion, lack of water and pollution problems, which are so severe they might constrain GDP growth. What's more, the Chinese expect the international community to take the lead in environmental protection. If that doesn't happen, multinationals face clear risks to their operations, their workers' health and their reputations.

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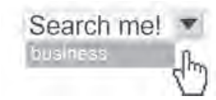
SEARCH ME!



creativity
innovation
invention
left brain
right brain
stereotyping

6 PATHWAYS TO ENTREPRENEURIAL VENTURES

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

chapter objectives

- **01**
  To describe the major pathways and structures for entrepreneurial ventures
- **02**
  To examine bootstrapping and minipreneurship as fast lanes to becoming an entrepreneur
- **03**
  To identify and discuss what is involved in acquiring an established venture that already has some entrepreneurial momentum
- **04**
  To outline key questions to ask when buying an ongoing venture that is already generating value
- **05**
  To define a franchise and outline its structure
- **06**
  To examine the benefits and draw-backs of franchising
- **07**
  To look at the route that social entrepreneurs take to creating a new venture.

PATHWAYS TO NEW VENTURES FOR ENTREPRENEURS

Every prospective entrepreneur wants to know the best methods for launching a new venture. There certainly are a variety of different pathways, but six common pathways come to mind. In this chapter, we examine: bootstrapping, creating a new venture, acquiring an existing venture, buying a franchise and establishing a social venture. In Chapter 15 we look at the sixth way that new venturers come to enterprise – through their entrepreneurial families. Each pathway has its own particular compensations and rewards; there are also certain disadvantages and difficulties that have to be considered. It is unwise for an entrepreneur to rush into a decision without the proper understanding of the particular form of entry. This chapter is devoted to outlining some of the particular issues related to each pathway to becoming an entrepreneur.

BOOTSTRAPPING

One common pathway to steady self-employment is bootstrap entrepreneurship.[1] **Bootstrapping** is a means of starting a new venture through highly creative acquisition and use of (sometimes other people's) resources. Some people say that bootstrapping means starting a new business without financing. Bootstrapping relies greatly on networks, trust, cooperation and wise use of existing resources, rather than going into debt or giving away equity.

Here are some tips that have come from experience. Look for the 'low-hanging fruit'. Use a copycat idea. Find quick, break-even, cash-generating products. Firms that are already making money are able to build credibility in the eyes of investors. Meanwhile, keep growth in check. Too many start-ups fail because they grow beyond their financial means. Focus on cash (not on profits, market share, or anything else). Because of their financial means bootstrapped firms cannot afford to pursue a number of strategic goals. For example, bootstrapped firms cannot pursue loss-making strategies to build a market share or a customer base. Having a healthy cash flow is critical to survival, so sales strategies must ensure healthy returns from the outset (see also 'Ways to find bootstrap capital', on page 263).[2]

Loss acquiring companies

Another good way to launch a business paradoxically is as a *loss-acquiring business*. Different countries have different models but a good example is New Zealand, which always is highly ranked in the World Bank's 'Ease of Doing Business' index. One way the country helps entrepreneurs is by allowing bootstrappers to set up a **Loss Attributing Qualifying Company** (LAQC). That means that losses are allocated to shareholders to *offset against their personal income*, resulting in a lower income tax rate for the shareholders. This results in large refunds from the tax authority from personal income that can then be invested in the business. Normally when a non-LAQC company makes a loss, losses can only be offset against future profits. For example, if you make a loss of $10 000 then you must wait until the company has a profit of $10 000 and then you will pay no tax on the $10 000 profit. But with an LAQC, a start-up entrepreneur who has a regular job as a wage earner can claim the losses and thereby lower their tax rate. This may amount to many thousands of dollars in tax refunds, which can be invested in building up the company. Imagine a married couple starting a business in the evenings and weekend while holding down regular paid employment. They can pay themselves tax-free dividends from their company and/or offset company losses against their own personal income for tax purposes in proportion to the shares that they own. The shares can even be shifted so that for a couple of years all the losses in the company can be attributed to the person with the higher income. When that person jumps from wage income to self-employment, those shares can be shifted to the other person to do the same thing.

HOW TO BOOTSTRAP A BUSINESS

>>ENTREPRENEURSHIP IN PRACTICE

Bootstrapping options for product development:

- >> prepaid licences, royalties, or advances from customers
- >> special deals on access to product hardware
- >> development of product at night and on weekends while working elsewhere
- >> customer-funded research and development
- >> turning a consultant project into a commercial product
- >> least useful methods here are research grants and university-based research incubators.

Bootstrapping options for business development:

- >> foregone, delayed or reduced compensation
- >> working from home using personal savings
- >> deals with professional service providers at below-competitive rates
- >> space at below-market or very low rent
- >> personal credit cards and home equity loans
- >> least useful here are severance payments, barter and special terms with customers.

Bootstrapping options to minimise the need for capital:

- >> Buy used equipment instead of new.
- >> Borrow equipment from other businesses for short-term projects.
- >> Use interest on overdue payments from customers.
- >> Hire personnel for shorter periods instead of employing permanently.
- >> Coordinate purchases with other businesses (mutual purchasing of goods).
- >> Lease equipment instead of buying.
- >> Cease business relations with customers who frequently pay late.
- >> Offer same conditions to all customers (no preferential treatment).
- >> Buy on consignment or trade credit from suppliers.
- >> Deliberately choose customers who pay quickly.
- >> Share business premises with others or run business out of your house.
- >> Employ relatives or friends at non-market salaries.
- >> Least useful are sharing of equipment and employees employed with other local businesses.

Bootstrapping options to meet the need for capital:

- >> Withhold entrepreneur's salary payment for short or long period of time.
- >> Pay employees with company shares (give employees some ownership).
- >> Seek out best purchasing conditions with suppliers.
- >> Deliberately delay payment to suppliers.
- >> Use the entrepreneur's private credit card for business expenses.
- >> Obtain loans from relatives and friends.
- >> Barter under-used products or services with other firms.
- >> Franchise or license the product or business idea to others for a royalty fee.
- >> The least employed methods here include raising capital from a factoring company – through selling the firm's accounts receivable.
- >> Another innovative way is called 'invoice financing'. Under this system, a business outsources its invoices to another company, such as a bank, which pays most of their value immediately and takes on the burden of chasing up payments.[3]

Source: Vadim Kotelnikov, 'Bootstrapping: The most common source of initial equity for entrepreneurial firms', www.1000ventures.com/venture_financing/bootstrapping_methods_fsw.html

Business assistance funding

At the next level are entrepreneurs who take advantage of business development programs that are part of government (see Table 6.1). If small business is strong the overall economy is strong. If small business is held back, the economy is held back. Ssewamala and Sherraden (2004) assert that technical assistance programs and institutions are key elements in the success

TABLE 6.1: BUSINESS DEVELOPMENT ASSISTANCE IN THE ASIA–PACIFIC

Asian Development Bank	www.adb.org
Australia Business Enterprise Centres	www.bec.org.au
Brunei Directory and Information Portal	www.onebrunei.com
Malaysia Small and Medium Industries Development Corporation	www.smidec.gov.my
Malaysian Small and Medium Industries Development Corporation	www.miti.gov.my
New Zealand business information	business.govt.nz
Philippines Micro, Small and Medium Enterprises	www.dti.gov.ph
Philippines SME.COM.PH	www.sme.com.ph
Singapore International Enterprise	www.iesingapore.gov.sg
Thailand Office of Small and Medium Enterprises Promotion	www.cms.sme.go.th

of small businesses.[4] These programs can help the bootstrapping entrepreneur gain greater access to economic programs, establish incentives to save money, provide information about local accounting and financial procedures and give mentoring and other forms of technical assistance.

For example, Thailand has embarked on spending projects with the intention of supporting community economic development. One of the most successful in entrepreneur creation has been Otop (One Tambon [village], One Product). Rather than providing easy credit, Otop focused on creating markets of community entrepreneurs and assisting in exports.[5]

There is ample evidence to support the fact that the start-up sector has a high failure rate in the first three years of business, so access is vital to business information, training programs, business referrals, government programs, business networks, workshops and seminars, mentoring support and business analysis. Especially important to bootstrap entrepreneurs are business incubators and access to finance.

Minipreneurship

Another pathway to launching your entrepreneurial career is online minipreneurship.[6] Imagine that you could look inside Google on any given day. In Singapore on that day there might be only 10 people on the island looking for edible ink (for cake decorating) or vinyl (record collectors) or sources of funding (for their businesses). (See Chapter 9, page 303 on assessment of entrepreneurial opportunities for a discussion on 'The Long Tail' of Internet searches.) Thousands of entrepreneurs start out trading on online auction sites and make interesting businesses selling niche products to gap markets. It is ideal because accounting, promotion and marketing are largely taken care of. The minipreneur can focus then on inventory, fulfilment and most importantly, new business models. Minipreneurs keep costs down by availing themselves of low-cost online products and services, such as Skype for phone calls or Paypal for accepting credit card payments. Others take advantage of programs such as Google AdSense and other online advertising schemes that allow them to earn additional income streams.

Graduating from that and using their own off-the-shelf e-commerce software, many people are launching their own online businesses. It has never been easier to set up a 'miniprise' to services those niche needs in the **Long Tail**. Niche is the new mass as consumerism is now more about standing out, not conforming to trends.

What are the main drivers behind this trend toward minipreneurship? Resources once exclusively available to multinationals, from access to marketplaces to partnering with top talent, are now at the fingertips of experienced, entrepreneurial individuals. Consumers are discovering

06 FREDERICK 9780170181570 TXT.indd 186 10/16/09 4:53 PM

that they can make a buck by doing their own manufacturing, enterprising, venturing, selling, trading, or auctioning themselves. Being one's own boss, even if it is only for a few hours a week, is just too tempting to forego, as is the extra income. In essence, minipreneurship is chic. Minipreneurs have a highly developed network of intermediaries, tools, resources and processes at their disposal. It is an elaborate ecosystem of co-dependent entrepreneurs. Minipreneurs have access to hardware, software, information and communications technology and skills, design, production and manufacturing, extensive marketplaces, advertising, talent, finance, payment and logistics. Minipreneurs get their business up and running instantly, relying on everything from rock-bottom priced laptops, printers and open-source software, to broadband connections and free telephony. Take humble salt. You can go online and scoop up hundreds of gourmet varieties from sulphurous Indian black salt to flaked pink salt from Australia's Murray River basin, all marketed by enterprising minipreneurs.[7] If you are working online the only limits are your own imagination and a clever new business model. There is really no need for an office. In many cities in Asia, the world's largest established culture of minipreneurship, wireless cafes are full of business owners with their laptops, meeting contacts or managing their inventory. Minipreneurship is already an established career option understood by any youngster.

THE RISE OF THE MINIPRENEUR

>>ENTREPRENEURSHIP IN PRACTICE

Website www.trendwatching.com coined the term 'minipreneurs', embracing small and micro businesses, freelancers, co-creators, Trade Me traders, Web-driven entrepreneurs, mumpreneurs, solopreneurs, advertising-sponsored bloggers, free agents, weekend entrepreneurs, seniorpreneurs and so on. In other words, any independent service professional is a minipreneur.

The statistics on this vast group are something of a surprise; according to a July 2005 survey conducted by eBay, more than 724 000 Americans use eBay as their primary or secondary source of income and over 1.5 million people use the site as a source of income supplement. A study by the Centre for Economics and Business Research shows that over 50 000 people in the UK use the online selling of goods to boost their average household income by £3000.

Now entrepreneurship encompasses exciting ventures that can be accessed and marketed through online tools around the world. Ted Turner, hailed as one of the greatest media tycoons and entrepreneurs of his time, once said, 'My son is now an entrepreneur. That's what you're called when you don't have a job'. Today, however, negative connotation no longer accompanies the entrepreneur title.

Minipreneurs are waking up to the reality that through manufacturing, enterprising, selling and trading, wealth and self-employment are at their fingertips. Having control over one's destiny is an appealing prospect. Despite living in times of greater risk and uncertainty, people seek independence and the chance to develop a portfolio of revenue streams.

With minipreneurship being the trend of future entrepreneurs, a potential gap in the marketplace exists for those facilitating to such individuals. Like any other business, minipreneurs have administration, production, advertising, insurance, travel, networking, public relations, technological support and Web-hosting demands. Although their needs may be scaled down in comparison to larger operations, the need is still present.

In order to profit from the minipreneur movement, business owners and service providers around the country need to be asking one question: How can my business help these minipreneurs succeed? By helping them gain profit through facilitating their administration, technological, production and other needs, businesses can benefit from this emerging market. Instead of thinking about how these new businesses can become customers, start thinking about how to market services to help them succeed.

Source: Laura Westphal, 'Marketing to Minipreneurs', *NZ Marketing Magazine*, 25(1), February 2006

CREATING NEW VENTURES Next up is the more 'conventional' **new venture creation**. The essence of Schumpeter's theory of creative destruction is that entrepreneurs distort the market equilibrium by introducing new products and innovations. In so doing entrepreneurs drive less innovative products out of the market and advance the product frontier. We can see this happening by looking at the novelty (or unfamiliarity) of their products or services relative to the customers' current experience. We can also see it by looking at the degree of competition faced by the new entrepreneurial firm (whether other businesses offer similar products or services).

Actually there are two ways to split this. The most effective way to approach a new business venture is to create a unique product or service – one that is not being offered today but would be in great demand if it were. The next-best way is to adapt something that is currently on the market or extend the offering into an area in which it is not presently available. The first approach is often referred to as *new-new*, the second as *new-old*.

New-new approach

New products or services frequently enter the market. Typical examples include smart phones, MP3 players, plasma televisions and global positioning systems (GPS). All of these products and more have been introduced as a result of research and development (R&D) efforts by major corporations. What we must realise, however, is that unique ideas are not produced only by large companies. Moreover, the rate at which new products enter the market has caused the public to expect many of their household goods to improve continually.

How does one discover or invent new products? One of the easiest ways is to make a list of annoying experiences or hazards encountered with various products or services during a given period of time. Common examples include objects that fall out of one's hand, household chores that are difficult to do and items that are hard to store. These are **PITA products**, or 'pain in the arse' products. Can certain innovations alleviate these problems? This is how some people get ideas for new products. For example, an engineer once observed the mechanism for recording the revolutions of a ship's propeller. As he watched the device tally the propeller's revolutions, he realised that the idea could be adapted to the recording of sales transactions – a problem he had been trying to solve for some time. The result led eventually to development of the traditional cash register.

Most business ideas tend to come from people's experiences. Table 6.2 illustrates just a few of the new business ideas that are creating commercial value.

One hot area is Internet social utilities, such as Facebook and MySpace. Facebook was founded by Mark Zuckerberg, a Harvard University student who was frustrated by the lack of

TABLE 6.2: SOME TRENDS THAT ARE CREATING BUSINESS OPPORTUNITIES

Kids and teens: Study planning consultants, high school athletes and tech training and enrichment courses.

Green products: Organic foods, fibres and textiles, solar, bio-fuel, fuel cells energy conservation, green apparel, green business services and solar energy products.

Healthcare: Healthy food, school and government-sponsored programs, exercise, yoga, niche gyms, children, non-medical, pre-assisted living, assisted living transition services, health tech, healthcare staffing, senior services, senior products, in-home nonmedical care and gyms targeting seniors.

Home automation and media storage: Lighting control, security systems, energy management, comfort management, entertainment systems and networked kitchen appliances.

Food & beverages: Gourmet chocolate, new spirits, wine in cans, local beer, enhanced beverages, special needs food, gastro-pubs, upscale frozen desserts, super-fruits, comfort food, one-item restaurants, convenience packaging, culinary tourism, local food, portion sizes/small bites and high-tech ordering.

Source: *Entrepreneur* magazine Hot Lists for 2007 and 2008 networking facilities on campus. The company was founded in February 2004 and is now the largest source for photos and one of the most trafficked sites on the Internet. In just two years the company attracted offers of $750 million from Viacom[8] and $900 million from Yahoo.[9] In general, the main sources for both men and women are prior jobs, hobbies or interests and personally identified problems. This **new-new approach** indicates the importance of people's awareness of their daily lives (work and free time) for developing new business ideas.

New-old approach

Most small ventures do not start with a totally unique idea. Instead, an individual *piggybacks* on someone else's idea by either improving a product or offering a service in an area in which it is not currently available – hence the term **new-old approach**. Some of the most common examples are setting up restaurants, clothing stores, or similar outlets in sprawling suburban areas that do not have an abundance of these stores. Of course, these kinds of operations can be risky because competitors can move in easily. Potential owners considering this kind of enterprise should try to offer a product or service that is difficult to copy. For example, a computerised billing and accounting service for medical doctors can be successful if the business serves a sufficient number of doctors to cover the cost of computer operators and administrative expenses in order to turn an adequate profit. Or perhaps another type of enterprise is likely to be overlooked by other would-be entrepreneurs.

Regardless of whether the business is based on a new-new or a new-old idea, the prospective owner cannot rely exclusively on gut feeling or intuition to get started. As we demonstrate in Part Three of this book, proper planning and analysis are the keys to any successful venture.

BIOMIMICRY AT DYESOL AUSTRALIA: IS THIS NEW-NEW OR NEW-OLD?

>>ENTREPRENEURIAL EDGE

Biomimics draws inspiration for new product designs from biological processes, physical traits and behavioural strategies observed in nature. The classic example of biomimicry innovation is Velcro, whose inventor, George de Mestral, observed that the hooked tips of thistle seeds caused them to stick to the fur of his dog.

Another innovation out of biomimicry that has been pioneered by an Australian company is dye-sensitised solar cells (DSSCs) that emulate plant photosynthesis. Unlike flat solar panels, leaves collect light at shallow angles, capture dim as well as full sun and work in scorching temperatures. They can go where silicon panels can't: on vertical surfaces such as windows, on structures in the shaded lower 'canopy' of cities (street lamps, for example), in the sunless cores of buildings, and in desert or tropical locations. Imagine the Sydney Harbour Bridge serving as an electric power plant.

Dyesol of New South Wales, Australia has pioneered advances in DSSC materials and manufacturing technologies that lower costs and improve performance. Husband-and-wife team Gavin and Sylvia Tulloch admit it has been a long and difficult journey. On top of all the technology challenges involved in the solar industry, the pair have battled funding problems and watched as other nations have more actively supported the development of solar technologies. 'It was particularly frustrating when we would make a significant breakthrough on a technically challenging process but were then unable to access funding to go to the next stage,' Sylvia says. 'In the early days, we had to triple-mortgage the house to be able to do so. Fortunately for Gavin and I, our enormous emotional and financial commitment to the project paid off.' Rather than taking on the entire solar supply chain, Dyesol has concentrated on making the various ingredients that go into creating dye solar cells. This allows Dyesol to limit its investment in manufacturing infrastructure to that necessary for creating the nano-scale dyes and other materials that are the heart of the technology, rather than creating the cells themselves.

Source: Adapted from Janine M. Benyus and Gunter A.M. Pauli, 'The Business of Biomimicry', *Harvard Business Review*, February 2009; Brad Howarth, 'Dyesol's Electric Blue Sky', *SmartCompany: Australia's online magazine for entrepreneurs & SMEs*, 31 October 2008, www.smartcompany.com.au

Examination of the financial picture

If, through a thorough analysis and business plan (covered in detail in Chapter 12), a prospective entrepreneur decides that a new venture is a wise one, it is imperative to remember that the plan may not work perfectly. Some modification may be necessary. Thus, the entrepreneur has to be flexible. If something does not work out, a contingency or backup plan (Plan B) should be available. The worst thing the entrepreneur could do is adopt an all-or-nothing strategy. The

TABLE 6.3: CHECKLIST FOR ESTIMATING START-UP EXPENSES

MONTHLY	EXPENSES	CASH NEEDED TO START THE BUSINESS	WHAT TO PUT IN COLUMN 2
ITEM	ESTIMATE BASED ON SALES OF $__ PER YEAR	(SEE COLUMN 3)	(THESE FIGURES ARE ESTIMATES. THE OWNER/MANAGER DECIDED HOW MANY MONTHS TO ALLOW, DEPENDING ON THE TYPE OF BUSINESS)
	Column 1 $	Column 2 $	Column 3 $
Salary of owner/manager			3 times Column 1
Other salaries and wages			3 times Column 1
Rent			3 times Column 1
Advertising			3 times Column 1
Delivery expenses			3 times Column 1
Supplies			3 times Column 1
Telephone			3 times Column 1
Other utilities			3 times Column 1
Insurance			6 times Column 1
Taxes, superannuation, social security			4 times Column 1
Interest			3 times Column 1
Maintenance			3 times Column 1
Legal and professional			3 times Column 1
Miscellaneous			3 times Column 1
START-UP COSTS			
ITEM	ESTIMATE $	TO ARRIVE AT ESTIMATE	
Fixtures and equipment		Determine what is typical for this kind of business: talk to suppliers.	
Decorating and remodelling		Talk to a contractor.	
Installation of fixtures, equipment		Talk to suppliers.	
Starting inventory		Talk to suppliers.	
Deposits and public utilities		Talk to utility companies.	
Legal and professional fees		Talk to a lawyer, accountant, or other professional.	
Licences and permits		Contact appropriate local offices.	
Advertising and promotion		Decide what will be used; talk to media.	
Accounts receivable		Estimate how much will be tied up in receivables by credit customers and for how long.	
Cash		Allow for unexpected expenses and losses, special purchases and other expenditures.	
Other expenses		List time and estimate costs.	
TOTAL CASH NEEDED TO START	$________	ADD ALL ESTIMATED AMOUNTS.	

Source: US Small Business Administration, 'Management Aids' MA 2.025, Washington DC: US Government Printing Office prospective entrepreneur of a new venture must evaluate the enterprise's financial picture. How much will it cost to stay in business for the first year? How much revenue will the firm generate during this time period? If the outflow of cash is greater than the inflow, how long will it take before the business turns the corner?

Answering these questions requires consideration of two kinds of expenses: start-up and monthly. Table 6.3 illustrates a typical worksheet for making the necessary calculations of start-up expenses. Notice that this worksheet is based on the assumption that no money will flow in for about three months. Also, all start-up costs are totally covered. If the firm is in the manufacturing business, however, it will be three to four months before any goods are produced and sold, so the factors in Column 3 have to be doubled and the amount of cash needed for start-up will be greater. Much of the information needed to fill in this worksheet already should have been gathered and at least partially analysed. Now, however, it can be put into a format that allows the owner to look at the overall financial picture.

At this point, the individual should be concerned with what is called **upside gain and downside loss**. This term refers to the profits the business can make and the losses it can suffer. How much money will the enterprise take in if everything goes well? How much will it gross if operations run as expected? How much will it lose if operations do not work out well? Answers to these questions provide a composite picture of the most optimistic, the most likely and the most pessimistic results. The owner has to keep in mind that the upside gain may be minimal, whereas the downside loss may be great.

>>ENTREPRENEURSHIP IN PRACTICE

TAKING CUES FROM THE DEVELOPING WORLD

Indian consumers currently use smart cards in conjunction with their mobile phones to make financial transactions, a technological development that currently eludes consumers in the US and Europe. This phenomenon is more than a fluke. Surprisingly, consumers in the developing world are beginning to demonstrate to those in developed countries the radical effects such developments can have. From buying groceries to withdrawing cash from an ATM, mobile technologies are destined to revolutionise the way people think about money.

How are countries such as Africa, Latin America and India leading the charge in introducing new technologies when – until recently – those same countries were using the antiquated technology abandoned by more developed countries? Ironically, their lack of infrastructure has led to their ability to quickly adopt more flexible options. For instance, as countries without basic phone services have begun to consider technical solutions, the cost savings associated with implementing an all-mobile system has made installing a network of telephone wires unattractive. Moreover, now that LEDs and fluorescent bulbs are readily available as a more eco-friendly alternative to incandescent bulbs, countries that need to electrify rural areas are in a position to embrace the most advanced offerings.

An interesting result of this transition has been companies' willingness to shift their focus away from consumers in the more developed countries. For instance, Intel has been working on a wireless broadband standard designed to connect billions of citizens in the developing world cost-effectively to the Internet. If the project is a success, the standard will soon be implemented in the US and Europe. Another example of this unprecedented shift can be found with Motorola's Motofone. The phone is designed to provide up to 400 hours of standby on a single battery charge and it retails for only $30. The lack of electrical infrastructure in developing countries led the company to engineer the phone without an internal lamp, resulting in a significant reduction in energy use.

Despite the new focus on relatively undeveloped countries, companies will continue to consider developed countries when innovating; yet, the influence that consumers in the developing world now have on new product development will forever change the process of how products are brought to market. Companies that refuse to acknowledge this transition will risk ignoring billions of potential customers.

Source: Adapted from Jeremy Kahn, 'Developing World First: The Rise of Cell Phone Banking in India Highlights a New Trend,' *Boston Globe*, 20 January 2008: sec. Ideas, K1

It is necessary to examine overall gains and losses. This kind of analysis is referred to as **risk v. reward** analysis and points out the importance of getting an adequate return on the amount of money risked.

ACQUIRING AN ESTABLISHED ENTREPRENEURIAL VENTURE

A prospective entrepreneur may seek to purchase a business venture rather than start up an enterprise. This can be a successful method of getting into business, but numerous factors need to be analysed. Purchasing a business venture is a complex transaction and the advice of professionals should always be sought. However, a few basic steps that can be easily understood are presented here, including the entrepreneur's personal preferences, examination of opportunities, evaluation of the selected venture and key questions to ask.

Personal preferences

Entrepreneurs need to recognise certain personal factors and to limit their choices of ventures accordingly. An entrepreneur's background, skills, interests and experience are all important factors in selecting the type of business to buy. In addition, personal preferences for location and size of a business should guide the selection process. If an entrepreneur always has desired to own a business in the south or west, then that is exactly where the search should begin.

Examination of opportunities

Entrepreneurs in search of a possible venture to buy need to examine the available opportunities through various sources:

- **Business brokers**: Professionals specialising in business opportunities often can provide leads and assistance in finding a venture for sale. However, the buyer should evaluate the broker's reputation, services and contacts. The entrepreneur also should remember that the broker usually represents – and gets a commission on the sale from – the seller.
- **Newspaper ads**: 'Business opportunity' classified ads are another source. Because an advertisement often will appear in one paper and not another, it may be necessary to check the classified sections of all the papers in the area.
- **Trade sources**: Suppliers, distributors, manufacturers, trade publications, trade associations and trade schools may have information about businesses for sale.
- **Professional sources**: Professionals such as management consultants, solicitors and accountants often know of businesses available for purchase.

Advantages of acquiring an ongoing venture

Of the numerous advantages to buying an ongoing venture, three of the most important are as follows:

1. Because the enterprise is already in operation, its successful future operation is likely.
2. The time and effort associated with starting a new enterprise are eliminated.
3. It sometimes is possible to buy an ongoing business at a bargain price.

Each of these three advantages is discussed next.

Less fear about successful future operation

A new business faces two great dangers: the possibility that it will not find a market for its goods or services, and the chance that it will not be able to control its costs. If either event occurs, the new business will go bankrupt.

Buying an existing concern, however, alleviates most of these fears. A successful business already has demonstrated the ability to attract customers, control costs and make a profit. Additionally, many of the problems a newly formed firm faces are sidestepped. For example: Where should the company be located? How should it advertise? What type of plant or merchandise layout will be the most effective? How much should be reordered every three months? What types of customers will this business attract? What pricing strategy should the firm use? Questions such as these already have been asked and answered. Thus, when a new owner buys an ongoing operation, he or she is often purchasing a known quantity. Of course, it is important to check whether hidden problems exist in the operation. Barring something of this nature, however, the purchase of an existing successful operating venture can be a wise investment.

Reduced time and effort

An ongoing enterprise already has assembled the inventory, equipment, personnel and facilities necessary to run it. In many cases, this has taken the owners a long time to do. They have spent countless hours 'working out the bugs' so that the business is as efficient as possible. Likewise, they probably have gone through a fair number of employees before getting the right type of personnel. Except for the top management in an operating venture, the personnel usually stay with the sale. Therefore, if the new owners treat the workers fairly, they should not have to worry about hiring, placing and training personnel.

In addition, the previous owners undoubtedly have established relations with suppliers, bankers and other businesspeople. These individuals often can be relied on to provide assistance to the new owners. The suppliers know the type of merchandise the business orders and how often it needs to be replenished. They can be a source of advice about managing the operation, as can the bankers with whom the enterprise has been doing business. These individuals know the enterprise's capital needs and often provide new owners with the same credit line and assistance they gave the previous owners. The same holds true for the accountant, the lawyer and any other professionals who served the business in an advisory capacity. Naturally, the new owners may have their own bankers, accountant, or lawyer, but these old relationships are there if the new owners need them.

A good price

Sometimes it is possible to buy an ongoing operating venture at a very good price. The owner may want to sell quickly because of a retirement decision or illness. Or the owner may be forced to sell the business to raise money for some emergency that has occurred. Or the owner may seek a greater opportunity in another type of business and therefore be willing to sell at a low price in order to take advantage of the new opportunity.

Ideally, when one is looking to buy an ongoing, successful operating venture, one of these three advantages (especially the last one) is present. However, seldom does someone in business sell a successful firm at an extraordinarily low price. The owner of a successful small venture built the enterprise through skilful business practices, knows how to deal with people and has a good idea of the operation's fair market value. That person will rarely sell for much below the fair market value. Therefore, the prospective owner must avoid bidding high on a poor investment or walking away from a good bargain because 'it smells fishy'. The way to prevent making the wrong decision is to evaluate the existing operation in a logical manner.

Key questions to ask

Ronald Reagan once said, about Gorbachev's weapons proposals: 'Trust, but verify'. It is worth remembering! It is all a bit emotional selling the business that you have nurtured from birth or buying someone else's 'baby'. But the entrepreneur needs to look under the covers to see the intimate details. It is a bit like a pre-nuptial agreement.

When deciding whether to buy, the astute prospective owner needs to ask and answer a series of 'right questions'.[10] The following section discusses questions and provides insights into the types of actions to take for each response.

Why is the business being sold?

One of the first questions that should be asked is *why* the owner is selling the business.[11] Quite often, a difference exists between the reason given to prospective buyers and the real reason. Typical responses include 'I'm thinking about retiring', 'I've proven to myself that I can be successful in this line of business, so now I'm moving to another operation that will provide me with new challenges', and 'I want to move to the Gold Coast of Australia and go into business with my brother-in-law there'.

Any of these statements may be accurate, and – if they can be substantiated – the buyer may find that the business is indeed worth purchasing. However, because it is difficult to substantiate this sort of personal information, the next best thing is to check around and gather business-related information. Is the owner in trouble with the suppliers? Is the lease on the building due for renewal and the landlord planning to triple the rent? Worse yet, is the building about to be torn down? Other site-location problems may relate to competition in the nearby area or zoning changes. Is a new shopping mail about to be built nearby that will take much of the business away from this location? Has the local council passed a new regulation that calls for the closing of business on Sunday, the day of the week when this store does 25 per cent of its business?

Financially, what is the owner going to do after selling the business? Is the seller planning to stay in town? What employment opportunities does he or she have? The reason for asking these questions is that the new owner's worst nightmare is to find that the previous owner has set up a similar business a block away and is drawing back all of the customers. One way to prevent this from happening is to have a lawyer write into the contract an agreement that the previous owner will refrain from conducting the same business within a reasonable distance for a period of at least five years. This is known as a **legal restraint of trade** – an agreement not to compete or '**non-compete clause**'. Doing this helps the new owner retain the business's customers.

What is the current physical condition of the business?

Even if the asking price for the operation appears to be fair, it is necessary to examine the *physical condition of the assets*. Does the company own the building? If it does, how much repair work needs to be done? If the building is leased, does the lease provide for the kinds of repairs that will enhance the successful operation of the business? For example, if a flower shop has a large refrigerator for keeping flowers cool, who has to pay to expand the size of the refrigerator? If the landlord agrees to do so and to recover the investment through an increase in the lease price, the total cost of the additional refrigerated space must be compared to the expected increase in business. Meanwhile, if the landlord does not want to make this type of investment, the new owners must realise that any *permanent additions to the property remain with the property*. This means that if something simply cannot be carried out of the building, it stays. Pictures on the walls, chairs and desks the previous business owner purchased can be removed. However, new bookshelves nailed to the wall, carpeting attached to the floor, a new acoustic ceiling installed to cut down on noise in the shop and the new refrigerated area all become permanent property of the building owner. Therefore, the overriding question while examining the physical facilities is, 'How much will it cost to get things in order?'

What is the condition of the inventory?

How much inventory does the current owner show on the books? Does a physical check show that inventory actually exists? Additionally, is inventory saleable, or is it out-of-date or badly deteriorated?

What is the state of the company's other assets?

Most operating ventures have assets in addition to the physical facilities and the inventory. A machine shop, for example, may have various types of presses and other machinery. An office may have computers, copiers and other technology that belong to the business. The question to ask about all of this equipment is, 'Is it still useful, or has it been replaced by more modern technology?' In short, are these assets obsolete?

Another often overlooked asset is the firm's records. If the business has kept careful records it may be possible to determine who is a good credit risk and who is not. Additionally, these records make it easy for a new owner to decide how much credit to extend to the prior customers. Likewise, sales records can be very important because they show seasonal demands and peak periods. This can provide the new owner with information for inventory control purposes and can greatly reduce the risks of over- or under-stocking.

Still another commonly overlooked asset is past contracts. What type of lease does the current owner have on the building? If the lease was signed three years ago and is a seven-year lease with a fixed rent it may have been high when it came into effect but could be on the low side for comparable facilities today. Furthermore, over the next four years the rent should prove to be quite low considering what competitors will be paying. Of course, if the lease is about to expire it's is a different story. Then the prospective owner has to talk to the landlord to find out what the terms of the lease will be. Additionally, a prospective owner's lawyer should look at the old lease to determine if it can be passed on to a new owner and, regardless of the rent, how difficult it is to break the lease if the business should start to fail.

Finally, the prospective buyer must look at an intangible asset called **goodwill**. Goodwill is often defined as the value of the company beyond what is shown on the books. For example, if a software company has a reputation for quick and accurate service, the company has built up goodwill among its customers. If the owners were to sell the business, the buyer would have to pay not only for the physical assets in the software company (office furniture, computers, etc.) but also for the goodwill the firm has accumulated over the years. The reputation of the business has a value.[12]

How many of the employees will remain?

It is often difficult to give customers the good service they have come to expect if seasoned employees decide they do not want to remain with the new owner. The owner is certainly an important asset of the firm, but so are the employees; they play a role in making the business a success. Therefore, one question the prospective buyer must ask is, 'If some people will be leaving, will enough be left to maintain the type of service the customer is used to getting?' In particular, the new owner must be concerned about key people who are not staying. Key employees are part of the value of the business. If it is evident that these people will not be staying the prospective buyer must subtract something from the purchase price by making some allowance for the decline in sales and the accompanying expense associated with replacing key personnel.

When purchasing an existing business, the prospective owner should conduct an assessment of the current group of employees. He or she should review existing performance evaluations and talk with the current owners about the quality of each employee and his or her value to the business. It may be easier to retain valuable employees by seeking them out before the purchase to ensure their feelings of security. The incoming owner should interview all of the current employees and make decisions about who to keep and who to let go before actually taking over the enterprise.

What type of competition does the business face?

No matter what goods or service the business provides, the number of people who will want it and the total amount of money they will spend for it is limited. Thus, the greater the competition the less the business's chance of earning large profits. As the number of competitors increases, the cost of fighting them usually goes up. More money must be spent on advertising. Price competition must be met with accompanying reductions in overall revenue. Simply too many companies are pursuing the same market.

Additionally, the quality of competition must be considered. If nine competitors exist, a new owner could estimate a market share of 10 per cent. However, some of these competitors undoubtedly will be more effective than others. One or two may have very good advertising and know how to use it to capture 25 per cent of the market. A few others may offer outstanding service and use this advantage to capture 20 per cent of the market. Meanwhile, the remaining six fight for what is left.

Then the location of the competition must be considered. In many instances, a new venture does not offer anything unique so people buy on the basis of convenience. A service located on the corner may get most of the business of local residents. One located across town will get virtually none. Because the product is the same at each location no one is going to drive across town for it. This analogy holds true for groceries, pharmaceuticals and hardware. If competitors are located near one another, each will take some of the business the others could have expected, but none is going to maximise its income. However, if the merchandise is an item that people shop for very carefully – furniture, for example – a competitor in the immediate area can be a distinct advantage. For example, two furniture stores located near each other tend to draw a greater number of customers than they would if located 10 blocks apart. When people shop for furniture they go where a large selection is available. With adjacent stores customers will reason that if the furniture they are looking for is not in one it might be in the other. Additionally, since they can step from one store to the next, they can easily compare prices and sale terms.

Finally, any analysis of competition should look for **unscrupulous practices**. How cutthroat are the competitors? If they are very cutthroat the prospective buyer will have to be continually alert for practices such as price fixing and kickbacks to suppliers for special services. Usually, if the company has been around for a couple of years it has been successful dealing with these types of practices. However, if some competitors are getting bad reputations the new owner will want to know this. After all, over time the customers are likely to form a stereotyped impression of enterprises in a given geographic area and will simply refuse to do business with any of them ('It is no use looking for clothing in that area'). In this case, the customers retaliate against unethical business practices by boycotting the entire area in which these firms are located. In short, an unethical business competitor can drag down other firms as well.

What does the firm's financial picture look like?

It may be necessary for a prospective buyer to hire an accountant to look over the company's books. It is important to get an idea of how well the firm is doing financially. One of the primary areas of interest should be the **company's profitability**.[13] Is the business doing anything wrong that can be spotted from the statements? If so, can the prospective buyer eliminate these problems?

Individuals who are skilled in buying companies that are in trouble, straightening them out, and reselling them at a profit know what to look for when examining the books. So do good accountants. Both also know that the seller's books alone should not be taken as proof of sales or profits. One should insist on seeing records of bank deposits for the past two to three years. If the current owner has held the firm for only a short time, the records of the previous owner also should be examined. In fact, it is not out of line to ask for the owner's income tax return, although national privacy laws may protect this. The astute buyer knows that the firm's records reflect its condition.

Another area of interest is the firm's **profit trend**. Is it making more money year after year? More important, are profits going up as fast as sales or is more and more revenue necessary to attain the same profit? If the latter is true, this means the business may have to increase sales 5 to 10 per cent annually to net as much as it did the previous year. This spells trouble and is often a sign that the owner is selling because 'there are easier ways to make a living'.

Finally, even if the company is making money, the prospective buyer should compare the firm's performance to that of similar companies. For example, if a small retail shop is making a 22 per cent return in investment this year in contrast to 16 per cent two years ago, is this good or bad? It certainly appears to be good, but what if competing stores are making a 32 per cent return on investment? Given this information, the firm is not doing as well.

One way to compare a company to the competition is to obtain comparative information on retail and wholesale firms in various fields and provide businesspeople with an overall view of many key financial ratios. For example, one of the most important is the comparison of current assets (cash, or items that can be turned into cash in the short run) to current liabilities (debts that will come due in the short run). This key ratio reflects a business's ability to meet its current obligations. A second key ratio is the comparison of net profits to net sales (net profit margin). How much profit is the owner making for every dollar in sales? A third key ratio is net profit to net worth (return on net worth). How much profit is the individual making for every dollar invested in the firm?

The scope of this chapter rules out a detailed treatment of valuation methodologies. There are some rules of thumb in every industry that make the initial winnowing a bit easier. But beware. You should be very cautious when using rules of thumb as they are based on averages and often don't accurately reflect individual situations. Rules of thumb should only be used to support other methods of valuation; that is, to *externally verify* what your valuation specialist has arrived at.

Despite the caveat, here's the most venerable rule of thumb (ROT), the earnings multiplier. This makes you focus on your immediate desire to make money. Don't be confused by real estate or earnings multiples. When you buy a rental property, you normally want a 10 per cent return per year on your investment (that is, pay off the property in 10 years). Share market prices are often as much as 20 times earnings. Running a small private business is much riskier and tougher and therefore the return on investment is shorter. So you should be looking at recouping your purchase/investment in three to five years, which is equivalent to a projected annual return on investment between 20 and 33 per cent. Now, isn't that the type of return on investment (ROI) that would make you take the leap? The real problem is which earnings figure to use. This year's? The last five-year average? The most usual may be *projected earnings*. You'll be satisfied by that figure only 'by feel'. Let your common sense prevail. It's tricky, but remember: The seller created the market but you can re-create it.

In the end, valuation of start-up companies is highly subjective. How much is this new business ultimately worth? Is the asking price reasonable? This is never an exact science and different people have different rules of thumb and methods. You might wish to hire an independent business valuer in the same way that you would have a property valuation or a building assessment done when you buy a new house. Each method has some value and one should use a number of methods to arrive at a range of prices which you can use to set an asking price or use in negotiating if you are buying.

Negotiating the deal

The potential buyer must negotiate the final deal.[14] This negotiation process, however, involves a number of factors. Four critical elements should be recognised: information, time, pressure, and alternatives.

Information may be the most critical element during negotiations. The performance of the company, the nature of its competition, the condition of the market and clear answers to

FIGURE 6.1: DUE DILIGENCE CHECKLIST

Rate each of the following using a scale of 1–10 (1 = lowest; 10 = highest)

MANAGEMENT TEAM		**RATING**
1	Previous experience (include bios)	
2	Management team strengths	
3	Functional areas of strength and weakness (marketing, development, finance, sales, etc.)	
4	Identified key functional areas that require immediate additions/changes	
	Overall rating:	
TARGETED INDUSTRY SEGMENT		**RATING**
1	Addressable market size	
2	Current competition and respective positioning	
3	Possible new entrants to the market	
4	Significant competitive advantage and/or differentiation	
5	Market and adoption related risks	
	Overall rating:	
TECHNOLOGY AND PRODUCTS		**RATING**
1	Patents pending	
2	Architecture	
3	Standards supported	
4	Performance/scalability metrics	
5	Current adoption level of technology	
6	Review of development methodology and selected tools	
7	Twelve-month product strategy, feature prioritisation and roadmap	
8	Technology risks (techniques/processes, tools, hiring/people etc.)	
	Overall rating:	
MARKETING PLAN		**RATING**
1	Addressable market size	
2	Percentage of market capture	
	Overall rating:	
FINANCIALS		**RATING**
1	Income statement (for three years)	
2	Sources and use document	
3	Industry comparables	
4	Valuation	
5	Capitalisation table	
6	Exit strategy	
	Overall rating:	

Source: Ten3 East-West, 'Due diligence worksheet: Evaluating a start-up company for venture investing', www.1000ventures.com/venture_financing/due_diligence_worksheet_byindiaco.html

DOS AND DON'TS OF BUYING A BUSINESS

>>ENTREPRENEURSHIP IN PRACTICE

Buying an ongoing business provides many advantages for a prospective purchaser, such as a proven track record, established credit, ongoing operations and a significantly lower chance for failure. However, without careful analysis, a person buying an ongoing business may suffer from hidden problems inherited with the business. The following list of dos and don'ts provides some practical tips to consider before signing over the cheque.

1 *Have a seller retain a minority interest in the business.* If a seller walks with 100 per cent of the purchase money, it is highly unlikely that he or she will give you any help running the business in the future. Another option would be to have the ultimate purchase price of the business dependent on the performance of the business over the next three- to five-year period.

2 *Never rely on oral statements.* Get everything in writing; oral promises count for little after you have bought the business.

3 *Have an accountant examine the books and check the cash flow.* Your accountant must reconstruct the seller's financial statements to determine exactly how much cash is available to you.

4 *Investigate, investigate, investigate!* Find out as much as you can about the business before you fork over your hard-earned cash. Talk to vendors, suppliers, customers and even the competition to get the real story. Go beyond the list of references the seller provides you. Investigate the entire industry, looking for possible major shifts that could affect future business. The more time you devote to such research, the better decision you'll make.

5 *Interview the employees.* All employees have valuable information about the company they work for. If the seller is serious about selling, he or she should not be afraid to let buyers communicate with employees. Try to do interviews in a confidential situation; otherwise, any information you gain may be incorrect or misleading.

6 *Find out the real reason the company is for sale.* True, many people want out of a successful business for legitimate reasons. Just make sure the reasons are legitimate.

Source: Adapted from Bruce J. Blechman, 'Good Buy,' *Entrepreneur*, February 1994: 22–5. Reprinted with permission from *Entrepreneur* magazine

all of the key questions presented earlier are all vital components in the determination of the business's real potential. Without reliable information the buyer is at a costly disadvantage. The seller never should be relied on as the sole information source. Although the seller may not falsify any information, he or she is likely to make available only the information that presents the business in the most favourable light. Therefore, the buyer should develop as many sources as possible. The rule should be to investigate every possible source.

Time is also a critical element. If the seller already has purchased another business and a potential buyer is the only prospect to buy the existing firm then that buyer has the power to win some important concessions from the seller. If, however, the owner has no such deadline but simply is headed to retirement, or if the buyer's financial sources wish to invest in the project quickly, then the buyer is at a serious disadvantage. In short, having more time than the other party can be very beneficial.

FRANCHISING ONE'S WAY INTO SELF-EMPLOYMENT

One form of business that incorporates some of the independence of an entrepreneur with the larger umbrella of a corporation is the franchise. Thus, it is a hybrid form of entering business for oneself. Today, more than a third of all retail sales and an increasing part of the gross domestic product are generated by private franchises. A **franchise** is any arrangement in which the owner of a trademark, trade name, or copyright has licensed others to use it in selling goods or services. A **franchisee** (a purchaser of a franchise) generally is legally independent, but economically dependent on the integrated business system of the **franchisor** (the seller of the franchise). In other words, a franchisee can operate as an independent businessperson, but still realise the advantages of a regional or national organisation.[15]

How a franchise works

Business franchise systems for goods and services generally work the same way. The franchisee, an independent businessperson, contracts for a complete business package. This usually requires the individual to do one or more of the following:

1. Make a financial investment in the operation.
2. Obtain and maintain a standardised inventory and/or equipment package usually purchased from the franchisor.
3. Maintain a specified quality of performance.
4. Follow a **franchise fee** as well as a percentage of the gross revenues.
5. Engage in a continuing business relationship.

In turn, the franchisor provides the following types of benefits and assistance:

1. The company name. For example, if someone bought a Burger King franchise, this would provide the business with drawing power. A well-known name, such as Burger King, ensures higher sales than an unknown name, such as Ralph's Big Burgers.
2. Identifying symbols, logos, designs and facilities. For example, all McDonald's units have the same identifying golden arches on the premises. Likewise, the facilities are similar inside.
3. Professional management training for each independent unit's staff.
4. Sale of specific merchandise necessary for the unit's operation at wholesale prices. All of the equipment to run the operation and the food or materials needed for the final product usually is provided.
5. Financial assistance, if needed, to help the unit in any way possible.
6. Continuing aid and guidance to ensure that everything is done in accordance with the contract.[16]

>>ENTREPRENEURSHIP
IN PRACTICE

ANZAC FRANCHISE FACTS

Top Australian franchises: Souvlakihut, Car Care, Snap-on Tools, Just Better Care, Mr Rental, Muzz Buzz, Mrs Fields, Mortgage Choice, ANZ Mobile Lending, Worldwide Online Printing.

New Zealand franchises: The population of 4 million is served by perhaps 350 franchise systems, giving it the highest proportion of franchises per capita in the world. Seventy per cent of these systems are locally bred, but New Zealanders have given a warm welcome to appropriate franchise systems from all over the world such as The Body Shop, Snap-on Tools, Speedy Sign A Rama (Speedy Signs), Action International and, of course, McDonald's. Approximately one quarter of New Zealand franchises have already expanded overseas, often starting with Australia.

Sources: 10THOUSANDFEET, www.topfranchise.com.au/Top10Franchises/; Simon Lord, 'An Introduction to Franchising in New Zealand', FranchiseNZ, n.d., www.franchise.co.nz/article/view/76

Advantages of franchising

Training and guidance

Perhaps the greatest advantage of buying a franchise, as compared to starting a new business or buying an existing one, is that the franchisor will usually provide both training and guidance to the franchisee. As a result, the likelihood of success is much greater for national franchisees who have received this assistance than for small-business owners in general. For example, it has been reported that the ratio of failure for small enterprises in general to franchised businesses may be as high as four or five to one.

Brand-name appeal

An individual who buys a well-known national franchise, especially a big-name one, has a good chance to succeed. The franchisor's name is a drawcard for the establishment. People are often more aware of the product or service offered by a national franchise and prefer it to those offered by lesser-known outlets.

A proven track record

Another benefit of buying a franchise is that the franchisor has already proved the operation can be successful. Of course, if someone is the first individual to buy a franchise, this is not the case. However, if the organisation has been around for five to 10 years and has 50 or more units it should not be difficult to see how successful the operations have been. If all of the units are still in operation and the owners report they are doing well financially, one can be certain the franchisor has proved that the layout and location of the store, the pricing policy, the quality of the goods or service and the overall management system are successful.

Financial assistance

Another reason a franchise can be a good investment is that the franchisor may be able to help the new owner secure the financial assistance needed to run the operation. In fact, some franchisors have personally helped the franchisee get started by lending money and not requiring any repayment until the operation is running smoothly. In short, buying a franchise is often an ideal way to ensure assistance from the financial community.

Disadvantages of franchising

The prospective franchisee must weigh the advantages of franchising against the accompanying disadvantages.

Franchise fees

In business, no one gets something for nothing. The larger and more successful the franchisor, the greater the franchise fee. For a franchise from a national chain it is not uncommon to be faced with a fee of $5000 to $100 000. Smaller franchisors or those who have not had great success charge less. Nevertheless, entrepreneurs deciding whether or not to take the franchise route into small business should weigh the fee against the return they could get putting the money into another type of business. Also, remember that this fee covers only the benefits discussed in the previous section. The prospective franchisee also must pay for building the unit and stocking it although the franchisor may provide assistance in securing a bank loan.

Additionally, a fee is usually tied to gross sales. Typically, the franchise buyer pays an initial franchise fee, spends their own money to build a store, buy the equipment and inventory and then pays a continuing royalty based on sales, usually between 5 and 12 per cent. Most franchisors require buyers to have 25 to 50 per cent of the initial costs in cash. The rest can be borrowed, in some cases from the franchising organisation itself.

>>ENTREPRENEURSHIP IN PRACTICE

TO FRANCHISE OR NOT TO FRANCHISE: THAT IS THE QUESTION . . . FOR YOUNG ENTREPRENEURS

Franchises are a vehicle for those individuals with entrepreneurial tendencies but without the desire to base a business on their own idea. Given this fact, franchising would seem a logical fit for young entrepreneurs fresh from universities. Experts differ on the merits of such an approach. Following are reasons for and against becoming a franchisee straight out of tertiary education:

FOR

- >> *Students learn best in structured learning environments, as provided by franchising.* The support structure provided by franchisors makes franchising an ideal option for students looking to experience entrepreneurship with a proven formula. The educational materials provided to new franchisees extend the classroom environment to a real-world application.
- >> *Students are experienced customers and, in many cases, employees of franchises.* Because fewer families have stay-at-home parents, today's students have experienced an active childhood, which often involved relying on 'fast' food between appointments. Many students also have taken part-time positions with these franchises, which has given them a behind-the-scenes look at how they are run.
- >> *So-called 'helicopter parents' often continue to provide support beyond university.* The support that students require when starting their first business extends beyond financial needs. Having parents who are actively involved can give students the boost they need to venture out on their own, knowing that there is a safety net in the event that they fail. Although some would argue that the limited financial contribution of the students inevitably leads to a lack of accountability, others argue that having the investments from family and friends on the line further motivates the students to succeed.
- >> *Students are accustomed to being visionary, which fuels innovation.* The Internet has given students a venue for self-expression on a grand scale. The immediacy of results from the digitisation of society has taught students how to generate an idea, implement it and assess the results. This enthusiasm often translates to ambition that franchisors look for in their franchisees.

AGAINST

- >> *Few university students have the financial wherewithal to start a franchise.* Although the costs associated with starting a franchise in the long run can be less than those for developing a new concept, the up-front franchising fees can cost several hundred thousand dollars, making the financial requirements a significant hurdle for individuals without the credit history to acquire a bank loan without a co-signer.
- >> *Students usually find staying motivated difficult when the business struggles.* Business concepts that initially were exciting can quickly lose their lustre when they lose momentum. Given that most students will have had financial assistance from family or friends, they have little to no financial commitment to the business, which can lead to a lack of ownership when problems arise.
- >> *Lack of management experience makes dealing with employees a challenge.* Franchisors will provide marketing materials, supplier connections and operational plans, but the responsibility for managing employees falls squarely on the shoulders of the franchisees. The recruitment, management and retention of employees can be stressful for even the most seasoned manager, so students with no experience in management find it difficult to keep employees motivated and committed. Gaining experience through trial and error as a manager in a large corporation is unlikely to lead to the collapse of the entire organisation, whereas franchises are far more susceptible to management mistakes. In the end, students have to determine what makes the most sense for their career aspirations as well as for their management style. Although there is more risk inherent with a new concept, franchising is not for everyone. Some entrepreneurs have concluded that franchiser agreements are too restrictive, relegating them to what they consider to be mere employees; however, all franchisors stipulate different policies and procedures. Deciding whether to purchase a franchise is only the beginning of the process. The real work begins when an entrepreneur decides what franchise to purchase.

Source: Adapted from Jeff Elgin and Jennifer Kushell, 'He Said, She Said,' *Entrepreneur*, January 2008, www.entrepreneur.com/magazine/entrepreneur/2008/January/187674.htmi, accessed 16 March 2008

Franchisor control

When one works in a large corporation, the company controls the employee's activities. If an individual has a personal business, they control their own activities. A franchise operator is somewhere between these extremes. The franchisor generally exercises a fair amount of control over the operation in order to achieve a degree of uniformity. If entrepreneurs do not follow franchisor directions they may not have their franchise licence renewed when the contract expires.

Unfulfilled promises

In some cases, especially among less-known franchisors, the franchisees have not received all they were promised.[17] For example, many franchisees have found themselves with trade names that have no drawing power. In addition, many franchisees have found that the promised assistance from the franchisor has not been forthcoming. For example, instead of being able to purchase supplies more cheaply through the franchisor, many operators have found themselves paying exorbitant prices for supplies. If franchisees complain they risk having their agreement with the franchisor terminated or not renewed.

Franchise law

It is still the Wild, Wild West in New Zealand. There is no specific legislation relating to franchising in New Zealand as the sale of businesses and business practices is covered by normal commercial law such as the *Fair Trading Act*, *Health & Safety in Employment Act*, *Consumer Guarantees Act* and the *Employment Act*. But this can go horribly awry. In 2007 about 200 victims, mainly Chinese and Indian immigrants, paid between $21 000 and $25 000 for non-existent ironing businesses and received no compensation.[18] Many observers believe it is inevitable that some form of regulation will be brought in, and when that time comes good operators will welcome it as ensuring the continued development of ethical franchising in New Zealand. The self-regulatory Code of Practice introduced in 1996 by the Franchise Association of New Zealand contains many provisions similar to Australian legislation.

Australia has gone down a different road. The Australian Franchising Code of Conduct ensures that franchisees are informed of all relevant facts when starting their business and that they can access a fast and relatively inexpensive way to resolve any disputes. Franchisors are required to disclose specific facts to franchisees and to follow set procedures in their dealings with franchisees. If a dispute arises either party can require the other to attend mediation. Potential franchisees must sign a statement that they have been given independent advice or that they were told to seek such advice and chose not to do so. The Code's disclosure obligations require franchisors to supply prospective franchisees, or those seeking to renew or extend an existing franchise, with a specifically prescribed disclosure document and a copy of the Code. Excluded from the Code are foreign franchisors with only one franchise operating within Australia. The Australian Competition and Consumer Commission (ACCC) administers the Code and enforces it through sanctions. Disputes are dealt with by a mediation adviser. The Australian Government-funded Office of the Mediation Adviser assists franchisors and franchisees to resolve their problems and disputes through mediation, which is often a less costly option than going to court.

Green franchise opportunities

Entrepreneurs who want to align their business to environmental practice are increasingly looking at green franchises. Throughout the Internet there are a variety of ideas for sale. Here are a few:

- Pizza franchisees with only organic ingredients that use hybrid cars for delivery
- Auto tune-ups with an eco-friendly inspection, synthetic oil, lifetime oil and air filters, platinum spark plugs and more

- Rubbish removal companies that completely recycle the waste
- Organic lawn care franchises using environmentally safe products
- Solar franchises with consultants, designers and installers
- Carpet cleaning with safe chemical-free methods
- Energy doctors with products designed to reduce heating and cooling costs and make homes more energy efficient
- Printer cartridge recycling that is cheaper and just as good as new.

SOCIAL VENTURING

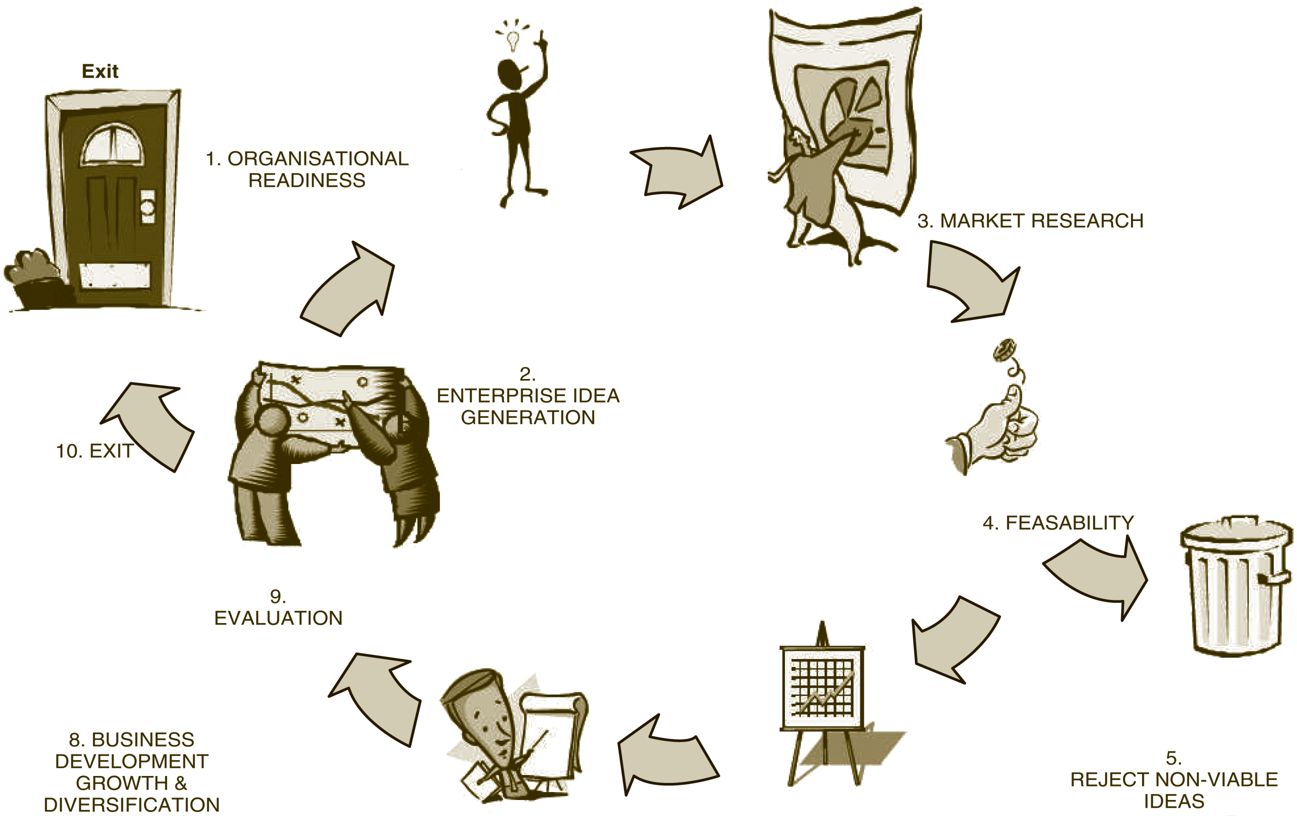
As former US presidential candidate Hubert H. Humphrey once said, 'Profit and morality are a hard combination to beat'.[19] That is why the fifth pathway in this chapter is social venturing. For the entrepreneur driven by a desire to right social injustice or help the environment there is definitely money available. Private foundations and private individuals are giving early funding for promising social business plans. Many funders and private investors are looking for enterprises that fulfil grander missions in ways that are self-sustaining.

Structuring a social enterprise is even more challenging than regular business ventures. Social entrepreneurs face a double challenge: They have to find an effective strategy for accomplishing lasting social change and they must find a viable profit-making business model to support that strategy. Social entrepreneurs need to 'run the numbers' as critically as they would with business ventures. **Social venturing** marries the best of entrepreneurial innovation with cutting-edge strategies that lead to a more sustainable planet. Entrepreneurs need to apply business skills to solve real-world challenges and capture opportunities in new market niches. Whether independent entrepreneurs or social intrapreneurs working within a corporation (see pages 585–7), entrepreneurs are always pushing the envelope to create new approaches and design new products to solve some of the world's most pressing problems.

A social venture, also called a **social enterprise**, is any non-profit enterprise, social-purpose business or revenue-generating venture, business-development service, micro-finance institution or cooperative that uses rigorous business models and is founded to support or create economic opportunities for a particular target population, while simultaneously operating with reference to the financial bottom line.[20]

The popularity of social entrepreneurship has increased the number of social ventures. What has resulted is the realisation that there are several kinds of potential business models for different kinds of social ventures. It is important to consider which business model would be appropriate for each project, and to understand the legal models that might influence particular models. Popular models are: licensing, start-up with seed funding and grants, incubation, partnering with a for-profit company and franchising. *Social ventures are business-like organisations structured as a social-purpose business.*[21] Viability is critical to success and social ventures use the same models of pricing, marketing, production planning and financial tools as regular businesses. Social ventures are market-driven in the sense that they absolutely need to know who their customers are and to respond to their wants and desires. Social ventures use market research techniques (see Chapter 10) so that they make sure their enterprise can have healthy performance. Unlike some for-profit businesses that believe in the build-it-and-they-will-come approach, social ventures must be developed with attention to the exact benefits the customers seek. Figure 6.2 has all the concepts of a regular business but they must be focused to social goals. Social venturing does not use any new methods or tools to achieve its ends. The newness, if anything, is the emphasis on achieving the **double bottom line** – social and business objectives – inherent in social enterprises or the **triple bottom line** (see Chapter 11, pages 412–16).[22]

FIGURE 6.2: THE SOCIAL ENTERPRISE DEVELOPMENT CYCLE



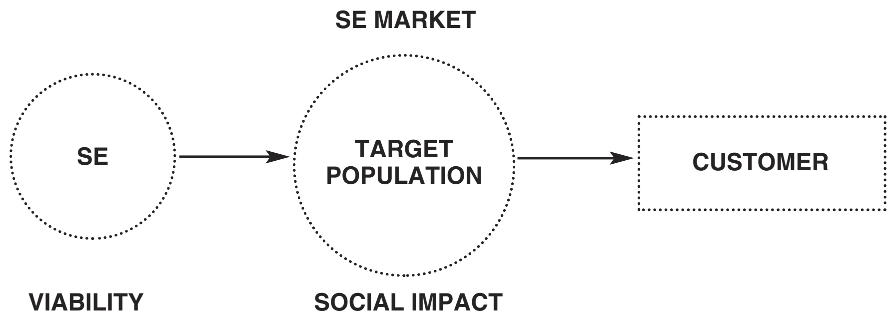
Source: Sutia Kim Alter, *Managing the Double Bottom Line: A Business Planning Reference Guide for Social Enterprises*. New updated, revised edition, Save the Children, 2000: 7. This work is licensed under the Creative Commons Attribution-Share Alike 3.0 License, http://creativecommons.org/licenses/by-sa/3.0/

Models of social enterprises

According to Kim, there are three social enterprise models that are configured to simultaneously serve their clients and survive in the market. Some sell products or services directly to their target population: In this case the market and the client are the same (Figure 6.3, model 1). This is the model typically used for a financial service or micro-finance program whereby enterprise viability is achieved through the sale of sufficient volume of services, and social impact is achieved via providing poor entrepreneurs with access to affordable credit to fuel their businesses. Other social enterprises act as intermediaries, buying goods produced by poor or disadvantaged entrepreneurs, and then selling these products in external markets (Figure 6.3, model 2). Marketing enterprises or economic development programs use this approach, realising income through a mark-up on products to final customers and achieving social impact by helping the disadvantaged self-employed access markets for their products. A third possibility is a social enterprise that employs its target population and sells products or services on the open market (Figure 6.3, model 3). This type of social enterprise is viable in much the same way

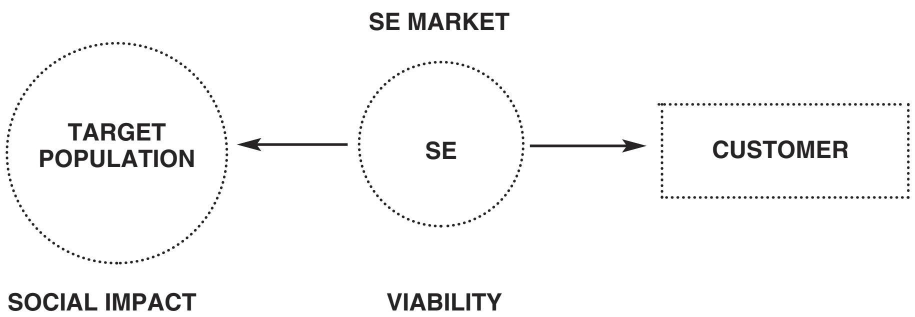
FIGURE 6.3: **SOCIAL ENTERPRISE MODELS**

MODEL 1: ENTREPRENEUR MODEL



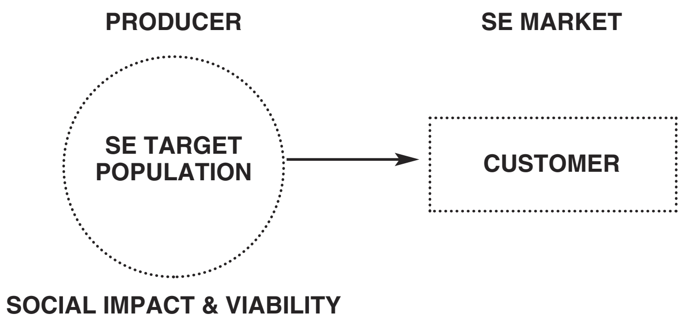
Social enterprise sells needed business products and services directly to its target population – self-employed poor or disadvantaged populations – to improve their business income. This is a classical model of Business Development and Microfinance Programs.

MODEL 2: MARKET INTERMEDIARY MODEL



Social enterprise acts as an intermediary between the target population and the market; it achieves viability through the sale of client-made products to the final customer and helps clients reach markets otherwise inaccessible to them.

MODEL 3: EMPLOYMENT MODEL



This social enterprise is a direct employer of its target population, (disadvantaged, at-risk individuals); it attains viability through the sales of its products and services to an external market.

Source: Sutia Kim Alter, *Managing the Double Bottom Line: A Business Planning Reference Guide for Social Enterprises.* New updated, revised edition, Save the Children, 2000: 16–17. This work is licensed under the Creative Commons Attribution-Share Alike 3.0 License, http://creativecommons.org/licenses/by-sa/3.0/

as a private business; social impact is accomplished by employing a target population that may otherwise be barred from work opportunities.

One outstanding example of a socially driven company is Aurolab of India, now one of the largest manufacturers of intra-ocular (inside the eye) lenses (IOLs) in the world. Started by David Green as a non-profit organisation in 1992, Aurolab is dedicated to the eradication of needless blindness worldwide. It supplies high-quality ophthalmic products at affordable prices to the vision impaired. IOLs are artificial lenses which are implanted in the eye during a cataract operation after the cloudy lens has been removed.

It emerged out of the realisation in the early 1990 that conventional surgeries and techniques were exorbitant and prevented the poor sight-impaired (primarily in the developing world) from receiving IOLs. In order to provide and ensure availability of IOL surgery to all sections of society, with support from other non-profit organisations Aurolab pioneered the launch of an IOL manufacturing facility in India.

The business model is simple. Aurolab sells lenses for $4 to $6 that are priced at over $100 in the US. This helps countless patients who otherwise could never afford such treatment to preserve their sight and ability to work. It is a different economic paradigm for making medical products and services affordable to the poor in developing countries. *Compassionate capitalism* utilises production capacity and surplus revenue to serve all economic strata, rich and poor alike. In Aurolab's paradigm, profit is the means to an end, not the other way around. Aurolab fulfilled the same regulatory requirements medical companies must fulfil for selling products in Europe. Aurolab is now one of the largest manufacturers of IOLs in the world, with 10 per cent of world market share. Following the success of these eye-care models Green turned his attention to developing similar solutions for the hearing impaired. The Business Plan (Appendix) was inspired by Aurolab.

Non-profit organisations may earn income from a range of activities, including providing healthcare and educational programs, operating retail stores, performing plays and concerts and offering training workshops and consulting services. The percentage of total income that a non-profit generates from these activities is closely tied to the field of service in which it operates. According to data from tax returns filed by non-profit organisations, healthcare non-profits may receive 85 per cent of their income from fees for services, while environmental, animal and international service organisations are likely to receive less than 25 per cent from earned income.

SUMMARY

The chapter started with one of the most common pathways to self-employment known as bootstrapping, sometimes defined as starting a new business without financing. We also looked at the exciting new area of minipreneurship which has been made possible by advances in technology and online communication. Also included was a discussion on business development assistance.

The chapter then went on to describe ways to design a unique product or service. Sometimes this involves what is called a *new-new approach* – that is, the development of an entirely new idea for a product or service (as was the case with MySpace and Google). In most instances, however, the prospective owner/manager must be content to use a *new-old approach* by piggybacking on someone else's ideas. This involves either expanding on what the competition is doing or offering a product or service in an area in which it is not presently available.

On the financial side, the prospective owner/manager needs to examine the enterprise's financial picture and determine the costs of setting up the operation and the amount of revenue that will be generated during the initial period. The prospective owner/manager must review a series of other operational considerations ranging from the building, merchandise and equipment needed for operations to record keeping, insurance, legal, marketing and personal matters.

Another opportunity is the purchase of an existing successful firm, which has a number of advantages. Three of the most important are that its successful future operation is likely, the time and effort associated with starting a new enterprise are eliminated and a bargain price may be possible.

Before deciding whether to buy, however, the prospective owner needs to ask and answer a series of right questions. These include: Why is the business being sold? What is the physical condition of the business? What is the condition of the inventory? What is the state of the company's other assets? How many of the employees will remain? What competition does the business face? What is the firm's financial picture?

After all questions have been answered satisfactorily, the prospective buyer must negotiate for the business. In the final analysis, however, the prospective owner should be concerned with buying the company's assets at market value then paying something for goodwill if it is deemed an asset.

The chapter then moved to franchising. A franchise can be a number of common legal structures and is often associated with entrepreneurs who wish to launch their careers to self-employment. We discussed the advantages and disadvantages as well as the legal aspects.

Finally, we examined the very interesting area of social venturing. Social ventures use similar planning tools to regular business ventures, but at each step there are different considerations and nuances. We looked at the models of social venturing and discussed the steps that a social entrepreneur would go through to create a social venture.

KEY TERMS & CONCEPTS

Anglo or Western model
barter and Bartercard
bootstrapping
business assets
business broker
business environment
company profitability
consignment
double bottom line
franchise
franchise fee
franchisee
franchisor
goodwill
legal restraint of trade
Long Tail
Loss Attributing Qualifying Company (LAQC)
new venture creation
new-new approach
new-old approach
non-compete clause
pain and painkiller
PITA products
profit trend
profits, sales and operating ratios
risk vs. reward
social enterprise
social venturing
unscrupulous practices
upside gain and downside loss

REVIEW & DISCUSSION QUESTIONS

1. Identify the five main pathways to entering business for a prospective entrepreneur.
2. What are some examples of bootstrapping that you could use in your business idea?
3. What is a loss-acquiring company and does this type of business exist in your country?
4. Who are minipreneurs and what kinds of businesses are they engaged in?
5. What is the new-new approach to starting a new venture? How does this approach differ from a new-old approach?
6. How can an individual who is thinking of going into business evaluate the financial picture of the enterprise? Use the methodology of Table 6.3 to prepare your answer.
7. In addition to personal and financial issues, what other factors should the prospective owner be concerned with? Describe at least four.
8. What are the advantages of buying an ongoing business? Explain them.
9. What *right questions* need to be answered when deciding whether to buy a business?
10. How should a prospective buyer examine the assets of a company? Explain.
11. What is meant by the term 'franchise'?
12. In a franchising agreement, what is the franchisee often called on to do? What responsibility does the franchisor assume?
13. What are some of the major advantages of franchising? Cite and explain three.
14. What are some of the major disadvantages of franchising? Cite and explain at least two.
15. How can a prospective franchisee evaluate a franchise opportunity? Explain.
16. In evaluating whether or not to buy a franchise operation, the potential investor should ask a series of questions. What questions should the potential investor ask about the franchisor, the franchise, the market and the potential investor (himself or herself)?
17. What are the advantages and disadvantages of franchising?

18 How is a social venture different from a conventional business?
19 Is the social enterprise development cycle different from that of a regular business?
20 What are the three social enterprise models?
21 If you have an older sibling, what does that mean about the chances that you will become an entrepreneur?

EXPERIENTIAL EXERCISE: DO YOU HAVE WHAT IT TAKES TO GET ON THE PATHWAY?

Studies of successful entrepreneurs reveal common characteristics – family backgrounds, experiences, motivations, personality traits, behaviours, values and beliefs. How do you fit these patterns? What is your E.Q. (Entrepreneurial Quotient)? A US insurance company, Northwestern Mutual Life, created the following test to predict how suited you are to entrepreneurship.[23] This test cannot predict your success – it can only give you an idea whether you will have a head start or a handicap with which to work. Entrepreneurial skills can be learned. The test is intended to help you see how you compare with others who have been successful entrepreneurs.

Add or subtract your score as you evaluate yourself:

------ Significantly high numbers of entrepreneurs are children of first-generation Americans. If your parents immigrated to the US, score one. If not, score minus one.
------ Successful entrepreneurs are not, as a rule, top achievers in school. If you were a top student, subtract four. If not, add four.
------ Entrepreneurs are not especially enthusiastic about participating in group activities in school. If you enjoyed group activities – clubs, team sports, double dates – subtract one. If not, add one.
------ Studies of entrepreneurs show that, as youngsters, they often preferred to be alone. Did you prefer to be alone as a youngster? If so, add one. If not, subtract one.
------ Those who started enterprises during childhood – lemonade stands, family newspapers, greeting card sales – or ran for elected office at school can add two, because enterprise usually can be traced to an early age. If you didn't initiate enterprises, subtract two.
------ Stubbornness as a child seems to translate into determination to do things one's own way – a hallmark of proven entrepreneurs. If you were stubborn as a child, add one. If not, subtract one.
------ Caution may involve an unwillingness to take risks, a handicap for those embarking on previously uncharted territory. Were you a cautious youngster? If yes, deduct four. If no, add four.
------ If you were daring or adventuresome, add four more.
------ Entrepreneurs often have the faith to pursue different paths despite the opinions of others. If the opinions of others matter a lot to you, subtract one. If not, add one.
------ Being tired of a daily routine often precipitates an entrepreneur's decision to start an enterprise. If changing your daily routine would be an important motivation for starting your own enterprise, add two. If not, subtract two.
------ Yes, you really enjoy work. But are you willing to work overnight? If yes, add two. If no, subtract two.
------ If you are willing to work as long as it takes with little or no sleep to finish a job, add four more.
------ Entrepreneurs generally enjoy their type of work so much they move from one project to another – non-stop. When you complete a project successfully, do you immediately start another? If yes, add two. If no, subtract two.
------ Successful entrepreneurs are willing to use their savings to finance a project. If you are willing to commit your savings to start a business, add two. If not, subtract two.
------ Would you be willing to borrow from others? Then add two more. If not, subtract two.
------ If your business should fail, would you immediately start working on another? If yes, add four. If no, subtract four.
------ Or, if you would immediately start looking for a job with a regular pay cheque, subtract one more.
------ Do you believe being an entrepreneur is risky? If yes, subtract two. If no, add two.
------ Many entrepreneurs put their long-term and short-term goals in writing. If you do, add one. If you don't, subtract one.
------ Handling cash flow can be critical to entrepreneurial success. Do you believe you have the ability to deal with cash flow in a professional manner? If so, add two. If not, subtract two.

______ Entrepreneurial personalities seems to be easily bored. If you are easily bored, add two. If not, subtract two.

______ Optimism can fuel the drive to press for success in uncharted waters. If you're an optimist, add two. Pessimist, subtract two.

WHAT'S YOUR E.Q. (ENTREPRENEURIAL QUOTIENT)?

If you scored +35 or more, you have everything going for you. You ought to achieve spectacular entrepreneurial success (barring acts of nature or other variables beyond your control).

If you scored +15 to +34, your background, skills and talents give you excellent chances for success in your own business. You should go far.

If you scored 0 to +15, you have a head start of ability and/or experience in running a business and ought to be successful in opening an enterprise of your own if you apply yourself and learn the necessary skills to make it happen.

If you scores 0 to −15, you might be able to make a go of it if you ventured on your own, but you would have to work extra hard to compensate for a lack of built-in advantages and skills that give others a leg up in beginning their own business.

If you scored −15 to −43, your talents probably lie elsewhere. You ought to consider whether building your own business is what you really want to do, because you may find yourself swimming against the tide if you make the attempt. Another work arrangement – working for a company or for someone else, or developing a career in a profession or an area of technical expertise – may be far more congenial to you and allow you to enjoy a lifestyle appropriate to your abilities and interests.

EXPERIENTIAL EXERCISE: THE PERSONAL ENTREPRENEURIAL ACTION PLAN

Before making the final decision about going into business, a prospective entrepreneur needs to ask a number of personal questions. Ten of the most important ones are listed here. As you read, mark the response that best describes you.

1 Are you a self-starter?

- ☐ I can get going without help from others.
- ☐ Once someone gets me going, I am just fine.
- ☐ I take things easy and do not move until I have to.

2 How do you feel about others?

- ☐ I can get along with just about anyone.
- ☐ I do not need anyone else.
- ☐ People irritate me.

3 Can you lead people?

- ☐ I can get most people to go along with me once I start something.
- ☐ I can give the orders if someone tells me what should be done.
- ☐ I let someone else get things done and go along if I like it.

4 Can you take responsibility?

- ☐ I take charge and see things through.
- ☐ I'll take over if necessary but would rather let someone else be responsible.
- ☐ If someone is around who wants to do it, I let him or her.

5 Are you an organiser?

- ☐ I like to have a plan before I begin.
- ☐ I do all right unless things get too confusing, in which case I quit.
- ☐ Whenever I have things all set up, something always comes along to disrupt the plan, so I take things as they come.

6 Are you a hard worker?

- ☐ I can keep going as long as necessary.
- ☐ I work hard for a while, but then that's it.
- ☐ I cannot see that hard work gets you anywhere.

7 Can you make decisions?

- ☐ I can make decisions, and they usually turn out pretty well.
- ☐ I can make decisions if I have plenty of time, but fast decision making upsets me.
- ☐ I do not like to be the one who has to decide things.

8 Can people rely on your word?

- ☐ Yes, I do not say things I do not mean.
- ☐ I try to level with people, but sometimes I say what is easiest.
- ☐ Why bother? The other person does not know the difference.

9 Can you stick with it?

- ☐ When I make up my mind to do something, nothing stops me.
- ☐ I usually finish what I start.
- ☐ I If things start to go awry, I usually quit.

10 How good is your health?

- ☐ Excellent.
- ☐ Pretty good.
- ☐ Okay, but it has been better.

Now count the number of checks you have made next to the first responses and multiply this number by 3. Count the checks next to the second responses and multiply by 2. Count the number of times you checked the third answer. Total these three numbers. Of a possible 30 total points, a potentially successful entrepreneur should have at least 25 points. If not, the prospective entrepreneur should consider bringing in a partner or abandoning the idea of going into business alone. The potential entrepreneur should always keep in mind these personal factors while formulating the action plan.

CASE 6.1: AN IDEA FOR THE BIRDS!

Thanaphol Virasa is a salesperson for a large Thai firm. He has a bachelor's degree in marketing and is one of the firm's best salespeople. It is likely that Thanaphol will one day become a sales manager if he stays with the firm. However, he secretly hopes to start his own business.

Since he was hired seven years ago, Thanaphol has managed to build a nest egg of 5 million Thai bhat (about $170 000 Australian dollars). He now is looking for a business that would require no more than $2 million Thai bhat to get started. The rest would be used for operating capital and to keep him going until the company turns profitable. In the past, Thanaphol has gathered ideas by reading magazines that report new types of businesses.

Last week, Thanaphol read a story that intrigued him. A man on the Malaysian border has been building 'bird houses' so that anyone can get into the lucrative Chinese Bird's Nest business. Bird's Nest is centuries-old Chinese medication 'yan wo (燕窝)' or 'swiftlet's nest' (yan = swiftlet, wo = nest). Swiftlets weave their nests from long, gooey saliva strands that come from glands under their tongues. The birds coil the threads of saliva into nests shaped like half a teacup. They attach them high off the ground against the walls of caves, abandoned apartments and now even small custom-built concrete bird's nest factories that can be run by a peasant. Although the benefits of edible bird's nest are still scientifically disputed, Bird's Nest has been used for thousands of years in traditional Chinese medicine and cooking. Bird's Nest is one of the most valued commodities on the market today, typically costing about $AUD4000 per kilogram. Currently these Bird's Nest 'factories' sell for 300 000 Thai bhat each.

Thanaphol knows that few people can afford to pay this much for a bird house. He believes a market may exist for cheaper bird houses, in the range of 20 000 Thai bhat each. Thanaphol has done the research and believes it would not be too difficult to differentiate his product from the standard bird house with all the same functionality. The two biggest obstacles will be marketing and production; that is, getting people to order bird houses from him rather than copying the design and building it themselves. Thanaphol believes that, with his background, he can handle the marketing and it should not be too difficult to find someone to handle the construction. Moreover, until the business takes off, he believes he can continue with his sales job.

Questions

1 Is anything unique about Thanapol's idea? Explain.
2 What is the first thing Thanaphol should do to follow up on his idea? Explain.
3 When this is done, what else should Thanaphol do? Outline a general course of action for him.

CASE 6.2: CHECKING IT OUT

When Arlene Ryan inherited $150 000 from her grandfather, she decided to use the money to start her own business. Arlene has been a legal secretary for 14 years and feels she knows quite a lot about business. 'Every day I take depositions and type legal memoranda,' she noted to a friend. 'And I've seen lots of businesses fail because they didn't have adequate capital or proper management. Believe me, when you work for a law firm, you see – and learn – plenty'.

Almost six months passed before Arlene decided on a business to pursue. A franchise ad in a business magazine caught her attention; Arlene called and found out that the franchiser was selling fast-food franchises in her area. 'We are in the process of moving into your section of the country,' the spokesperson told her. 'We have 111 franchisees throughout the nation and want to sell 26 in your state'. Arlene went to a meeting that the franchiser held at a local hotel and, along with a large number of other potential investors, listened to the sales pitch. It all sounded very good. The cost of the franchise was $75 000 plus 4 per cent of gross revenues. The franchiser promised assistance with site location and personnel training and encouraged the prospective franchisees to ask questions and investigate the organisation. 'If you don't feel this is a good deal for you, it's not a good deal for us either; good business is a two-way street,' the spokesperson pointed out. 'We are going to be looking very carefully at all franchise applications and you ought to be giving us the same degree of scrutiny.'

Arlene liked what she heard but felt it would be prudent to do some checking on her own. Before leaving the meeting, she asked the spokesperson for the names and addresses of some current franchisees. 'I don't have a list with me,' he said, 'but I can write down some that I know of, and you can get their numbers from the operator'. He then scribbled four names and locations on a piece of paper and handed it to her.

Arlene called information and was able to get telephone numbers for only two of the franchises. The other addresses apparently were wrong. She then placed calls to the two franchisees. The first person said she had owned her franchise for one year and felt it was too early to judge the success of the operation. When she found out Arlene was thinking about buying a franchise, she asked if Arlene would consider buying hers. The price the woman quoted was $5000 less than what the company currently was quoting. The second person told Arlene he simply did not give out information over the phone. He seemed somewhat edgy about talking to her and continually sidestepped Arlene's requests for specific financial information. Finally, he told her, 'Look, if you really want this information, I think you should talk to my lawyer. If he says, 'It's okay to tell you, I will'. He then gave Arlene the lawyer's number. Before she could call the lawyer, Arlene left for lunch. When she returned, one of the partners of her firm was standing beside her desk. 'Hey, Arlene, what are you doing calling this guy?' he asked, holding up the telephone number of the franchisee's lawyer. 'Are you planning to sue someone? That's his specialty, you know'. Arlene smiled. 'As a matter of fact, I am. I'm thinking of suing you guys for back wages.' The lawyer laughed along with her and then walked back into his office.

Questions

1 What is your appraisal of the situation? Does it look good or bad?
2 Would you recommend that Arlene buy the franchise from the woman who has offered to sell? Why or why not?
3 What would you recommend Arlene do now? Be complete in your answer.

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RECOMMENDED CASES FROM HARVARD BUSINESS SCHOOL ONLINE

Zipcar

Publication Date: 1 October 2001
Author(s): Myra M. Hart, Wendy Carter
Product Number: 9-802-085

This case provides a detailed description of the processes and tasks associated with creating a new venture in an emerging industry (subscription car-sharing for urban dwellers). It chronicles the entrepreneur's concept development, industry analysis, market research, identity definition and brand building, and also provides background on writing the business plan, creating a budget and building financials, developing a management team, creating business partnerships and financing the businesses. It raises several issues including how to manage the 'chicken and the egg' process of building and testing the concept, getting resources and engaging customers when starting a new venture, and provides examples of bootstrapping and creative fundraising and concludes with the question of how to grow the business strategically.

Threadless: The Business of Community

Publication Date: 30 June 2008
Author(s): Karim R. Lakhani, Zahra Kanji
Product Number: 608707

Threadless.com, the online, Chicago-based, T-shirt company, was not your typical fashion apparel company. The company turned the fashion business on its head by enabling anyone to submit designs for T-shirts and asking its community of more than 500 000 members to help select winning designs. Threadless encouraged community members to actively participate by critiquing submitted designs, blogging about their daily lives, posting songs and videos inspired by the designs, and, most importantly, purchasing T-shirts that won the weekly design competitions. In 2007 Threadless was faced with making a decision about a potentially lucrative offer from a major retailer offering to carry large volumes of select Threadless T-shirts in its retail stores. Should it accept?

Challenges of Launching a Start-Up in China: Dorm99.com

Publication Date: 4 January 2007
Author(s): William C. Kirby, F. Warren McFarlan, Tracy Yuen Manty
Product Number: 9-307-075

After graduating from Harvard Business School, Ken Pao and Bill Li were ready to fully commit to the Internet start-up they had been working on since they first stepped foot on the business school campus. They moved to Beijing, organised their management team, received venture capital investment, developed joint-venture partnerships and set key milestones to create a full-impact product launch for their social networking website catering to the college market. On the day of their launch they faced a setback from China's Ministry of Education and were forced back to square one. This case discusses the pluses and minuses of partnering with China's government ministries, the highs and lows of entrepreneurship, and the numerous opportunities available to entrepreneurship in China today.

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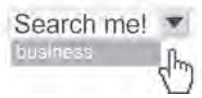

bootstrapping
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goodwill
legal restraint of trade
profitability
social enterprise
social venturing

7

LEGAL AND REGULATORY CHALLENGES FOR ENTREPRENEURIAL VENTURES

Ridwan always wanted to start his own business. So last January the Indonesian quit his job as a nurse, sold his car and took his savings out of the bank. Five months later he is the owner of a health spa in Jakarta. Almost. He still hasn't received an inspection from the municipal authorities, mandatory for the business to operate legally. Nor has he gotten his operational permit. This is not unusual. It takes 151 days to start a business in Jakarta.

World Bank[1]

chapter objectives

• **01**
To introduce the importance of legal and regulatory issues to entrepreneurs

• **02**
To review the regulatory environments of the Asia–Pacific within which a new venture must exist

• **03**
To examine intellectual property protection, including copyright, patents, trademarks and domain names

• **04**
To recognise the important international protection regimes for intellectual property

• **05**
To critically examine the IP practices of Asia–Pacific countries

• **06**
To compare the common legal forms of business organisation in the Asia–Pacific such as sole proprietorship, partnership and corporation

• **07**
To examine the trend for environmental regulations that will affect business entrepreneurship.

This chapter has a broad remit in considering the four types of legal and regulatory challenges that entrepreneurs will face in the Asia–Pacific region. We begin with a look at the various regulatory regimes that make up *ease of doing business*, from starting a firm to closing it down. We then examine one of the most critical aspects for entrepreneurs: how to protect one's intellectual property. Equally important is to then consider under what legal form to incorporate the firm. Finally we look at regulations concerning climate change and global warming, regulations that are becoming increasingly troublesome for entrepreneurs.

UNDERSTANDING ASIA–PACIFIC REGULATORY ENVIRONMENTS

We first look at the fascinating diversity of regulatory environments in our region. Why do some entrepreneurs succeed while others fail in international competition? Perhaps it is better to turn the question around and ask: Why is it that a particular economy becomes the home base for competitive globally oriented entrepreneurs? What makes Australia a global leader in wine exports? What made Malaysia a world leader in palm oil production? How did New Zealand make it to global ranks in the creative industries? What propelled South Korea into the forefront in electronics? Why is it location, location, location? One powerful factor is the regulatory environment.

The regulatory environment in the Asia–Pacific ranges from best-in-the-world (for example, Australia, New Zealand and Singapore) to the dreadful (Indonesia). A business must comply not only with governmental rules and regulations in the country of origin, but also in other countries. Unfortunately costs and profits can be affected as much by a government directive as by a management decision. Fundamental entrepreneurial decisions – such as which lines of business to go into, which products and services to produce, which investments to finance, how and where to make goods and how to market, what prices to charge and **environmental protection** – are increasingly subject to governmental control.[2]

The entrepreneur needs to know legal frameworks in such areas as dispute settlement and arbitration, customs and tariffs, standards setting, R&D and innovation policy, anti-trust legislation, personnel and human resources, finance and taxation, securities and banking, trade and securities commissions, food and drug regulations, consumer products and protection regimes, transportation and communications, defence and security, occupational health and safety, environmental protection, energy regulation, export–import transactions and foreign relations and defence – the list boggles the mind.

Overall, some countries in our region are leaders in the global 'ease of doing business' sweepstakes. According to the World Bank,[3] Singapore and New Zealand top this list followed by the US, Hong Kong and Australia. Thailand comes in 12th and Japan ranks 15th. Indonesia is 122nd (see Table 7.1).

Of course, being at the top of this list does not mean there is no regulation. No one would argue that it is a free-for-all in New Zealand, that workers are abused in Australia, or that there is no fair bankruptcy process in Japan. Indeed, to make the top 20 list in terms of ease of doing business, countries need to put strong regulations in place, such as property rights protection and labour provisions. The problem is that some countries in our region make it excessively difficult for entrepreneurs to operate. Ironically, the countries with the biggest obstacles for entrepreneurs are the ones that most need them for creating jobs and wealth.

Let's have a look at some regulatory areas for entrepreneurs, particularly those that are globally focused – all with an Asia–Pacific focus in 2010. These figures churn each year, so don't be surprised if one or another country dramatically improves. Global attention is having its effect!

Even within countries there can be great variation. Have a look at the World Bank's map of doing business in China (see Figure 7.1). The coastal cities have the friendliest environments. Guangzhou is ranked best overall, followed by Nanjing, Shanghai, Hangzhou, Jiman, Guzhou,

TABLE 7.1: EASE OF DOING BUSINESS, 2009

ECONOMY	EASE OF DOING BUSINESS	ECONOMY	EASE OF DOING BUSINESS
Singapore	1	Samoa	57
New Zealand	2	Pakistan	85
Hong Kong	3	China	89
United States	4	Vietnam	93
Australia	9	Brunei	96
Thailand	12	Papua New Guinea	102
Japan	15	Sri Lanka	105
Korea	19	Indonesia	122
Malaysia	23	India	133
Taiwan	46	Philippines	144

Source: World Bank and International Monetary Fund, *Doing Business in 2010*, Oxford University Press, 2010: 2, available from www.doingbusiness.org/EconomyRankings, accessed 9 September 2009

FIGURE 7.1: DOING BUSINESS IN CHINA: WHERE IT'S EASY, WHERE IT'S NOT

Source: World Bank and International Finance Corporation, *Doing Business in China 2008, Part I*, Social Sciences Academy Press and World Bank: 3, www.doingbusiness.org/subnational/exploreeconomies/china.aspx

Tianjin and Beijing. The cities with most challenging environments tend to be those in western and central China.

Starting a business

Starting a business should be easy. Australia and New Zealand are the best in the world in the ease of **business formation** and have only one or two required procedures (notification of existence and registration for tax and social security) to start a business. In Australia you can be up and running in two days; in New Zealand just one day (see Table 7.2).

Compare this to the Sultanate of Brunei, where it takes on average 116 days. The cost of starting a business (measured in percentage of per capita income) is very low in New Zealand and Singapore, but in India it takes 66 per cent of a year's average annual salary. The minimum capital requirements to start a business (usually a frozen account) are 0 per cent in Australia, New Zealand, Singapore, Sri Lanka and Hong Kong, but 210 per cent of yearly income in India.

TABLE 7.2: STARTING A BUSINESS IN THE ASIA–PACIFIC – BEST AND WORST

ECONOMY	PROCEDURES (NUMBER)	TIME (DAYS)	COST (% OF INCOME PER CAPITA)	MIN. CAPITAL (% OF INCOME PER CAPITA)
New Zealand	1	1	0.4	0
Australia	2	2	0.8	0
Singapore	3	3	0.7	0
Hong Kong	3	6	1.8	0
Sri Lanka	4	38	5.9	0
Vietnam	11	50	13.3	0
India	13	30	66.1	210.9
China	14	37	4.9	130.9
Philippines	15	52	28.2	5.5
Brunei	18	116	9.8	0

Source: World Bank and International Monetary Fund, *Doing Business in 2010*

Licensing and permits

Entrepreneurs often face a myriad of sector-specific licences as well as inspections to enforce compliance. The World Bank index looks at licences in the construction industry (all procedures required for a business in the construction industry to build a standardised warehouse). New Zealand comes out as the least procedural economy, but other countries in the Asia–Pacific are very regulated in terms of licences (see Table 7.3). In China it takes 336 days and costs almost six times the average annual income to get these licenses. In India, it took an astounding 24 years per capita income to license a warehouse!

TABLE 7.3: LICENSING AND PERMITS IN THE ASIA–PACIFIC, BEST AND WORST

ECONOMY	PROCEDURES (NUMBER)	TIME (DAYS)	COST (% OF INCOME PER CAPITA)
Hong Kong	7	67	18.7
New Zealand	7	65	37.3
Singapore	11	25	19.9
Thailand	11	156	12.1
Pakistan	12	223	716.3
Malaysia	25	261	7.1
Taiwan	28	142	96.2
Brunei	32	163	4.9
China	37	336	579.2
India	37	195	2394.9

Source: World Bank and International Monetary Fund, *Doing Business in 2010*

Labour regulations

Employment or **labour regulations** protect workers from discriminatory and unfair practices by their employers. The best way to encourage job creation is through policies such as flexible working hours and term contracts, ease of contracting workers and ease of hiring and firing (see Table 7.4). Singapore and Hong Kong are the leaders here. But Indonesia, Pakistan and Taiwan have put numerous obstacles in place regarding the ease of hiring and firing. One of the most startling observations is how much it costs to fire a person in terms of weeks of severance pay. In the US there is no such protection; that is, required severance pay is actually zero. Singapore and Australia have modest rates of four weeks. In Korea, severance pay provisions are 91 weeks. But imagine the Sri Lankan entrepreneur that has to pay 217 weeks salary to get rid of someone!

TABLE 7.4: LABOUR REGULATIONS IN THE ASIA–PACIFIC, BEST AND WORST

ECONOMY	DIFFICULTY OF HIRING INDEX	RIGIDITY OF HOURS INDEX	DIFFICULTY OF REDUNDANCY INDEX	RIGIDITY OF EMPLOYMENT INDEX	FIRING COSTS (WEEKS OF WAGES)
Hong Kong	0	0	0	0	10
Singapore	0	0	0	0	4
Australia	0	0	0	0	4
United States	0	0	0	0	0
Sri Lanka	0	0	60	20	217
Korea	44	40	30	38	91
Philippines	56	0	30	29	91
Indonesia	61	0	60	40	108
Pakistan	78	20	30	43	90
Taiwan	78	20	40	46	91

Source: World Bank and International Monetary Fund, *Doing Business in 2010*

Property laws

Since land and buildings make up a sizable proportion of a business's productive capacity, entrepreneurs thrive in countries where **property laws** are predictable. Many Asia–Pacific countries are leaders in this regard. New Zealand has the greatest ease of registering property. The buyer checks the legal status of the property with the local authority and then pays a conveyancer a standard fee of 0.1 per cent of the property value to register the transfer online (see Table 7.5). Registration is complete in two days. Thailand has a world-class system where all contracts are prepared in the land office as part of registration. In Singapore the buyer conducts all due diligence and pays taxes online.

TABLE 7.5: PROPERTY LAWS IN THE ASIA–PACIFIC, BEST AND WORST

ECONOMY	PROCEDURES (NUMBER)	TIME (DAYS)	COST (% OF PROPERTY VALUE)
New Zealand	2	2	0.1
Thailand	2	2	1.1
Singapore	3	5	2.8
Taiwan	3	5	6.2
United States	4	12	0.5
Indonesia	6	22	10.7
Pakistan	6	50	7.2
Korea	7	11	5.1
Sri Lanka	8	83	5.1
Philippines	8	33	4.3

Source: World Bank and International Monetary Fund, *Doing Business in 2010*

Getting credit

Getting credit is one of an entrepreneur's greatest obstacles. Small businesses, especially women-owned firms, typically face high hurdles in securing credit. A good credit information regime benefits both the creditor and the debtor. Singapore, Malaysia and Hong Kong have a very efficient and transparent legal rights index. In Australia and New Zealand, private credit bureaus cover 100 per cent of adults (see Table 7.6). Such countries as Indonesia, Philippines, Thailand and Taiwan are ranked poorly in this dimension.

TABLE 7.6: GETTING CREDIT IN THE ASIA–PACIFIC, BEST AND WORST

ECONOMY	LEGAL RIGHTS INDEX	CREDIT INFORMATION INDEX	PUBLIC REGISTRY COVERAGE (% ADULTS)	PRIVATE BUREAU COVERAGE (% ADULTS)
Singapore	10	4	0	40.3
Hong Kong	10	4	0	71.9
Malaysia	10	6	48.5	82
New Zealand	9	5	0	100
Australia	9	5	0	100
Thailand	4	5	0	32.9
Taiwan	4	5	0	63.2
Sri Lanka	4	5	0	14.3
Indonesia	3	4	22	0
Philippines	3	3	0	6.1

Source: World Bank and International Monetary Fund, *Doing Business in 2010*

Investor protection

Looting by corporate insiders happens all the time and often goes undetected. **Investor protection** against self-dealing – the use of corporate assets for personal gain – is necessary for equity markets to develop. Entrepreneurs require regulatory regimes that provide incentives for investors to provide finance without the need to exercise daily control of the business. They need laws that prevent expropriation and expose it when it does. In the **disclosure index**, the best in the world are Thailand, China, New Zealand and Singapore (see Table 7.7). But China falls way down in terms of the liability for self-dealing (director liability index). Vietnam is the most difficult country for shareholders to sue officers and directors for misconduct and it comes out poorly in the overall average investor protection index.

TABLE 7.7: INVESTOR PROTECTION IN THE ASIA–PACIFIC, BEST AND WORST

ECONOMY	DISCLOSURE INDEX	DIRECTOR LIABILITY INDEX	SHAREHOLDER SUITS INDEX	INVESTOR PROTECTION INDEX
Thailand	10	7	6	7.7
China	10	1	4	5
New Zealand	10	9	10	9.7
Singapore	10	9	9	9.3
Hong Kong	10	8	9	9
Pakistan	6	6	7	6.3
Vietnam	6	0	2	2.7
Sri Lanka	4	5	7	5.3
Brunei	3	2	8	4.3
Philippines	2	2	8	4

Source: World Bank and International Monetary Fund, *Doing Business in 2010*

Paying taxes

Taxes are a necessary fact of life. Business thrives in a system of simple, moderate taxes and fast, cheap administration. Even such advanced entrepreneurial countries as New Zealand fall behind Hong Kong and Singapore in total number of taxes that must be paid (see Table 7.8). New Zealand has the easiest regime in terms of the time it takes to prepare, file and pay (or withhold) the corporate income tax, the value added tax and social security contributions (in hours per year). In perhaps the most controversial dimension, Hong Kong, Singapore and Pakistan are best in terms of total amount of all taxes payable by the business, as a percentage of gross profit.

TABLE 7.8: PAYING TAXES IN THE ASIA–PACIFIC, BEST AND WORST

ECONOMY	PAYMENTS (NUMBER)	TIME (HOURS)	TOTAL TAX RATE (% PROFIT)
Hong Kong	4	80	24.2
Singapore	5	84	27.8
China	7	504	78.5
New Zealand	8	70	32.8
United States	10	187	46.3
Pakistan	47	560	31.6
Philippines	47	195	49.4
Indonesia	51	266	37.6
India	59	271	64.7
Sri Lanka	62	256	63.7

Source: World Bank and International Monetary Fund, *Doing Business in 2010*

International trading

Best practice from around the world shows that entrepreneurs who have the fewest required documents and signatures export and import more. They also make it cheaper for exporters to operate. Red tape cuts profits from trade. Inefficient customs and trade transport mean that businesses must hold larger inventories at their warehouse. Furthermore, filing more documents is associated with more corruption in customs. The World Bank measured international trading regulations (the number of every official procedure) – from the contractual agreement between the two parties to the delivery of goods – along with the time necessary for completion (see Table 7.9). Hong Kong and Singaporean entrepreneurs clearly have the advantage here as they lead in almost all categories. Surprisingly, it takes 20 days on average to import a container into India, according to the World Bank.

TABLE 7.9: INTERNATIONAL TRADING IN THE ASIA–PACIFIC, BEST AND WORST

ECONOMY	DOCUMENTS FOR EXPORT (NUMBER)	TIME FOR EXPORT (DAYS)	COST TO EXPORT (US$ PER CONTAINER)	DOCUMENTS FOR IMPORT (NUMBER)	TIME FOR IMPORT (DAYS)	COST TO IMPORT (US$ PER CONTAINER)
Korea	3	8	742	3	8	742
Hong Kong	4	6	625	4	5	583
Singapore	4	5	456	4	3	439
United States	4	6	1050	5	5	1315
Japan	4	10	989	5	11	1047
Taiwan	7	13	720	7	12	732
Philippines	8	16	816	8	16	819
India	8	17	945	9	20	960
Sri Lanka	8	21	715	6	20	745
Pakistan	9	22	611	8	18	680

Source: World Bank and International Monetary Fund, *Doing Business in 2010*

Enforcing contracts

Entrepreneurs rely on being able to enforce a contract with their customers. If there is no system for enforcing contracts, then trade and credit may be limited to family or a small community of people. Even where the courts enforce contracts, they may be slow, inefficient and even corrupt. Here we are looking at the number of procedures, the time it takes, and the associated cost involved that must be paid to the court, receivers, lawyers, etc. (see Table 7.10). Entrepreneurs in Singapore, Hong Kong and Australia are clearly at an advantage in enforcing contracts. But imagine the unfortunate entrepreneur in Indonesia who is trying to enforce a contract. It may cost as much as 123 per cent of the actual debt to make the collection!

TABLE 7.10: ENFORCING CONTRACTS IN THE ASIA–PACIFIC, BEST AND WORST

ECONOMY	PROCEDURES (NUMBER)	TIME (DAYS)	COST (% OF DEBT)
Singapore	21	150	25.8
Hong Kong	24	280	19.5
Australia	28	395	20.7
Malaysia	30	585	27.5
New Zealand	30	216	22.4
Indonesia	39	570	122.7
India	46	1420	39.6
Pakistan	47	976	23.8
Taiwan	47	510	17.7
Brunei	58	540	36.6

Source: World Bank and International Monetary Fund, *Doing Business in 2010*

Closing a business

The World Bank also examines the time, cost and outcomes of bankruptcy proceedings against a limited liability company. In their hypothetical case, the business has too many creditors to negotiate an informal out-of-court settlement. In Vietnam, Indonesia and the Philippines it can take more than five years to wind a business down. In the Philippines, it can cost 38 per cent of the estate to do so. While an entrepreneur could expect to recover more than 90 per cent in Japan or Singapore, the luckless Filipino entrepreneur could count on only four per cent!

TABLE 7.11: CLOSING A BUSINESS IN THE ASIA–PACIFIC, BEST AND WORST

ECONOMY	TIME (YEARS)	COST (% OF ESTATE)	RECOVERY RATE (CENTS ON THE DOLLAR)
Japan	0.6	4	92.5
Singapore	0.8	1	91.3
Australia	1	8	78.8
Hong Kong	1.1	9	79.8
New Zealand	1.3	4	76.2
Thailand	2.7	36	42.4
Pakistan	2.8	4	39.2
Vietnam	5	15	18
Indonesia	5.5	18	13.7
Philippines	5.7	38	4.4

Source: World Bank and International Monetary Fund, *Doing Business in 2010*

ENTREPRENEURS FACE REGULATORY NIGHTMARES

>>ENTREPRENEURIAL EDGE

CHICKENS IN CHINA

Since he went into business with 1000 chickens and 50 pigs in the 1980s, outspoken Chinese rural entrepreneur Sun Dawu has been battling red tape and official interference that are legacies of decades of communist economics. Mr Sun's toughest trial came in 2003 when he was detained for six months on charges of illegally accepting financial deposits in a case that highlighted the funding problems of rural enterprises.

He says his company repeatedly tried to raise loans for expansion from local state credit cooperatives, only to be rejected because it 'lacked scale, lacked approval and lacked (a place in lending) quotas'. Eventually, the group began to raise funds openly by accepting deposits from employees and local residents. Banks and cooperatives – many technically insolvent – rarely channel funds to productive enterprises and much of the vital capital flows to richer urban areas, he argues. Sun sees a systemic problem in an insistence by authorities on official control that is intended to shield local savers from the risk of putting their cash in private hands – even when they know best who is most transparent and trustworthy. Mr Sun is now searching for other ways to raise funds for his company, which lost 600 of its 1300 employees during his detention. And as he tours the school he built partly with money raised from local deposits, he reveals an ambition to build a university.

CAMELS IN NEW ZEALAND

New Zealander John Magill has been frustrated by red tape after returning home to New Zealand with plans to run a camel trekking business – a business he had been operating successfully in Melbourne for years. He was told camels qualified as 'new organisms' under the *Hazardous Substances and New Organisms Act* and to import them he would have to go through a lengthy process of Environmental Risk Management Authority hearings. After spending three years and $7000 trying to bring in his three camels – Kelly, Laura and Jenna – he had to give up and sell them. Environment Minister Marian Hobbs said camels qualified as new organisms as did other exotic animals that were only in zoos or not present in New Zealand.

Sources: Mure Dickie, 'There's Hope for China, Says Freed Entrepreneur: Sun Dawu Tells Mure Dickie about His Battles with Officialdom and Struggle to Find Finance for His Farm Business', *Financial Times,* London, 14 November 2003; Peter Marsh, 'Red Tape Means Hatful of Problems for Entrepreneur', *Financial Times,* London, 21 June 2004; Jonathan Milne, 'Camels Sent Packing', *The Dominion Post,* Wellington, 18 September 2002

Political instability and corruption

Political instability and corruption can be practical barriers for entrepreneurs. Frequent government changes can lead to business policy reversals that undercut an entrepreneur's marketplace certainty and hinder the efficient functioning of business plans. It may still be possible to do business in a country with transitory governments or inconsistent policies (see Table 4.2, 'Asia Pacific Corruption Perceptions Index 2008').

INTERNATIONAL PROTECTIONS FOR INTELLECTUAL PROPERTY

Now we move from Asia–Pacific regulation to the legal frameworks within which entrepreneurs operate. This section is a bit of good news/bad news. First, we need to know how new products, services and innovations can be protected and exploited for commercial gain. That's called **intellectual property rights**.

The continuing growth of IPR theft and trade in fakes and pirated materials threatens innovative and creative economies worldwide. Consider these facts:

- The World Health Organization estimates that 25 per cent of medicines sold in developing countries are counterfeit.

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- Business Software Alliance's estimates that 35 per cent of the software on computers throughout the world is pirated.
- The International Chamber of Commerce believes that worldwide sales of counterfeit goods is $650 billion a year.[4]

Even in comparatively incorrupt New Zealand and Japan about a quarter of business software is pirated. Singapore and South Korea have admirably low rates of record and music piracy.

TABLE 7.12: ASIA–PACIFIC LEVELS OF COPYRIGHT PIRACY, BEST AND WORST

	BUSINESS SOFTWARE	RECORDS & MUSIC
Bangladesh	92%	70%
Vietnam	85%	95%
Pakistan	84%	100%
Indonesia	84%	91%
China	82%	85%
South Korea	43%	7%
Taiwan	40%	28%
Singapore	37%	5%
Japan	23%	NA
New Zealand	22%	NA

Source: United States Trade Representative, USTR 2008 'Special 301' Decisions

>>ENTREPRENEURSHIP IN PRACTICE

NOTORIOUS ASIAN MARKETS

Global piracy and counterfeiting continue to thrive, due in part to large marketplaces that deal in counterfeit goods. Here are some of the biggest violators:

- Baidu (China): The largest China-based MP3 search engine offering deep links to copyright-protected music files for unauthorised downloads or streaming – www.baidu.com/.
- Business-to-business (B2B) and business-to-consumer (B2C) websites (China): A large number of these Chinese websites, such as Alibaba and Taobao, have been cited by industry as offering infringing products to consumers and businesses – www.alibaba.com, www.taobao.com.
- Quiapo (Manila, Philippines): Street stalls in this neighborhood are notorious for selling counterfeit and pirated merchandise. Other notorious markets in Manila include Binondo, Greenhills, Makati Cinema Square and Metrowalk.
- Harco Glodok (Jakarta, Indonesia): This is reported to be one of the largest markets for counterfeit and pirated goods in Indonesia, particularly well known for pirated optical discs. Enforcement officials are reportedly reluctant to conduct regular enforcement actions because of the presence of organised criminal gangs.
- Panthip Plaza, Mah Boon Krong (MBK) Center, Klong Thom, Patpong and Sukhumvit Road (Bangkok, Thailand): These locations are notorious for openly selling pirated and counterfeit goods.
- Silk Street Market (Beijing, China): Beijing's Silk Street Market is 'perhaps the single biggest symbol of China's IP enforcement problems. Sixty-five per cent of outlets carry counterfeit goods.

Source: Office of the United States Trade Representative, *2008 Special 301 Report*

Ideas and knowledge are an important part of global trade. Some would say that in the modern era, intellectual property is the engine that drives the economy. A lot of the value of entrepreneurial products lies in the invention, innovation, research, design and commercialisation of new products – most often abroad. So it is vital that entrepreneurs have the incentive to create – and intellectual property rights are central to it because a rising proportion of economic output is conceptual rather than physical.

Intellectual property protection is actually a two-way street. Entrepreneurs can legally obtain and exploit intellectual property from abroad. Or they can protect it abroad, stop others from using it and use these rights to negotiate payment in return for using it. The countries of the Asia–Pacific are actually net importers of intellectual property. That means that many of the creators and inventors of intellectual property consumed in the Asia–Pacific are actually located overseas. It also means that Asia–Pacific entrepreneurs will just as frequently take advantage of licensing intellectual property from abroad as they will protecting it.

Of course, most entrepreneurs are not lawyers, so they need to be knowledgeable about intellectual property protection. The term intellectual property (IP) is used to describe the intellectual assets that have been given some form of legal protection in order to prevent unauthorised use by others. These rights fall under the umbrella of intellectual property rights (IPR) and they include **patents**, **trade secrets and copyright**, as well as **trademarks** or service marks.

Intellectual property protection has advanced considerably in the past 10 years. A great deal of the action is now taking place outside the US (see Table 7.13). The field of IP protection is huge, but globally operating entrepreneurs need to know at least about these five institutions:

- The World Trade Organization (WTO) is a place where member governments sort out the trade problems and negotiate compliance with WTO agreements signed by the bulk of the world's trading nations.
- The WTO's agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPs) is especially important. It is an international agreement covering copyright, patents, trademarks, trade secrets, industrial designs and integrated circuit layouts. TRIPs is the most important international agreement on copyright, patents and other intellectual property rules in force today.
- The Berne Convention for the Protection of Literary and Artistic Works guarantees that copyrights are respected across national borders. Together with the Paris Convention, it is one of the world's oldest treaties and is respected by most of the countries of the world.
- The World Intellectual Property Organization (WIPO) is an international organisation that administers 23 international treaties dealing with different aspects of intellectual property protection. The organisation counts 182 nations as member states.
- The Patent Cooperation Treaty (PCT) streamlines patent applications across several countries at once.

In 1995, the World Trade Organization (WTO) became the chief administrator of the international trade arena. Currently, 97 per cent of the world's population (especially after China and nine other nations joined between 1999 and 2001) falls under the umbrella of the WTO. The WTO regime rests on what are called the 'Four Pillars' of WTO membership:

- **Most Favoured Nation:** All WTO members receive the benefit of, and are bound to extend, 'most favoured nation' (MFN) status in order to prohibit discriminatory trade practice.
- **National Treatment:** Every WTO country is entitled to 'national treatment' of its goods, services and intellectual property. The importing country must treat imported products like a domestic product.

TABLE 7.13: ASIA–PACIFIC COUNTRIES' PARTICIPATION IN MAJOR IP REGIMES

	WTO	TRIPs	Berne	WIPO	PCT	Responsible authority
Australia	✓	✓	✓	✓	✓	IP Australia: www.ipaustralia.gov.au
Bangladesh	✓	✓	✓	✓		
Brunei Darussalam	✓	✓	✓	✓		
China	✓	✓	✓	✓	✓	State Intellectual Property Office of the People's Republic of China: www.sipo.gov.cn. State Administration for Industry and Commerce Trademark Office: http://sbj.saic.gov.cn
Fiji	✓	✓	✓	✓		Fiji Government Online Portal: www.fiji.gov.fj
Hong Kong	✓	✓				Intellectual Property Department of Hong Kong: www.ipd.gov.hkenghome.htm
India	✓	✓	✓	✓	✓	Intellectual Property India: www.patentoffice.nic.in
Indonesia	✓	✓	✓	✓	✓	Directorate General of Intellectual Property Rights: www.dgip.go.id
Japan	✓	✓	✓	✓	✓	Japan Patent Office (JPO): www.jpo.go.jp
Korea	✓	✓	✓		✓	Korean Intellectual Property Office (KIPO): www.kipo.go.kr
Malaysia	✓	✓	✓	✓	✓	Ministry of Domestic Trade and Consumer Affairs Intellectual Property Division: www.kpdnhep.gov.my
New Zealand	✓	✓	✓	✓	✓	Intellectual Property Office of New Zealand: www.iponz.govt.nz
Pakistan	✓	✓	✓	✓		
Papua New Guinea	✓	✓		✓	✓	Intellectual Property Office of PNG: www.ipa.gov.pg
Philippines	✓	✓	✓	✓	✓	IP Philippines: http://ipophil.gov.ph
Singapore	✓	✓	✓	✓	✓	Intellectual Property Office of Singapore (IPOS): www.ipos.gov.sg
Sri Lanka	✓	✓	✓	✓	✓	National Intellectual Property Office of Sri Lanka: www.nipo.lk
Taiwan	✓	✓				The Chinese Taipei Intellectual Property Office: www.tipo.gov.tweng
Thailand	✓	✓	✓	✓		Department of Intellectual Property of Thailand: www.ipthailand.org
Vietnam	✓	✓	✓	✓	✓	National Office of Industrial Property (NOIP): www.noipvietnam.com

- **Tariff reductions:** Members agreements to limit, reduce or eliminate tariffs over a given period of time.
- **Non-tariff reductions:** Members also agree to eliminate or reduce non-tariff barriers such as quotas, excessive paperwork and undisclosed trade rules.

PATENTS

One might say that a patent is a contract between society as a whole and an individual inventor. The objective of a patent is to provide the holder with a temporary monopoly on their innovation and thus to encourage the creation and disclosure of new ideas and innovations in the marketplace. A patent provides the owner with exclusive rights to hold, transfer and license the production and sale of the product or process. The WTO's TRIPs agreement provides the international standard for duration of patent exclusivity, which is 20 years from the date of filing. Under all patent systems, once this period has expired people are free to use the invention as they wish. Although all WTO members are subject to patent provisions in the TRIPs agreement, patents are actually granted under national laws so the rights are also national in scope. For example, an Australian patent can be defended only against infringements in Australia. However, the PCT allows entrepreneurs to patent an innovation simultaneously in other countries.

Patents are provided for products or processes that are 'new, involve an inventive step and are capable of industrial application'. A patent is the result of a unique discovery and patent holders are provided protection against infringement by others. In general, machines, products, plants, compositions of elements (chemical compounds) and improvements on already existing items can qualify for patent protection.[5]

One of the keys to a successful defence of a patent is an *irreducible statement* or claim made on the patent application. Here are some examples:

- Thomas Edison described the light bulb as 'an electric lamp for giving light by incandescence consisting of a filament of carbon of high resistance . . . enclosed in a receiver made entirely of glass and conductors passing through the glass and from which receiver the air has been exhausted . . . with a carbon filament or strip coiled and connected to electric conductors so that only a portion of the surface of such conductors shall be exposed for radiating light'.
- The Wright Brothers described the airplane as 'a flying-machine, a normally flat aeroplane having lateral marginal portions capable of movement to different positions above or below the normal plane of the body of the aeroplane, such movement being about an axis traverse to the line of flight, whereby said lateral marginal portions may be moved to different angles relative to the normal plane of the body of the aeroplane so as to present to the atmosphere different angles of incidence, and means for so moving said lateral marginal portions, substantially described'.
- Nikola Tesla described the electrical motor as 'a motor wound with coils forming independent energising circuits on the armature, which is a cylinder or disk mounted to rotate between two opposite magnetic poles. As a result of this, when the generator is set in motion, currently of alternately opposite directions are directed . . . in such a manner as to produce a progressive shifting or rotation of the magnetic poles of the motor armature'.

Any inventor must weigh the value of the innovation against the time and money spent to obtain the patent. Also, it is important to remember that many patents are declared invalid after being challenged in court. This occurs for several reasons. One is that the patent holder waited an unreasonable length of time before asserting his or her rights. A second is that those bringing suit against the patent holder are able to prove that the individual misused the patent rights – for example, by requiring certain purchases of other goods or services as part of the patent-use arrangement. A third is that other parties are able to prove the patent itself fails to meet tests of patentability and is therefore invalid.[6]

Another factor is whether the invention actually is obsolescent before the patent is issued, especially in a fast-moving market. Nor is there any guarantee that a patent is in fact valid. Many cases have been lost by showing that the patent examiner was mistaken and missed an important precedent.

A good example is the Toyota RAV4, which has been perfectly copied as the Chinese-built Jonway UFO. Toyota has not been able to stop UFO sales because it did not get proper patent protection for the car's design in Europe. The car is perfect down to the body panels and doors, which are interchangeable with the original Toyota model parts. BMW and Daimler have started lawsuits to try to prevent the launch of Chinese clones of their cars. The brands argue that the look-alikes could hurt their brand images.

One author recommends that the entrepreneur should spend the money on turning investors' heads rather than on high-priced lawyers. Too much protection of intellectual property increases litigation and slows innovation, some say. It is better to stay ahead of the competition by rolling out new products faster than people can copy them.[7]

>>ENTREPRENEURSHIP IN PRACTICE

TOP PATENTS THAT INFLUENCED BUSINESS

1855: Isaac Singer for the sewing machine
1865: John Deere for ploughs
1876: Alexander Graham Bell for the telephone
1878: Thomas Edison for the phonograph
1880: Thomas Edison for the light bulb
1888: Nikola Tesla for the 'electrical transmission of power'
1895: Charles Jenkins for the motion picture machine
1911: Henry Ford for an automobile transmission mechanism
1913: William Burton for the manufacture of gasoline
1930: Philo Farnsworth for the television
1950: Shockley, Bardeen and Brattain for the transistor.

Source: US Patent and Trademark Office

TABLE 7.14: INTELLECTUAL PROPERTY INFORMATION SOURCES

IP MENU is an Internet directory system aimed at users and researchers working in the intellectual property field	www.ipmenu.com
'New Zealand's Intellectual Property Framework' The Ministry of Economic Development has produced information sheets on various forms of intellectual property in New Zealand	www.med.govt.nz/
IP Australia is the federal government agency responsible for granting rights in patents, trademarks and designs	www.ipaustralia.gov.au
The United States Patent and Trademark Office website provides a wealth of valuable information for entrepreneurs Go Trademarks > Trademark Electronic Search System (TESS) Users can locate patent and trademark information, such as registration forms, international patents, legal issues and FAQs Users can also check the status of a trademark or patent application on this site	www.uspto.gov
Patents.com provides the most comprehensive worldwide source of patent data	www.patents.com
This site, sponsored by Source Translation and Optimisation, offers assistance with Internet, biotech and e-commerce patents Users also can sign up for the free daily information email, 'Internet patent news service', at this site	www.bustpatents.com
The United States Copyright Office at the Library of Congress website provides information on copyright protecting works, licensing and legal issues Users also can search copyright records on the site	www.loc.gov/copyright
This site allows the user to look up any topic in a search and yield returns of the actual written law, court precedents and current cases and interpretations The site also gives topical searches that aid the user in getting started as well as a business section to help put the laws into more practical applications	www.findlaw.com
West's Business Law Textbook's website offers an overview of the book, cases and updates that allow surfers the ability to check contents before purchasing	wbl.westbuslaw.com

How to secure a patent

Because quite often the patent process is complex, careful planning is required. Experts recommend the following basic rules:

- **Rule 1**: Pursue patents that are broad, are commercially significant and offer a strong position. This means that relevant patent law must be researched in order to obtain the widest coverage possible on the idea or concept. In addition, there must be something significantly novel or proprietary about the innovation. Record all steps or processes in a notebook and have them witnessed so that documentation secures a strong proprietary position.

- **Rule 2**: Prepare a patent plan in detail. This plan should outline the costs to develop and market the innovation as well as analyse the competition and technological similarities to your idea. Attempt to detail the precise value of the innovation.
- **Rule 3**: Have your actions relate to your original patent plan. This does not mean a plan cannot be changed. However, it is wise to remain close to the plan during the early stages of establishing the patent. Later, the path that is prepared may change – for example, licensing out the patent versus keeping it.
- **Rule 4**: Establish an infringement budget. Patent rights are effective only if potential infringers fear legal damages. Thus it is important to prepare a realistic budget for prosecuting violations of the patent.
- **Rule 5**: Evaluate the patent plan strategically. The typical patent process takes three years. This should be compared to the actual life cycle of the proposed innovation or technology. Will the patent be worth defending in three years or will enforcement cost more than the damages collected?[8]

Truth be told, the entrepreneur might waste a lot of money on protecting intellectual property that could have funded marketing and product development.

If, after careful review, an entrepreneur concludes that the innovation will withstand any legal challenge and is commercially worthwhile, a patent should be pursued. If a challenge is mounted, legal fees may be sizable, but a successful defence can result in damages sufficient to compensate for the infringement plus court costs and interest. In fact, the court may award damages of up to three times the actual amount. In addition, a patent infringer can be liable for all profits resulting from the infringement as well as for legal fees.[9]

Most people do not realise that just 2 per cent of all patents ever realise any profits. Considering the cost of the patent process and the amount of time and resources it takes to protect patents, getting patent protection may not even be the best way to go. Because of this, many experts suggest that inventors consider licensing their product rather than marketing it themselves.[10]

COPYRIGHTS

A **copyright** provides exclusive rights to creative individuals for the protection of their literary or artistic productions. It is not possible to copyright an idea, but the particular way that an idea is expressed often can be copyrighted. This expression can take many forms, including books, periodicals, dramatic or musical compositions, art, motion pictures, lectures, sound recordings and computer programs. Under TRIPs:

- copyright extends 50 years after the death of the author (one exception is photographs, which have only 25-year terms)
- copyright must be granted automatically
- computer programs are viewed as 'literary works' and receive the same level of protection
- national exceptions to copyright – such as the **fair use doctrine** in the US – must be tightly controlled
- in each state, intellectual property laws may not offer any benefits to local citizens which are not available to citizens of other TRIPs signatories (this is called 'national treatment'); TRIPs also has a most favoured nation clause.

The owner of this copyright may:

- reproduce the work
- prepare derivative works based on it (for example, a condensation or movie version of a novel)

- distribute copies of the work by sale or otherwise
- perform the work publicly
- display the work publicly.

Each of these rights, or a portion of each, also may be transferred.[11]

One very controversial area is software copyright used by proprietary software companies to prevent the unauthorised copying of their software. It is also used by proponents of open-source software to encourage the disclosure of improvements to source code. Manufacturers are trying to broaden this to include nearly all transactions in information. The broad definition of 'computer information' would cover everything from copyrighted expressions such as stories, computer programs, images, music and Web pages to intellectual property such as patents, trade secrets and trademarks as well as online databases and interactive games. The so-called Uniform Computer Information Transactions Act (UCITA) would in effect license information. Rather than owning a copy, the purchaser would receive only permission to use the copy within limits dictated by the licence.

Understanding copyright protection

For the author of creative material to obtain copyright protection, the material must be in a tangible form so it can be communicated or reproduced. It also must be the author's own work and thus the product of the author's skill or judgement. Concepts, principles, processes, systems, or discoveries are not valid for copyright protection until they are put in tangible form – written or recorded.

Formal registration of a copyright with the National Copyright Office of one's resident country is a requirement before an author can begin a lawsuit for infringement. In addition, an author can find their copyright invalidated if proper notice isn't provided.

Anyone who violates an author's exclusive rights under a copyright is liable for infringement. However, because of the *fair use* doctrine, it is sometimes difficult to establish infringement. Fair use provides for the legal, non-licensed citation or incorporation of copyrighted material in another author's work under certain, specifiable conditions. The US is the only country with a fair use doctrine. But outside the US, comparable copyright limitations can be found in many nations' copyright statutes. Most common law countries (especially those with a history as British territories or colonies) have a related doctrine known as *fair dealing* with narrowly drawn exceptions. For example, in Australia, the grounds for fair dealing are:

- research and study
- review and criticism
- 'reporting the news'
- legal advice (although the Crown is deemed to own copyright in federal statutes and each state in state statutes).[12]

If, however, an author substantiates a copyright infringement, the normal remedy is recovery of actual damages plus any profits the violator receives. As a matter of course, writings should be copyrighted by putting the copyright notice (©) on it. It is not necessary to register copyrights with the Copyright Office unless and until you want to sue somebody for infringement. Remember, ideas cannot be copyrighted. Therefore, if someone writes an article and copyrights it, you are certainly free to read that article, digest it, take the ideas from that article and other sources and weave them into your own material without any copyright problems. On the other hand, if someone has copyrighted an article, you cannot simply rephrase it or change minor words and claim it as your own. Exactly where the line is to be drawn is not clear. However, a little common sense will give the appropriate answer in most cases.[13]

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WATCH WHAT YOU SAY!

>>ENTREPRENEURSHIP IN PRACTICE

The government can't help protect your business from the competition if your employees are willingly sharing valuable information. Copious amounts of sensitive and confidential information are being made public every day by business travellers who pay no heed to the fact that people have ears. Carrying on a seemingly harmless conversation with a co-worker on an airplane, in a bus, or in a restaurant has wreaked havoc for more than one company. An employee of Fuld & Company, a management consulting firm, was riding a shuttle bus when he heard every bit of a company's distribution strategy being discussed in the seat in front of him. Luckily for the two talkers, he wasn't competition. He did, however, let it be known what had just occurred.

Protecting trade secrets is not a new concept, but with the amount of businesspeople travelling every day and the development of technology, the smallest slip can be dangerous. Leonard Fuld, a competitive intelligence expert, states that it's common for companies to overlook the human factor when it comes to information leaking out. He emphasises the point by talking about the 'Nerd Bird', a frequent shuttle flight from Austin, Texas, to San Jose, California, that carries mostly engineers and executives from the semiconductor and software industries. 'I was even told an anecdote about an executive who waited until passengers had disembarked and then quickly roamed the aisle to see if any documents had been left behind'. 'I know of people in firms who justify booking first-class airfares based on the quality of information they might be able to pick up that way', states a Silicon Valley businessperson.

Verbal exchanges aren't the only way travellers are hurting themselves. Rental car trunks, stolen briefcases and the simple misplaced memo are known to be gold mines as well.

Business travellers should keep these things in mind to protect intellectual property that can't be protected by the government:

- >> Avoid talking shop in public areas where competitors are likely to be present. Business jargon isn't a code when the executive sitting right beside you is in the same industry.
- >> Never expose laptop screens on airplanes, buses, or other conveyances when working on confidential facts and figures. If the work is unavoidable, ask for a window seat and use smaller font sizes.
- >> Be particularly vigilant at trade shows. Proprietary technology, new product releases and the like should be discussed in detail only behind closed doors.
- >> Pay phones and cellphones pose an amazing opportunity for others to partake in the conversation. Be cautious of your surroundings when making important phone calls.
- >> Protect the files on your computer by purchasing a cable lock or security software. Help deter computer theft by labelling both the case and computer and never letting them out of your sight.
- >> Keep unnecessary documentation back at the office. Also check your work area and account for all paperwork after handling important documents to see if anything has 'mysteriously' landed on the floor.

Source: David Barber, 'Loose Lips Sink You', *Inc.*, www.inc.com, June 1999

What ideas can you protect?

Copyright acts throughout the world diversely seek some variation of 'protecting idea, procedure, process, system, method of operation, concept, principle, or discovery, regardless of the form in which it is described, explained, illustrated, or embodied' (*US Copyright Act*). Note that it is not possible to copyright an *idea* – the underlying ideas embodied in a work may be used freely by others. What is copyrightable is the particular way an idea is expressed. Whenever an idea and an expression are inseparable, the expression cannot be copyrighted. Generally, anything that is not an original expression will not qualify for copyright protection. Facts widely known to the public are not copyrightable. Page numbers are not copyrightable because they follow a sequence known to everyone. Mathematical calculations are not copyrightable. Compilations of facts, however, are copyrightable.

>>ENTREPRENEURSHIP IN PRACTICE

NIKE V. MIKE: A PARODY ON TRADEMARK INFRINGEMENT

Mike Stanard had a great idea for his daughter to try during summer vacation: Establish an enterprise called 'Just Did It' (a spoof on Nike's 'Just Do It' slogan) and sell T-shirts with the famous swoosh design (identical to Nike's) but accompanied by the word 'Mike' instead of Nike. The T-shirts would be sold for $19.95 and long-sleeved ones for $24.95. They would send out 1400 brochures to college athletes and celebrities named Michael. What a great idea!

Nike did not think so. From 1971 to 1994, Nike had invested more than $300 million advertising its trademarks. Aggregate sales revenues from Nike trademarked apparel had exceeded $10 billion. The 'Just Do It' slogan alone produced 1989–1994 revenue exceeding $15 million. Nike sued Stanard for trademark infringement.

Stanard's defence was parody. A parody must convey two simultaneous and contradictory messages: that it is the original, but also that it is not the original and is instead a parody. The customer must be amused and not confused.

To assess whether a trademark infringement has occurred, the courts consider seven factors: (1) the degree of similarity between the trademarks, (2) the similarity of the products for which the name is used, (3) the area and manner of concurrent use, (4) the degree of care likely to be exercised by consumers, (5) the strength of the complainant's trademark, (6) whether actual product confusion exists among buyers and (7) an intent on the part of the alleged infringer to palm off his or her products as those of another.

Since Stanard sold the shirts by mail (customers had to write a cheque to 'Just Did It') and he had no apparent intent to copy Nike's products specifically, the court concluded no confusion existed. Thus, the parody defence succeeded. The parody defence doesn't always work, however. Marketers will have to decide whether the legal risk involved in parody marketing is worth unknown sales results.

Some examples of court rulings include these:

>> Miami Mice was a valid parody of *Miami Vice*.

>> Starballz was a valid parody of *Star Wars*.

>> A parody of the O.J. Simpson double murder trial entitled *The Cat NOT in the Hat! A Parody by Dr Juice* was permitted to do a take-off on Dr Seuss.

>> Hard Rain Cafe was likely to confuse consumers regarding the Hard Rock Cafe.

>> Enjoy Cocaine was not a valid parody of Enjoy Coca-Cola, where both used the familiar red-and-white logo.

>> People Eating Tasty Animals was closed down by People for the Ethical Treatment of Animals (PETA).

>> Bagzilla was a permissible pun of Godzilla and would not confuse consumers.

>> The Danish band Aqua was allowed to use Mattel's Barbie doll to mock the values she supposedly represents.

Clearly there's no one guideline. As one legal scholar has said, 'given these disparate court decisions, a parodist has no clear guidelines for what will and will not constitute a parody. A parodist also cannot know until it is too late whether he made too much use of the targeted work'.

Source: Reprinted with permission from *Marketing News*, published by the American Marketing Association, Maxine S. Lans, 3rd January 1994: p.20.

TRADEMARKS Article 15 (1) of TRIPs states that 'signs, in particular words including names, letters, numerals, figurative elements and combinations of colours as well as any combination of such signs, shall be eligible for registration as trademarks'. A trademark is a distinctive name, mark, symbol, or motto identified with a company's product(s) and registered at the National Trademark Office of one's resident country. Thanks to trademark law, no confusion should result from one venture using the symbol or name of another.

Specific legal terms differentiate the exact types of marks. For example, trademarks identify and distinguish goods. Service marks identify and distinguish services. Certification marks denote the quality, materials, or other aspects of goods and services and are used by someone other than the mark's owner. Collective marks are trademarks or service marks members of groups or organisations use to identify themselves as the source of goods or services.[14] A trademark can be a design, like the Nike Swoosh. It can be a colour like brown for UPS. It can even be a sound, like the MGM lion's roar.

- **Fanciful trademarks**: These have no meaning before they became trademarks – examples include Starbucks (coffee) and Vero (insurance).
- **Arbitrary trademarks**: These are common words that have an arbitrary relationship to the product – examples include Apple (computers) and Amazon (e-commerce).
- **Suggestive trademarks**: Suggestive trademarks indirectly allude to a quality of the product – examples include *Playboy* (men's magazine).
- **Descriptive trademarks**: These describe the goods or service they market – examples include Computerland (computer store) and Vision Center (optics store).
- **Generic trademarks**: Generic trademarks describe a whole class of products – examples include Personal computer (for a personal computer) and Milk (for milk).[15]

Once issued, the trademark is listed in the register of the trademark office. This listing offers several advantages:

- nationwide constructive notice of the owner's right to use the mark (thus eliminating the need to show that the defendant in an infringement suit had notice of the mark)
- protection against importers using the mark
- incontestability of the mark after five years.[16]

A trademark registration lasts for a period of 10 years. The registration is thereafter renewable for further periods of 10 years, for an indefinite period. To obtain protection for your trademark overseas you will need to file an application with intellectual property offices in overseas countries of interest.

If a trademark is properly registered, used and protected, the owner can obtain an injunction against any uses of the mark that are likely to cause confusion. Moreover, if infringement and damages can be proven in court, a monetary award may be given to the trademark holder.

Avoiding the trademark pitfalls

Trademark registration and search can be costly, sometimes ranging into the thousands of dollars. Trademark infringement can be even more expensive. To avoid these pitfalls, one author has noted five basic rules entrepreneurs should follow when selecting trademarks for their new ventures.

- Never select a corporate name or a mark without first doing a trademark search.
- If your lawyer says you have a potential problem with a mark, trust that judgement.
- Seek a coined or a fanciful name or mark before you settle for a descriptive or a highly suggestive one.
- Whenever marketing or other considerations dictate the use of a name or a mark that is highly suggestive of the product, select a distinctive logotype for the descriptive or suggestive words.

FIGURE 7.2: THE SPECTRUM OF TRADEMARK DISTINCTIVENESS

Fanciful/arbitrary	Descriptive	Generic
Very protectable ◄	———————————	► Not protectable

Source: Kenneth DeLeon, 'Trademark law basics', www.registeringatrademark.com/trademark-law-basics.shtml

>>ENTREPRENEURSHIP IN PRACTICE

WHO OWNS THE MARK 'ENTREPRENEUR'?

Hundreds of trademark applications have been filed in the United States that include the word 'entrepreneur'. Many of the claimed owners of entrepreneur-formed trademarks have engaged in legal disputes over the scope and extent of each other's rights. Is the word 'entrepreneur' capable of exclusive appropriation by anyone?

The answer is 'it depends'. In order for a word to serve as a trademark, it must be distinctive of a specific source's goods or services. Generally, when a consumer observes a word that serves as a trademark, he or she immediately is reminded of the owner of the trademark. For example, the word 'Macintosh' when used with computers, conjures up Apple Computers.

Because 'entrepreneur' is a word in the dictionary, it is generic for the thing it defines, namely, 'a person who organises and manages any enterprise, especially a business, usually with considerable initiative and risk'. But, as applied to other things, it may be a trademark capable of exclusive ownership by one or more companies or individuals.

The legal battles over where uses of 'entrepreneur' fall are legendary. In 2008, Entrepreneur Media, Inc. ('EMI'), publisher of *Entrepreneur Magazine*, filed a declaratory judgment lawsuit against Ernst & Young to obtain a court ruling that EMI is not infringing upon Ernst & Young's trademark for the Entrepreneur of the Year Awards. Ernst & Young owns a federal trademark registration for the mark, albeit with the word 'entrepreneur' disclaimed, and demanded that EMI stop soliciting entries for its *Entrepreneur Magazine* 2008 Entrepreneur of the Year Awards. EMI claims in the lawsuit that the phrase 'Entrepreneur of the Year Awards' is generic and in use by many other parties, such that the trademark should be declared invalid and unenforceable because the general public does not exclusively associate EMI's awards with those of Ernst & Young. EMI argues that Ernst & Young cannot 'selectively enforce' only against parties it considers a competitive threat.

In a prior case, EMI was on the other side, successfully protecting its claimed trademark rights in 'Entrepreneur' for various other goods and services. In that case, EMI sued Scott Smith, an entrepreneur advocate, for using the name 'Entrepreneur PR' for his PR firm. The court found that EMI had protectable rights in 'Entrepreneur' for numerous goods and services, extending to 'paper goods and printed matter; namely magazines, books and published reports pertaining to business opportunities; computer programs and programs/user manuals all sold as a unit; trade show exhibitions, seminars and workshops'. Smith's use was found to be confusingly similar to EMI's prior uses of 'Entrepreneur' for these goods and services. The court ordered Smith to pay $1.4 million to EMI, including attorney fees and damages.

That decision did not end the battle, and Smith has since filed a Notice of Opposition with the U.S. Patent & Trademark Office (PTO) against EMI's application to register 'Entrepreneur' for 'radio and TV programming, and for pre-recorded audio and visual media, including CDs, videotapes and audiotapes'. Smith argues that the word 'entrepreneur' is merely descriptive for these services, and should not be protected as a trademark. Smith also filed a lawsuit alleging that EMI defrauded the PTO by making willful false statements in 'an elaborate scheme' to acquire and maintain several federal trademarks for the phrase 'Entrepreneur Expo'.

In short, the word 'entrepreneur' is capable of protection as a trademark, but also may be deemed merely descriptive or generic, depending on the context in which it is used. The various legal disputes serve to clarify the boundaries of ownership and protection.

Source: Deborah Wilcox, 'Who Owns the mark "Entrepreneur"?', WTN News (Wisconsin Technology Network), 7 July 2008, wistechnology.com/articles/4861/

- Avoid abbreviations and acronyms wherever possible and when no alternative is acceptable, select a distinctive logotype in which the abbreviation or acronym appears.[17]

Clearly there's no one guideline. As one legal scholar has said:

> given these disparate court decisions, a parodist has no clear guidelines for what will and will not constitute a parody. A parodist also cannot know until it is too late whether he made too much use of the targeted work.[18]

DOMAIN NAMES

Domain names are the human-friendly forms of Internet addresses and are commonly used to find websites. While designed to serve the function of enabling users to locate computers (and people) in an easy manner, domain names have acquired a further significance

SOME INTERESTING WIPO UDRP DECISIONS

>>ENTREPRENEURSHIP IN PRACTICE

- >> An Arizona cyber-squatter was forced to desist using the URL www.pornsche.com by the F. Porsche AG company of Germany because it resolved into a porno search engine and that the domain name is confusingly similar to the Complainant's trade name and trademark PORSCHE, since the addition of the letter 'n' is not sufficient to prevent confusing similarity and serves the purpose of a pornographic business.
- >> The 140 year-old BERLITZ language training company got www.berlitzsucks.com removed from the Internet for extortion, inflammatory remarks and defamation.
- >> 'Hard Yakka' are common words in colloquial Australia, simply meaning 'hard work'. The Australian clothing firm Yakka Pty Ltd, which has a line of clothes called HARD YAKKA got back www.hardyakka.com from a retail outlet in Victoria because it confused the customer.
- >> Chanel succeeded in an action in Korea to have the registration 'chanel.co.kr' cancelled. The domain name had been attached to a site selling condoms, pheromone perfumes and lingerie. This act was held to be contrary to Korea's unfair competition legislation.
- >> Pfizer, the gigantic pharmaceutical, was successful in stopping the use of the use of <辉瑞.net> despite the plaintiff arguing that 辉瑞 is a very common word consisting of the characters for brightness and luck. The plaintiff argued that the literal translation of a foreign company's name was copied from Chinese in a paradoxical way and then registered as its own and exclusive trademark in China.

Source: Thousands of interesting cases are found in the 'Index of WIPO UDRP Panel Decisions', www.wipo.int/amc/en/domains/search/legalindex.jsp

as business identifiers and, as such, have come into conflict with the system of business identifiers (protected by intellectual property rights) that existed before the arrival of the Internet. Domain names may be awarded to trademark holders over others through arbitration or litigation. This means that having trademark registration in the same name as your domain name may ensure that you retain ownership of the name.

The problem is that *cyber squatters* (people who purchase a large number of domain names in general) offer domain names for sale back to the person or company who should rightfully have the domain under trademark laws. Needless to say, trademark holders object to third parties registering domain names which they believe should be theirs. The domain name registries, many of whom are not governmental organisations, have had to find a solution to this and therefore have dispute resolution systems which operate in parallel with national laws. The majority of the generic top level domain names (.com, .net etc.) now use the Uniform Dispute Resolution Policy (UDRP), but some critics claim that the UDRP process favours large corporations. There have been instances of companies, individuals or governments trying to get domain names away from their current owners by making false claims of trademark violation. Sometimes they are successful. This practice is called reverse-cyber squatting.

TRADE SECRETS

Trade secrets are business processes and information that are unpatentable, patentable but not enforceable, or patentable but for some reason you do not wish to disclose. This might include customer lists, plans, research and development, pricing information, marketing techniques and production techniques. For example, no company would reveal a complete map of its supply chain. Generally, anything that makes an individual company unique and has value to a competitor could be a trade secret.[19] Trade secret protection is only possible with employer and employee diligence. Staff who are privy to trade secrets must be clearly advised of their obligations, especially on leaving the organisation, and should be bound to these obligations through their employment contract.

Protection of trade secrets extends both to ideas and to their expression. For this reason and because a trade secret involves no registration or filing requirements, trade secret protection is ideal for software. Of course, the secret formula, method, or other information must be disclosed to key employees. Businesses generally attempt to protect their trade secrets by having all employees who use the process or information agree in their contracts never to divulge it. Theft of confidential business data by industrial espionage, such as stealing a competitor's documents, is a theft of trade secrets without any contractual violation and is actionable in itself.

In many instances, trade secrets are based on discoveries or inventions that could be patented, but the owner has chosen to keep the discovery or invention secret. Trade secrets, such as the formula for Coca Cola, have been in effect for many years and will continue for as long as the secret is kept from the public. If it had been patented, the formula would have long been in the public domain.

The law clearly outlines the area of trade secrets: Information is a trade secret if: (1) it is not known by the competition, (2) the business would lose its advantage if the competition were to obtain it and (3) the owner has taken reasonable steps to protect the secret from disclosure.[20]

Keep in mind that prosecution is still difficult in many of these cases.

ROGUE STATES AND INTELLECTUAL PROPERTY Advances in technology have opened up whole new areas of patentable products; for example, biotechnologies and computer software, to mention only two of the most noteworthy areas at the cutting edge of leading technologies – witness the problems involved in patenting life forms, and the question of so-called Internet patents.[21] Technology development is making it increasingly difficult to enforce many of the more conventional forms of intellectual property. A good example of this is MP3 file-sharing on the Internet, which raises questions regarding the future viability of copyright in musical recordings. This has led to a movement to toughen protections. Perhaps now is the time for a radical rethink of traditional intellectual property concepts.[22] Instead of considering reforms to *strengthen* patents and copyrights, perhaps we should be moving in the opposite direction.

Business Software Alliance estimates that total losses due to software piracy were at least $50 billion in 2008, not counting significant losses due to Internet piracy, for which meaningful estimates are not yet available.[23] While the US is toughening patent and copyright protections, the rest of the world is dancing to a different beat. While some of it is enlightened, much of it is from the dark side of entrepreneurship replete with **piracy** and **rogue states**. On the positive side, countries such as Australia and India are sidestepping agriculture patents held by large American multinationals to develop competitive technologies (such as a high-protein potato) and are leaving the intellectual property open and unrestricted. India is skirting patents to create generic AIDS drugs that are much less expensive than those made by the transnational drug companies. Entire nations (for example, China) are leaving Microsoft in the dust as they install open-source operating systems on their computers.

While most owners of intellectual property are working fervently to lock in their old entitlements and are pushing for increasingly restrictive laws and enforcement,[24] vast parts of the world are seceding from these intellectual property rights regimes and setting up offshore havens for infringers of intellectual property to carry out their predatory activities. In some ways intellectual property crime mirrors illicit drug trafficking in its scope, pervasiveness and nimbleness in resisting eradication. (Not that some big firms aren't also engaged in some of these tricks. Their lawyers have many ways to house intellectual property abroad so as to shelter income from overseas sales. For example, a multinational may transfer a patent to a newly

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formed Bermuda subsidiary so that royalties from sales of products made outside the US flow to the subsidiary, where they accumulate tax-free.) Rogue states in the Asia–Pacific are particularly active. Here are some examples.[25]

China

Internet and mobile piracy have become a major impediment to the development of the legitimate digital marketplace and commerce in China. Piracy of DVDs and game cartridges continues at the 85–95 per cent level. Piracy for business software in government and private enterprises is now 80 per cent of the market. Pirated entertainment software continues to range between 90–95 per cent of the market. Book and journal publishers continue to suffer from piracy in three key forms: illegal printing of academic books and commercial bestsellers, unauthorised commercial-scale photocopying and Internet piracy encompassing online academic and professional journals and sites offering scanned books for download.

Indonesia

Piracy levels have increased in terms of the number of outlets in the notorious pirate shopping malls providing optical discs of all kinds, including factory and burned-to order CDs and DVDs and piracy in the form of loading illegal copyrighted files onto various mobile devices or carriers. The unauthorised loading or preloading of illegal copyright content onto mobile devices such as mobile telephones, iPods, other MP3 players and recordable media such as flash drives and memory sticks has emerged as a major problem. Most universities actively or tacitly condone students' photocopying activities. The software piracy rate remains high at 85 per cent.

Korea

In the Internet-savvy environment of the Korean market, copyright industries face extraordinary enforcement challenges because of the prevalence of all kinds of pirated materials online. While most Korean students prefer to go to a copy shop to get a hard copy of a book rather than deal with online versions, there are also some reported instances of digital piracy, such as cellphones with high resolution cameras being used by university students inside bookshops to copy up to 200 pages of textbooks rather than purchase them,

Malaysia

Pirate activity including CD and DVD burning-to-order in shopping centres and night markets remains a major source of losses for copyright companies in Malaysia. A major problem has involved the unauthorised use of copyright materials at Internet cafes or game rooms. Another problem involves the use of websites to advertise the sale and delivery of physical pirated goods. Significant unauthorised photocopying takes place at on-campus facilities. The vast majority of movies that are pirated are stolen right off the screen by professional camcorder pirates.

Pakistan

Pakistan remains perhaps the worst book piracy haven in the world. Large-scale photocopying and print piracy make the Pakistani market virtually untenable for legitimate publishers. Often, one student will purchase the required reading and then organise photocopying for the entire class. Piracy of cable and satellite broadcasting signals is out of control in Pakistan, with cable companies estimated to transmit without authorisation 94–97 per cent of the programming they provide to end users. Pakistan holds the dubious distinction of having one of the highest end-user software piracy levels in the world.

Philippines

Book and journal piracy remain significant problems, affecting foreign and domestic publishers alike. Illegal commercial-scale photocopying of entire books continues in commercial establishments surrounding universities, or in street stalls in metropolitan areas. Photocopy shops operate on campuses, in hospitals and in medical and nursing schools, often in highly organised fashion, selling door-to-door to doctors' offices and medical establishments. Dedicated booths and stalls within shopping malls load pirate content (music, published materials, etc.) onto mobile telephones, MP3 devices, flash drives, recordable optical discs and even computer hard drives. Of greatest concern to the motion picture industry is the alarming growth of illegal camcording.

Taiwan

The Taiwan government's university computer network, TANet, which is operated by the Ministry of Education (MOE), is being widely used for Internet piracy including unauthorised P2P file sharing of all types of copyright material, including scanned academic texts and journals. Copy shops continue to grow more sophisticated in their efforts. Photocopy shops do not generally keep stockpiles of copies, but make them to order. Furthermore, print runs are often at night or after hours, with immediate offsite delivery to avoid detection. Taiwan continues to do an admirable job in its enforcement efforts against hard-goods piracy, but needs to do more to combat illegal photocopying, especially on campus.

Thailand

Thailand has become one of the few pirate book exporters in the world. Massive shipments of high-quality pirated academic texts are shipped out of Thailand. Unauthorised photocopies abound in and around university campuses. Malls serve as the primary retail channel for pirated entertainment software, pirate video games and cartridges. Retail piracy in Thailand remains rampant, whether in otherwise legitimate shopping centres, in makeshift street stalls or at night markets.

Vietnam

The music/sound recording industries report piracy rates of over 90 per cent. Technological advances in Vietnam and lax IP laws have made Vietnam an attractive place for pirate DVD manufacture. Vietnamese-sourced pirate products have been found in other Asian countries. Business software piracy remains the most damaging form of piracy in Vietnam for the business software sector. Government-owned bookshops, roadside vendors and copy shops all sell illegal copies of bestselling trade books, travel books and academic textbooks and unlicensed print overruns continue to plague foreign publishers who engage local production. The English language teaching market continues to be hard hit, with approximately 90 per cent of this market (private-sector education and universities) being supplied by unauthorised reprints and adaptations.

IDENTIFYING LEGAL STRUCTURES FOR ENTREPRENEURIAL VENTURES

Having examined Asia–Pacific regulations as well as the legal environment that entrepreneurs face, we now turn to the third aspect of this chapter: legal structures that might be chosen to incorporate the company.

According to the World Bank, on average in a rich country it takes 7.4 per cent of annual per capita income and 20 days time to start a business. In a poor or lower-middle-income

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economy, the same process takes 47 per cent of annual per capita income and 38 days. In some poor countries registering a new business takes more than 100 days. New Zealand, US, Singapore, Australia and Hong Kong are among the easiest countries in the world to start a business. So imagine poor Ridwan in the opening quote to this chapter. He lives in Indonesia where it actually takes more than 60 per cent of per capita annual income and 60 days to start a business. In this chapter, we are concerned with two subjects – legal structures and legal issues – that greatly affect new business ventures.

Every country has a **regulatory body** – composed of legislation and a regulatory authority – that dictates how businesses are started, operated and wound up. Famous ones include: Australian Securities & Investments Commission (ASIC), New Zealand Companies Office, Singapore Accounting and Corporate Regulatory Authority (ACRA) and US Securities & Exchange Commission (SEC). These government bodies oversee the **incorporation** of companies and the regulation of businesses. We now look at the types of legal structures that businesses use to run their affairs. In the Asia–Pacific, there is a variety of common legal business structures. They include unincorporated forms such as the **sole tradership** and **partnerships**; **incorporated companies**; and other forms of business such as **trading trusts**, cooperatives and **non-profit organisations**. Because each form has specific advantages and disadvantages it is impossible to recommend one form over the other. The entrepreneur's specific situation, concerns and desires will dictate this choice.

Choosing the appropriate legal structure is a complex issue because of the inherent tax consequences and liabilities of the owner(s) and because the structure selected will determine what capital-formation options are available. Here are some of the important factors that must be taken into consideration when selecting a business structure:

- **Asset protection**: The business structure will determine the extent to which personal assets (such as the family home) are at risk against business failure.
- **Limited liability**: This refers to the important commercial characteristic where the business participants' personal liability for the business debts is limited to a specified amount.
- **Distribution flexibility**: Some business structures enable payment of different types of income such as trading profits, capital gains and franked dividends to different participants.
- **Financing**: As the business grows, it may be necessary to raise more funds by way of borrowing or equity. Consider the ease with which future financing can be raised while selecting the business structure.
- **Taxation**: This is a complex issue that goes well beyond merely selecting the structure that is taxed at the lowest rate.
- **Business environment**: This includes stringency of the regulatory approval systems and technological risks.
- **Personal relationships**: Increasingly, couples are sharing ownership, management and responsibility. Sometimes called co-preneurs, they share trust, commitment, loyalty and work–life balance – or not!

INCORPORATED COMPANIES

New ventures initially can be categorised as incorporated or **unincorporated businesses**. In fact, legally the term 'company' should only be applied to an incorporated business and not an unincorporated business. What is the difference between a company and a **corporation**? The public perception is confusing. Most people think that a company is a locally owned and operated business (such as a convenience store), while a corporation is a very large business (such as Woolworths). In legal terms, this is totally misleading.

In the US a corporation is a legal entity (distinct from a natural person) that often has similar rights in law to those of a natural person. In Australia, New Zealand and Singapore, as well as in the UK and Ireland, this is known as an **incorporated company**. They both have limited liability and their shareholders are not normally responsible for the company's debts beyond the amount they paid for their shares. Accordingly, while the terminology differs, the concept of a company or corporation is largely the same.

Inc. is used to indicate that an entity is a corporation, namely an incorporated company where personal assets of the shareholders are protected. In the US, corporations are often identified by the term 'Incorporated' added after the business name, such as 'Texas Instruments, Incorporated'. Curiously, in Australia, an Inc. is an incorporated association; that is, a non-profit entity, also with limited liability for its members.

Incorporation is the birth of a company; it means giving legal form to a company. The Certificate of Incorporation is basically a birth certificate. Just like infants themselves, incorporated businesses become separate legal entities in their own right and are recognised therefore as separate from their owners.

Around the world there is a variety of terms used for the different types of incorporated small businesses and Table 7.15 details some of these.

Limited liability companies

For almost all business purposes around the world, two forms – the private company and the public company – are the most frequent legal structures. In Australia, these different types of companies are denoted by the abbreviations Pty Ltd (proprietary limited) and Ltd (limited), respectively. The essential difference is that the private company cannot legally offer its shares to the public.

Private company

In English law and in other countries with similar laws, the assets available to the creditors in the event of bankruptcy are limited to the assets of the company. Consequently, if the company goes bankrupt, creditors cannot seize the private assets of the directors, such as home, car and savings. In theory, individual directors do not go bankrupt and they can start up in business immediately afterwards. In practice, however, directors are personally liable if they knowingly allow the company to trade when there is no reasonable expectation that it can pay its debts. A private company's shares cannot be offered to the general public, whereas a public company's shares can be offered to the public. This is the major distinguishing feature between a private company and a public company. Most businesses are private companies.[26] A private company in Australia is referred to as a **proprietary limited company (Pty Ltd)**. A Pty Ltd is the opposite of a public company. For example, a Pty Ltd cannot invite the public to invest or deposit money with it, whereas a public company can raise capital by offering shares to the public by issuing a prospectus.

- Advantages of a private company:
  - liabilities of the shareholders are limited to their subscribed share capital and any debts that are personally guaranteed
  - the company is a separate legal entity, which may enter into agreements, can be sued and can sue others
  - retained profits are taxed at the company income tax rate
  - ease in attaining ownership in the company by acquiring shares
  - ease of ownership change

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TABLE 7.15: BUSINESS STRUCTURES AROUND THE WORLD

ABBREVIATION	WHAT IS IT?	WHERE USED
Inc.	An incorporated association; that is, a non-profit entity	Australia
	A corporation or incorporated company	United States
LLC	Limited liability company Similar to a corporation combined with a limited liability partnership	Worldwide (not used in Australia)
ILP	Incorporated limited partnership Similar to LLC but with more flexible investment vehicles – minimum level of investment $20 million	Australia (Vic., Qld, NSW)
LLP	Limited liability partnership Each partner is fully liable for the debts of the partnership, not including acts of professional negligence or malpractice	Worldwide
Ltd	Private company with liability limited by shares (not traded publicly)	Commonwealth countries (other than Australia)
	A public company Liability limited by shares or guarantee (not-for-profit companies only) Shares may be traded publicly but will not always be	Australia
NL	Mining company not entitled to call on the unpaid issue price of shares No liability for shareholders, as distinct from limited liability	Australia
PLC	**Public limited company** Liability limited by shares which are traded publicly	Commonwealth countries (other than Australia)
Pty Ltd	Proprietary Limited A private company with liability limited by shares (not traded publicly)	Australia

  - additional capital is more available to this type of legal structure
  - shares are transferable and the authority of shareholders can be controlled through the type of shares issued
  - continuity of the company's existence – not dependent on the owners.
- Disadvantages of a private company:
  - set-up, administrative and operating costs are high
  - increased statutory requirements for taxation and corporation law
  - revenue and capital losses must be retained by the company – these cannot offset the owners' incomes.[27]

Public company

In Australia, a public company is indicated by the word 'Limited' or the abbreviation 'Ltd' at the end of the company's name, for example BHP Billiton Limited. 'PLC' indicates that a company is a public company in many other Commonwealth jurisdictions. A public company is a type of limited company whose shares may be offered for sale to the public. The abbreviation Ltd or PLC status is roughly equivalent to a US corporation. It is not compulsory for a public company to 'float'. However, many do float and their shares are usually traded on the stock exchange. The following offers a summary of the key advantages and disadvantages of the PLC.

- Advantages of a public company:
  - essentially those of a private company, plus
  - increased potential for raising finance by share issues to the public or through other financial investors.

- Disadvantages of a public company:
  - most expensive set-up cost of all forms of business organisation considered
  - if shares are traded publicly, more open to hostile takeover bids
  - tighter levels of regulation
  - public ownership by minority shareholders does not provide them (as owners) with any real control of the business.

For more on owning shares in a limited company, common stock and preferred stock in public companies, see Chapter 11.

Quasi-incorporated businesses

Limited partnerships are used in situations (for example, passive investor) where capital investment comes without responsibility for management and without liability for losses beyond the initial investment. Such an organisation allows the right to share in the profits with limited liability for the losses. The advantage of the limited liability partnership is that it allows an investor to invest in a partnership without being liable beyond the extent of their financial investment, provided certain conditions are met. Limited partners may not:

- draw out or receive back any part of their contribution to the partnership during its lifetime
- take part in the management of the business or have power to bind the firm.

We have referred to these entities as quasi-incorporated as they share some similarities with both incorporated and unincorporated business structures. However, strictly speaking limited liability partnerships are unincorporated while limited partnerships are incorporated.

Limited liability partnership

In a **limited liability partnership (LLP)** structure, the liability of a partner contributing capital can be limited to the amount of financial contribution, provided that person does not take part in the management of the business. LLPs are particularly common in oil and gas exploration, in motion-picture ventures and in venture capital investments. A general partner in a limited partnership has **unlimited liability** and therefore is personally liable for the debts of the firm. However, a limited partner can be an investor whose liability is limited to the size of the investment they make and who can only be involved in the firm's management in certain prescribed circumstances. The standard features of limited partnerships include flow-through tax status, limited liability for passive investment partners and separate legal personality.

Incorporated limited partnership

An **incorporated limited partnership (ILP)** is a form of a limited partnership and is a relatively recent development in Australia, although the US equivalent (confusingly entitled a limited liability company or LLC) has been in existence for some time. The ILP has been developed in response to calls by venture capital and private equity investors for more flexible investment vehicles. An incorporated limited partnership is a partnership with the capacity and powers of an individual as well as the powers of a company. It can have up to 20 general partners and an unlimited number of limited partners. As with all limited partnerships the limited partners are not entitled to participate in management and general partners have unlimited liability.

- Advantages of an ILP:
  - limited liability for limited partners
  - **flow-through taxation** – that is, each partner of the ILP is taxed based on their pro rata portion of the ILP's taxable income
  - the partners can also have the benefit of any losses incurred by the ILP to offset against other taxable income which they may have.

- Disadvantages of an ILP:
  - only able to be used for limited investment purposes
  - short life span of between five and 15 years
  - must have minimum investment funds of $20 000 000 – means that substantial investment is required before ILP structure can be implemented.

UNINCORPORATED BUSINESSES There are two very frequent forms of doing business that are called unincorporated; that is, not organised and maintained as a legal corporation.

Sole tradership

A sole trader (also known as a sole proprietor) is a business that is owned and operated by one person. The enterprise has no existence apart from its owner. This individual has a right to all of the profits and bears all of the liability for the debts and obligations of the business. The individual also has unlimited liability, which means their business and personal assets stand behind the operation. If the company cannot meet its financial obligations the owner can be forced to sell the family car, house and whatever assets that would satisfy the amounts owing to the creditors.

To establish a sole tradership a person merely needs to obtain the permissions or licences that are necessary in the field to begin operations. One must also normally apply for registration of your business name with the relevant state or territory department. Because of its ease of formation, the sole tradership is the most widely used legal form of organisation.[28]

- Advantages of sole traderships:
  - ease of formation – it is an inexpensive business structure to establish and maintain and it has the least government reporting requirements
  - losses reduce personal taxes – in both Australia and New Zealand, losses from the business can be offset against any other income or future earnings
  - less formality and fewer restrictions are associated with establishing a sole tradership than with any other legal form
  - sole ownership of profits – the proprietor is not required to share profits with anyone
  - decision making and control vested in one owner – no co-owners or partners must be consulted in the running of the operation
  - flexibility – management is able to respond quickly to business needs in the form of day-to-day management decisions as governed by various laws and good sense
  - relative freedom from governmental control – very little governmental interference occurs in the operation, although there may be considerable compliance costs
  - freedom from corporate business taxes – proprietors are taxed as individual taxpayers and not as businesses
  - easy to wind it up – it is easy to close the company and stop trading.
- Disadvantages of sole traderships:
  - there are few tax concessions – if the business is successful, the personal tax rate in Australia and New Zealand may be higher than the company rate
  - unlimited liability – the individual proprietor is personally responsible for all business debts and this liability extends to all of the proprietor’s assets
  - lack of continuity – the enterprise may be crippled or terminated if the owner becomes ill or dies
  - lack of personal freedom – it may not be possible to take holidays, as there is nobody else with the expertise to run your business while you are away; the same problems arise with sickness or accidents

- less available capital – ordinarily, proprietorships have less available capital than other types of business organisations, such as partnerships and corporations
- relative difficulty obtaining long-term financing – because the enterprise rests exclusively on one person it often has difficulty raising long-term capital
- relatively limited viewpoint and experience – the operation depends on one person and this individual's ability, training and expertise will limit its direction and scope.

Partnerships

Partnerships emerge in various ways. A sole trader may reach a stage where further growth requires the taking-on of a partner. Alternatively, two or more people may decide to combine their skills and resources to start a business in partnership with each other.

In a partnership, a group of people contribute their time, talents and money towards the business. In return they share the responsibilities and profits. A partnership can be created by oral or written agreement, but a written agreement is preferable. In the absence of a formal partnership agreement, the law will assume that each partner has an equal share in the business. If, for example, one partner is contributing more money or time, the partnership agreement will normally provide that they have a greater share in the business. By clearly spelling out in the partnership agreement what has been agreed upon, the likelihood of disputes is reduced.

- Advantages of partnerships:
  - ease of formation – legal formalities and expenses are few compared with those needed to create a more complex enterprise, such as a corporation
  - direct rewards – partners are motivated to put forth their best efforts by direct sharing of the profits
  - flexibility – in a partnership, it is often possible to obtain more capital and a better range of skills than in a sole proprietorship
  - responsiveness – a partnership often is able to respond quickly to business needs in the form of day-to-day decisions
  - relative freedom from governmental control and regulation – very little governmental interference occurs in the operation of a partnership
  - confidentiality – partnerships do not have to disclose profits to the public.
- Disadvantages of partnerships:
  - few tax concessions – most partnerships pay taxes as individuals and the personal tax rate in Australia and New Zealand may be higher than the company rate
  - unlimited liability of at least one partner – although some partners can have limited liability (as in limited partnerships), at least one must be a general partner who assumes unlimited liability
  - lack of continuity – if any partner dies or simply withdraws from the business, the partnership arrangement ceases (however, operation of the business can continue based on the right of survivorship and the possible creation of a new partnership by the remaining members or by the addition of new members)
  - relative difficulty obtaining large sums of capital – most partnerships have problems raising capital, especially when long-term financing is involved; usually the collective wealth of the partners dictates the amount of total capital the partnership can raise, especially when first starting out
  - bound by the acts of just one partner – a general partner can commit the enterprise to contracts and obligations that may prove disastrous to the enterprise in general and to the other partners in particular

– difficulty in exit strategy – if the partnership is dissolved or altered, difficulties may be experienced in obtaining an acceptable valuation or in raising capital to purchase a retiring partner's share
– difficulty of disposing of partnership interest – buying a partner out may be difficult unless specifically arranged for in the written agreement.

It is important to correctly draw up the partnership agreement from the beginning. Uncertainty and ambiguity may come back to haunt a venture. Let us say that Alice, Bette and Cathy work as partners without an explicit agreement. The three women lease a factory as tenants in common and produce widgets. Each receives one-third of the profits. Later, Alice signs a contract for some plant and equipment to produce the Mark II widget. However, their business falters and Alice has to go back on the contract. Then, for totally unrelated reasons, Alice is declared bankrupt and the supplier sues for breach of contract. The court determines that Alice, Bette and Cathy were in fact partners. Alice is found to have bound the partnership to the equipment contract. As Alice has gone bankrupt, Bette and Cathy are ordered to pay all of the supplier's damages and costs.[29]

OTHER BUSINESS FORMS

Trading trust

A common alternative business form in Australia and New Zealand is the **trading trust**. It is very much like a family trust, except that it is able to operate as a business with the added advantage of being able to pay money (profits) to the beneficiaries without them having to work in the business (unlike a company). A trading trust can ring-fence assets and insulate professional life from personal life when, for example, a doctor or dentist is facing malpractice or medical misadventure claims.

Cooperative society

The main difference between a **cooperative society** and companies is dividend distribution. Under a company structure there is a profit motive that returns dividends to the members of the company. A cooperative, in contrast, operates on a service motive that provides services to its members and any return of capital is limited. In other ways, it is run in a similar fashion to a company.[30]

Charitable trust

A familiar form of non-profit corporation (or not-for-profit) is the religious, charitable, or educational organisation. Its purpose is not to make a profit, but it is permitted to do so if the profit is left within the trust.

Franchises

Actually, a **franchise** is not a legal form per se; it could be any one of the structures we have discussed. However, we include it here because it is a consideration as entrepreneurs launch new ventures.

A franchise is any arrangement in which the owner of a trademark, trade name, or copyright has licensed others to use it in selling goods or services. A franchisee (a purchaser of a franchise) is generally legally independent but economically dependent on the integrated business system of the franchisor (the seller of the franchise). In other words, a franchisee can operate as an independent businessperson but still realise the advantages of a regional or national organisation.[31]

What business legal structure should a franchise have? There is no right or wrong answer to this question. A franchise can be any of the forms discussed in this chapter. The differences relate to tax treatment and liability. Franchise entrepreneurs should take care to protect their personal assets from business liability in relation to contracts they execute; for example, lease contracts and supplier contracts. For this reason many new franchisees are more interested in the corporate form for its tax differences than for its potential liability protection. The advantage they see is the potential that corporate income will be subject to tax rates lower than personal income rates. There are also possible benefits related to increased options for retirement accounts and different treatment of certain income tax deductions (see also related text on franchising in Chapter 6).

Final thoughts on legal forms

An entrepreneur always should seek professional legal advice in order to avoid misunderstanding, mistakes and, of course, added expenses. The average entrepreneur encounters many diverse problems and stumbling blocks in venture formation. Since they do not have a thorough knowledge of law, accounting, real estate, taxes and governmental regulations, an understanding of certain basic concepts in these areas is imperative.

The material in this chapter is a good start towards understanding the legal forms of organisations. It can provide entrepreneurs with guidelines for seeking further and more specific advice on the legal form that appears most applicable to their situation. The following key questions can be helpful for placing legal forms of business in perspective:

- What is the size of the risk? What is the amount of the investor's liability for debts and taxes?
- What would the continuity (life) of the firm be if something happened to the principal(s)?
- What legal structure would ensure the greatest administrative adaptability for the firm?
- What effects will federal, state and local laws have on the operation?
- What are the possibilities of attracting additional capital?
- What are the needs for and possibilities of attracting additional expertise?
- What are the costs and procedures associated with starting the operation?
- What is the ultimate goal and purpose of the enterprise and which legal structure can best serve this purpose?

BANKRUPTCY

'Looking back on it, my judgement was often terribly wrong', said one entrepreneur who had burned through more than $20 million trying to launch a Web-based business. 'Unfortunately, I was never in doubt.'[32]

How do we define **business failure**? According to Shepherd, it occurs:

> . . . when a fall in revenues and/or rise in expenses are of such magnitude that the firm becomes insolvent and is unable to attract new debt or equity funding; consequently, it cannot continue to operate under the current ownership and management.[33]

In other words, bankruptcy occurs when a venture's financial obligations are greater than its assets. Shepherd et al. observe three reasons for business failure:

- **The liability of newness**: There are higher costs for new firms in learning new tasks. Organisational conflicts are higher in new firms. There are barriers to entry for new firms. Competitors will sometimes commit unethical acts against new start-ups.
- **Overconfidence**: Entrepreneurs rank their chances of success at over 70 per cent. Perhaps there is a 'hubris theory of entrepreneurship'.
- **Lack of experience**: Entrepreneurs with more experience will generally possess the knowledge to perform more effectively the roles and tasks necessary for success.[34]

No entrepreneur intentionally seeks bankruptcy. Although problems can occasionally arise out of the blue, here are several ways to foresee impending failure:

- new competition enters the market
- other firms seem to be selling products that are a generation ahead
- the research and development budget is proportionately less than the competition's
- retailers always seem to be overstocked.[35]

The rate of bankruptcy differs from country to country. New Zealand and the US have relatively high 'churn' or firm failure and that leads to bankruptcy. Other countries, such as Thailand, South Korea and Japan, have extraordinarily low rates of bankruptcy.

In various countries bankruptcy carries a social stigma with it.[36] The society sees it as a sign of financial irresponsibility and failed entrepreneurs often find it difficult to obtain credit. The entrepreneur may suffer from loss of esteem and other negative social attitudes.

THE LEGAL FRAMEWORK REGULATING CLIMATE CHANGE

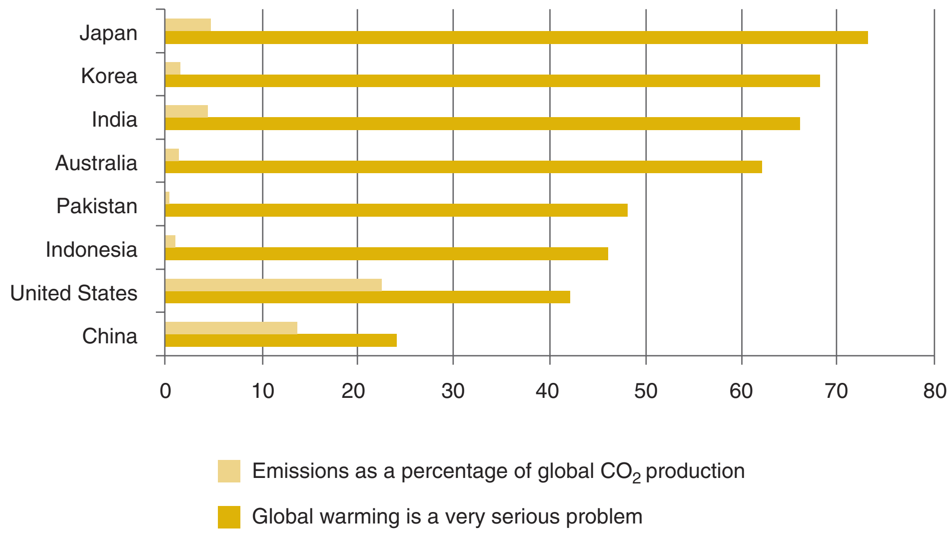
From outer space you can view a huge layer of air pollution that covers parts of the northern Indian Ocean, India, Pakistan, and parts of South Asia, Southwest Asia and China. It's called the 'Asian brown cloud', a giant brown stain hanging in the air over much of Asia and the Indian Ocean every year between January and March. But panning down it's staggering to see tiny Singapore, which has one of the world's highest rates of per capita CO_2 outputs exceeding both the US and Australia. China and India rank far behind. Yet while there is nearly universal awareness of global warming there is no evidence of alarm over global warming in either the US or China – the two largest producers of greenhouse gases (GHGs). In other words, consumers in the two countries responsible for the most emissions of GHGs care least about the issue.

The first and perhaps most successful regulation put on business had to do with air-conditioning and refrigeration. Back in 1987, the United Nations outlawed the use of chlorofluorocarbons (CFCs) in the Montreal Protocol on Substances that Deplete the Ozone Layer. Not only is this one of the first examples of international co-operation to limit greenhouse gases but it also shows how business can benefit by taking up the challenges imposed by regulations.

CFCs had four main uses: cooling agents in refrigeration and air-conditioners, solvent to clean electronic equipment, a propellant in aerosol sprays and a foaming agent in packaging. DuPont alone produced one-quarter of the world's CFC, which it marketed as Freon. But the company decided to support international controls on CFCs and to devote millions to research on substitutes. There are strong signs that the ozone layer will recover within the next 100 years. What the Montreal Protocol did was recognise the importance of stimulating and developing new technologies so that industry could use non-depleting alternatives and provide developing countries access to these technologies.[37]

Companies with international operations are today increasingly subject to various emissions regulations and standards in key markets. There already has been a move to regulate greenhouse gases at the level of international conventions sponsored by the United Nations. The UN Framework Convention on Climate Change and the Kyoto Protocol embody the core principles of a multilateral response to climate change.

FIGURE 7.3: **CO_2 EMISSIONS AND GLOBAL WARMING CONCERNS**



Sources: World Resources Institute, *Climate and Atmosphere Country Profiles,* http://earthtrends.wri.org; *Global Economic Gloom – China and India Notable Exceptions,* 24-Nation Pew Global Attitudes Survey, http://pewglobal.org

The international response to climate change dates back to 1979 when the first World Climate Conference highlighted concerns arising from increased carbon dioxide in the atmosphere. In 1988 the UN General Assembly passed a resolution, proposed by Malta, in favour of the protection of the climate for present and future generations. In the same year the World Meteorological Organisation and the United Nations Environment Programme jointly created the **Intergovernmental Panel on Climate Change (IPCC)**. The IPCC issued its First Assessment Report in 1990, confirming that climate change was a real concern and that human activities were likely to be contributing to it. In recognition of the global nature of the problem, the **United Nations Framework Convention on Climate Change** (UNFCCC) was agreed at the Earth Summit in Rio de Janeiro in 1992. All major developed and developing countries, 189 in all, have ratified the Convention.[38] The UNFCCC sets the overarching objective for multilateral action: to stabilise greenhouse gas concentrations in the atmosphere at a level that avoids dangerous human-caused climate change. It also establishes key principles to guide the international response, in particular that countries should act consistently with their responsibility for climate change as well as their capacity to do so, and that developed countries should take the lead given their historical contribution to greenhouse gas emissions. The Convention places a commitment on all signatories to act. Whereas for developing countries this commitment is unquantified and linked to assistance from developed countries, the developed countries agreed to return greenhouse gas emissions to 1990 levels by 2000.

The **Kyoto Protocol** is the key international agreement on climate change, and ties 36 industrialised nations to caps on greenhouse gas emissions by 2012. Unhappy about this lack of emission limits for developing countries, the US has not acceded to the Kyoto Protocol and is, therefore, not bound by its emission controls.

Asia is a crucial part of the negotiations, representing half of humanity and a large and rapidly growing share of the greenhouse gas pollution blamed for warming the planet. A brief look at the key players reveals the following:

- **China**: The world's top producer of greenhouse gases. Rich nations are exerting huge pressure on China to lower its emissions, but Beijing says economic growth is still the top priority for the developing nation. However, China's per capita emissions are far below those of rich countries.
- **India**: Has passed Russia as the No. 3 greenhouse gas emitter, though its per-capita emissions are a tenth of those in the US. It blames the bulk of greenhouse pollution on rich countries.
- **Australia**: The world's top coal exporter has already pledged to cut emissions and is a strong backer of a UN scheme that aims to save rainforests in developing nations in return for tradeable carbon credits. It wants Singapore and South Korea, currently not bound by Kyoto's 2008–12 first phase, to play a greater role in fighting climate change post-2012.[39]
- **Japan**: The world's fifth-highest emitter is far above its Kyoto target and has called for developing nations to agree on targets, albeit less strict ones than rich nations.
- **Indonesia**: Indonesia confronts global outrage over its release of vast amounts of CO_2 from burning and clearing forests.

Nonetheless, most of Asia, while having ratified Kyoto, does not report on emissions or announce reduction targets.

The Kyoto protocol may be on everyone's minds, but a dramatic ramp-up on environmental regulation is the next big thing that entrepreneurial businesses must tackle. A number of countries are close to a 'tipping point' that will result in greater regulatory involvement in climate issues and the resulting change in corporate behaviour. Pressure is coming from consumers and investors. Consumers are expressing growing interest in climate change, while the burgeoning number of climate-related regulations – ranging from usage of bio-fuels to building efficiency standards – means that individuals worldwide are increasingly aware of climate issues in their daily lives. Investors are concerned that corporations acknowledge the risks associated with climate issues.

SUMMARY

The regulatory environment for Asia–Pacific entrepreneurs is varied and complex. Doing business in Australia or New Zealand is quite different from doing business in Singapore or other countries in our region. The most important regulatory areas that influence entrepreneurs are bankruptcy laws, business formation, contract enforcement, credit regulations, international trading regulations, investor protection, labour regulations, licensing and permits and property laws.

A patent is an intellectual property right that is a result of a unique discovery. Patent holders are provided protection against infringement by others. This protection is for 14 years in the case of design patents and for 20 years in all other cases.

A copyright provides exclusive rights to creative individuals for the protection of their literary or artistic productions. This protection extends for the life of the author plus 50 years. In case of infringement, the author (or whoever holds the copyright) can initiate a lawsuit for infringement. This action can result in an end to the infringement and, in some cases, the awarding of financial damages.

A trademark is a distinctive name, mark, symbol, or motto identified with a company's product(s). When an organisation registers a trademark, it has the exclusive right to use that mark. The registration before 1989 lasts for 20 years. However, after 1989 registration is for 10 years and is renewable every 10 years thereafter. In case of infringement, the trademark holder can seek legal action and damages.

New forms of business require new forms of intellectual property protection. On the Internet it is important to protect domain names and trademarks. There are international provisions available through the World Intellectual Property Organisation (WIPO) that greatly speed up enforcement of provisions.

Trade secrets are business processes and information that are unpatentable and their protection is only possible with employer and employee cooperation. Prosecution is still difficult in many of these cases.

There are numerous rogue states and overseas havens when it comes to intellectual property rights protection. The wise entrepreneur has protections in place to guard against profit rip-offs.

The chapter then turned to examine the major forms of legal organisation. The advantages and disadvantages of each form were highlighted and compared. In addition, the characteristics and tax considerations of partnerships were compared with those of corporations.

The specific forms of partnerships and corporations were examined. In particular, the requirements and benefits of limited partnerships, incorporated limited partnerships and limited liability companies were presented.

Additional corporation classifications were reviewed and a section was devoted to the corporate considerations of costs.

Environmental regulations already exist in key markets. A number of countries are close to a 'tipping point' that will result in greater regulatory involvement in climate issues and the resulting change in corporate behaviour.

KEY TERMS & CONCEPTS

asset protection
bankruptcy
business failure
cooperative society
copyright
corporation
double taxation
fair use doctrine
flow-through taxation
franchise
Inc.
incorporated company
incorporated limited partnership (ILP)
incorporation
intellectual property rights
Intergovernmental Panel on Climate Change (IPCC)
Kyoto Protocol
limited liability
limited liability partnership (LLP)
limited partnerships
non-profit organisation
partnerships
patents
piracy
private limited company
proprietary limited company (Pty Ltd)
public limited company
regulatory body
rogue states
sole tradership
taxation
trade secrets
trademarks
trading trust
unincorporated businesses
United Nations Framework Convention on Climate Change
unlimited liability

REVIEW & DISCUSSION QUESTIONS

1. Briefly discuss each of the following effects of governmental regulations on small ventures: bankruptcy laws, business formation, contract enforcement, credit regulations, international trading regulations, investor protection, labour regulations, licensing and permits and property laws.
2. In your own words, what is a patent? Of what value is a patent to an entrepreneur? What benefits does it provide?
3. What are four basic rules entrepreneurs should remember about securing a patent?
4. When can a patent be declared invalid? Cite two examples.
5. If a patent is infringed on by a competitor, what action can the patent holder take? Explain in detail.
6. In your own words, what is a copyright? What benefits does a copyright provide?
7. How much protection does a copyright afford the owner? Can any of the individual's work be copied without paying a fee? Explain in detail. If an infringement of the copyright occurs, what legal recourse does the owner have?
8. In your own words, what is a trademark? Why are generic or descriptive names or words not given trademarks?

9 When may a trademark be invalidated? Explain.
10 What is a domain name? Give some examples of interesting cases of domain name infringement.
11 What are trade secrets? Why has Coca-Cola benefited from protecting its formula through trade secret rather than patenting the formula?
12 Identify the legal forms available for entrepreneurs structuring their ventures.
13 Define each of the following: sole tradership, partnership and corporation.
14 What are the specific advantages and disadvantages associated with each primary legal form of organisation?
15 Name three specific types of partners. How do they differ?
16 Explain the limited liability partnership.
17 How does a limited partnership work? Give an example.
18 What is a limited liability company?
19 Give your own examples of rogue states or overseas havens when it comes to intellectual property rights protection.
20 What was the first (and perhaps) the most successful global environmental regulation?
21 What impact does the Kyoto Protocol have on entrepreneurs?
22 What do you foresee in terms of future environmental regulations that will undoubtedly affect entrepreneurial ventures?

EXPERIENTIAL EXERCISE: GET IT RIGHT

The following list of advantages and disadvantages is associated with sole traderships, partnerships and corporations. Place an *S* next to those that relate to sole traderships, a *P* next to those that relate to partnerships and a *C* next to those that relate to companies. If the advantage or disadvantage applies to more than one type of organisational form, put all answers on the accompanying line. Answers are provided at the end of the chapter.

ADVANTAGES		DISADVANTAGES	
1	*Limited liability*	*1*	*Unlimited liability*
2	*Sole ownership of profits*	*2*	*Governmental regulation*
3	*Unlimited life*	*3*	*Lack of continuity*
4	*Ease of formation*	*4*	*Double taxation*
5	*Flexibility*	*5*	*Difficulty obtaining large sums of capital*
6	*Transfer of ownership*	*6*	*Organising expenses*
7	*Relative freedom from governmental control*	*7*	*Relatively limited viewpoint and experience*
8	*Increased ability and expertise.*	*8*	*Activity restrictions.*

EXPERIENTIAL EXERCISE: WHAT KIND OF TRADEMARK?

For each of the following trademarks, indicate whether you think it is suggestive, fanciful, arbitrary or generic by placing an *S*, *F*, *A* or *G* alongside. Answers are provided at the end of the chapter.

1 COPPERTONE for suntan oil
2 REEBOK for shoes
3 ROACH MOTEL for insect traps
4 MERCURY SOFTWARE for software that speeds communication
5 PHOENIX VENTURES for an investing firm that focuses on investing in failing companies and reviving these companies
6 ARETE COACHING for life coaches ('arete' is the Greek word for 'overall excellence')
7 QANTAS
8 AIR NEW ZEALAND

EXPERIENTIAL EXERCISE: PROTECTING YOUR LEGAL INTERESTS

Entrepreneurs need to know how to legally protect their interests in a property or work. The most effective way to gain legal protection is to obtain a copyright or a trademark. Two definitions – (1) and (2) – are given here. Place a *C* next to the one that defines a copyright; place a *T* next to the one that defines a trademark. Then, on the list underneath (a to j), place a *C* next to each item that could be protected with a copyright and a *T* next to each item that could be protected with a trademark. Answers are provided at the end of the chapter.

1 A distinctive name, mark, symbol, or motto identified with a company's product
2 An exclusive protection of a literary or an artistic production

- a Best-selling novel
- b Logo
- c Company's initials (such as IBM or ITT)
- d Motion picture
- e Word (such as Coke or Pepsi)
- f Computer program
- g Musical comedy
- h Slogan
- i Stage play
- j Symbol

CASE 7.1: GLORIA'S DECISION

When Gloria Talavera opened her boutique in Manila six years ago, she had only one full-time employee. Since then Gloria has added two general partners and greatly expanded the operation. Over the past year, it has become obvious that the group could open another boutique that would be equally successful. The problem is money. The partnership lacks funds for expansion.

Gloria's banker has suggested that the partnership borrow $200 000 from the bank and pledge the business assets as collateral. 'This will get you the money you need and once you have the boutique going, you can repay the money', he told them. The idea sounds fine to the partners, although they are concerned about the risk involved. If the second boutique does not do well, it could affect the success of the first boutique by siphoning off funds to repay the loan.

Gloria has been thinking about incorporating the business, selling shares and using these funds for expansion purposes. She has not shared this idea with her banker because she wants to give it more thought, but she intends to talk it over with her partners later in the week.

Questions

1 What are the benefits of incorporating a company to operate the business and raising money through the issue of shares? Is this a better idea than the banker's proposal of taking a $200 000 loan? Why or why not?
2 What would you recommend to Gloria? Explain in detail.

CASE 7.2: A QUESTION OF INCORPORATION

The Harlow family opened its first motel in 1982. Initially, business was slow. It took almost 11 months to break-even and three years for the Harlows to feel that the operation was going to be a success. They stuck with it and by 1987 they were able to increase the size of the motel from 28 to 50 rooms. They expanded again in 1989, this time to 100 rooms. In each case, the motel's occupancy rate was so high that the Harlows had to turn people away during the months of November to April and the occupancy rate was 85 per cent during the other months. By industry standards theirs was one of the most successful motels in the country.

As they entered the 1990s, Harold and Becky Harlow decided that, rather than expanding, they would be better off buying another motel, perhaps in a nearby locale. They chose to hire someone to run their current operation and spend most of their time at the new location until they had it running properly. In 1992, they made their purchase. Like their first motel, the second location was an overwhelming success within a few years. From then on, the Harlows bought a number of new motels. By 1999, they had seven motels with an average of 100 rooms per unit.

During all of this time, Becky and Harold kept their own financial records, bringing in a chartered accountant only once a year to close the books and prepare their income tax returns. Last week the new accountant asked them how long they intended to keep running seven motels. The Harlows told him that they enjoyed the operation and hoped to keep at it for another 10 years, when they planned to sell out and retire.

Harold admitted that trying to keep all of the motels going at the same time was difficult, but noted that he had some excellent managers working for him. The accountant asked him whether he would consider incorporating. 'If you incorporate', he said, 'you could sell shares and use the money to buy more motels. Additionally, you could keep some of the shares for yourself so you could maintain control of the operation, sell some for expansion purposes and sell the rest to raise some money you can put aside in a savings account or some conservative investment. That way, if things go bad, you still will have a nest egg built up.' The accountant also explained to Harold and Becky that, as a partnership, they are currently responsible for all business debts. With a corporation, they would have limited liability; that is, if the corporation failed, the creditors could not sue them for their personal assets. In this way, their assets would be protected, so the money the Harlows would get for selling the shares would be safely tucked away.

The Harlows admitted that they had never really considered another form of organisation. They always assumed that a partnership was the best form for them. Now they are willing to examine the benefits of a corporation and they will go ahead and incorporate their business if this approach promises them greater advantages.

Questions

1. What are the advantages and disadvantages of a partnership?
2. Contrast the advantages and disadvantages of a partnership with those of a corporation.
3. Provide your opinion on whether the Harlows should incorporate.
4. Would the limited liability company option be of value to them? Explain.

CASE 7.3: NEW ZEALAND AND KIWIFRUIT

There are at least three things named 'kiwi'. There's the flightless endangered ground dwelling bird in the New Zealand forest. There is the fruit, a relative of the Chinese gooseberry. And there are the people of New Zealand, who are often referred to as Kiwis.

The 100th year that the Chinese gooseberry (aka kiwifruit) arrived on New Zealand shores from China was marked in 2004. For years, New Zealand dominated the production of the fruit, but since the early 1990s it lost ground to foreign producers and lost control of the intellectual property related to its production.

While New Zealand was one of the first to export kiwifruit, its history began in China. In 1904, girl's college headmistress Isabel Fraser brought kiwifruit from the Yangtze valley to New Zealand and called it 'Chinese gooseberries'. By the mid-1920s horticulturalist Hayward Wright had developed its shape, colour, fuzzy skin and cool-lime taste. American sailors who landed during the Second World War were hooked on this exotic fruit and carried its reputation back home. By the 1950s New Zealand was supplying kiwifruit to the British market and was penetrating the American market through San Francisco. Branding advice suggested calling it the kiwifruit after the small national bird's brown fur. As to the fruit's parentage, one Chinese diplomat generously labelled the kiwifruit a 'crystallisation of the profound friendship between two people'. Surprisingly, the world's second largest production comes from Italy, followed by France, Japan and the US. This increased production led to a decline of kiwifruit prices between 1982 and 1988.

Enter 'Zespri'. Kiwifruit growers, with the support of the New Zealand Kiwifruit Marketing Board, re-engineered the fruit to have a golden colour and a soft honey-like taste. This led to huge growth of Zespri gold kiwifruit during the early 2000s. More importantly, they protected everything to do with its marketing including its 'trade dress' (everything that distinguishes it, the 'total image'): ZESPRI Group Limited is the owner of all intellectual property rights connected with the ZESPRI™ brand and its associated visual identity and trade dress including ZESPRI™, ZESPRI™ logo, D'LISH™, D'LISH™ Logo, ZESPRI™ GREEN Kiwifruit, ZESPRI™ GOLD Kiwifruit, ZESPRI™ BRIGHT GREEN Colour and combinations of the ZESPRI™ BRIGHT GREEN and DARK GREEN Colours of the ZESPRI™ Visual Identity, ZESPRI™ RED Colour, ZESPRI™ GOLD Colour and a combination of the ZESPRI™ RED and GOLD Colours of the ZESPRI™ Visual Identity, zespri.com and related domain names in relation to kiwifruit and related products.

Source: Re-written from Shinyoung Yun, 'New Zealand & Kiwifruit', *TED Case Studies Number 758*, 2004, www.american.edu/TED/kiwi.htm

Questions

1 What lessons did New Zealand kiwifruit growers learn from their experience?
2 What remedies did they seek in developing a new variety of the fruit?

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Why is Property Rights Pprotection Lacking in China? An Institutional Explanation

Publication date: 1 May 2004
Author(s): Shaomin Li
Product number: CMR286

China is one of the most important foreign investment markets in both volume and growth. However, property rights protection in China is extremely weak and expropriations by both public and private actions are rampant. How can the booming of foreign investment and the looting of property co-exist? Why is protecting property rights so difficult in China? This case shows that the different paces of institutional change between formal and informal constraints are the major cause behind the lack of property rights protection in China. It also discusses policy considerations for China to improve property rights protection and raises two fundamental issues for multinational firms doing business in China.

Bundy Asia Pacific – China Strategy

Publication Date: 20 April 2008
Author(s): Paul W. Beamish, Nancy Wang, Steven Zuo
Product Number: 9-998-M03

This is a rich case with detailed discussion possible around issues including: (a) business (re)development strategy, (b) joint ventures versus wholly owned subsidiaries, (c) organisational structure and (d) intellectual property rights violations. This is one of the first China-based cases which reflects just how competitive Indigenous Chinese manufacturing has become in recent years. It focuses on issues of mode choice, parent–subsidiary relations, dealing with intellectual property rights violations and the downside of joint-venturing.

Chery Automobile Company: Evolution of the Chinese Automotive Industry

Publication Date: 15 November 2007
Authors: Ali Farhoomand, Marcus Scheutz, Richard Farmer
Product Number: HKU676

In 1908 Henry Ford revolutionised the car industry by drastically cutting production costs using assembly lines. A century later, on the other side of the world, an unknown Chinese car manufacturer, the Chery Automobile Company, was partaking in an ostensibly similar revolution. In December 2004, GM Daewoo sued Chery for design piracy. Chery ignored threats to sue for violations of intellectual property rights (IPR) and is in a protected environment. Chery is successful because it has copied the right product and has benefited because no foreign manufacturer has been able to build a cheap and reliable car for the Chinese market.

Business and International Environmental Treaties: Ozone Depletion and Climate Change

Publication Date: 1 April 1997
Author(s): David L. Levy
Product Number: 9-CMR-081

The study of business interests adds an important dimension to our understanding of the development of international environmental agreements. The contrasting role of business interests in the cases of ozone depletion and climate change is critical to explaining why climate change is a much more difficult issue for the international community to tackle. In the case of ozone depletion, industry concentration and the technological factors provided incentives for industry leaders to invest in alternative products and processes. By contrast, fossil fuel substitutes present a long-term strategic threat to the major sectors that produce and use these fuels. Where relatively few actors were involved in ozone depletion, it will be much more difficult to craft an agreement that is acceptable to the broad range of industries affected by climate change. However, business does have substantial influence over the timing and shape of international environmental agreements, even when there is considerable disunity within business ranks.

Answers to 'Get it Right'

ADVANTAGES		DISADVANTAGES	
1	*C*	*1*	*S, P*
2	*S*	*2*	*C*
3	*C*	*3*	*S, P*
4	*S, P*	*4*	*C*
5	*S, P*	*5*	*S, P*
6	*C*	*6*	*C*
7	*S, P*	*7*	*S*
8	*C*	*8*	*C*

Answers to 'What Kind of Trademark?'

1	S
2	F
3	S
4	S
5	S
6	F
7	A
8	G

Answers to 'Protecting your legal interests'

1 T
2 C
- a C
- b T
- c T
- d C
- e T
- f C
- g C
- h T
- i C
- j T

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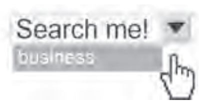


asset protection
bankruptcy
copyright
double taxation
fair use doctrine
flow-through taxation
franchise
incorporated companies
incorporated limited partnership (ILP)
incorporation
intellectual property rights
Kyoto Protocol
limited liability
limited liability partnership (LLP)
non-profit organisation
patents
piracy
rogue states
trade secrets
trademarks
United Nations Framework Convention on Climate Change

8

SOURCES OF FINANCE FOR ENTREPRENEURIAL VENTURES

Money is like a sixth sense without which you cannot make a complete use of the other five.

William Somerset Maugham, *Of Human Bondage*

He taonga no te whenua me hoki ano ki te whenua. What is given by the land should return to the land.

Māori proverb

chapter objectives

- **01** To be able to distinguish among the five forms of entrepreneurial capital
- **02** To identify how informal investors differ from other parts of the funding community
- **03** To differentiate between debt and equity as methods of financing
- **04** To examine commercial loans and public stock offerings as sources of capital
- **05** To understand the stages of venture investing
- **06** To study the market for venture capital and to review venture capitalists' evaluation criteria for new ventures
- **07** To discuss the importance of evaluating venture capitalists for a 'best fit' selection
- **08** To discuss private placements as an opportunity for equity capital
- **09** To examine the business angel market
- **10** To describe new forms of entrepreneurial capital beyond financial capital
- **11** To be familiar with Islamic finance and micro-credit
- **12** To understand the criteria used by socially responsible investors
- **13** To appreciate the need for raising natural capital as part of an entrepreneurial venture.

There was a time when an entrepreneur with a bright idea could just walk into a venture capitalist's office in Silicon Valley or Shanghai and get a heap of money to develop that idea. The VC would take a slice of the company and the entrepreneur would take the money and make something of it – or not.

Now, in a global recession, those days are gone. However, like all change, this situation has created its own opportunity, one that can benefit both the funding community and the start-up venturer. Funding in the new era will not simply be thrown at companies in the hope that one in 10 is wildly successful. Today, funding goes only to entrepreneurs who thoroughly understand their customers' requirements and who can insure the funder from the beginning that every product delivers on its value. This is a painful change for all those young entrepreneurs dreaming of the bygone era of 'free money'. They thought all they had to do was finish their studies and they would be offered a job with a terrific salary while they created fantastically cool, but not necessarily immediately cash-generating, businesses.

Today, Indian, Chinese and many other diverse entrepreneurs are still flooding to knowledge clusters around the world. They have similar pedigrees and the same fantastic depth and business acumen, but their attitudes differ. They are willing to live in cramped apartments and work day and night. These guys and gals are happy with $10 000 in funding from individuals rather than $10 million from VC firms. Meanwhile, they are building the same innovative and world-changing products as their earlier colleagues. As Pat House of Oracle and Siebel Systems fame says, 'the recession will trigger opportunities that will be seized upon by real entrepreneurs whose grit, determination and ferocity in building something will . . . drive us out of the recession'.[1]

In this chapter, we examine the sources of capital available to new ventures, with some insights into the approach required of the entrepreneur. We focus on **financial capital**, but we also make mention of other forms of capital that can be used in creating a new venture. We do not neglect alternative forms of finance such as micro-credit and Islamic banking. We return at the end to a discussion of the relationship of natural capital to entrepreneurial activity.

WHAT ARE THE FORMS OF ENTREPRENEURIAL CAPITAL?

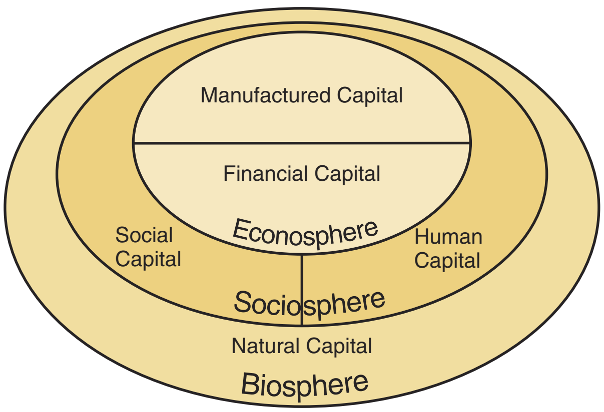
While this chapter is mostly about financial capital, it is important first to note that there are other forms of entrepreneurial capital. There is a growing consensus that other kinds of natural and social capital function in such a similar manner to classical 'industrial infrastructural capital', which drove 19th- and 20th-century entrepreneurship.

At its base, **capital** is any resource (human-made or natural) that is used to create other goods or services.[2] We call them all **factors of production,** or simply the '**Five Capitals**'. The Five Capitals Model of sustainable development was developed by the organisation Forum for the Future.[3] These are the types of sustainable capital from which we derive the goods and services we need to improve the quality of our lives. Two of them (financial and manufactured capital) are what we might call classical capital and are at the core of the entrepreneurial economy (see Figure 8.1). But there are three others kinds of capital that are just as important for start-up venturers in the new millennium. Let's look at all five of them:

- **Financial capital**, sometimes just called 'money', is the core of what entrepreneurs use to leverage other resources in the process of making products and services for the marketplace. This starts off typically being one's own cash or perhaps the funding from lenders or investors that entrepreneurs use to buy real capital equipment. Financial capital is usually provided with some *strings attached*, which is the subject of this chapter. Of course, capital can also be obtained by saving and investing the surplus or profit on production. The curious thing is that money has no real *value* in itself; dollars are only pieces of paper with printing on them. They do represent the other five forms of capital (they can be exchanged for them).

- **Manufactured capital** is made up of physical goods (ironically known as 'the plant') such as machinery for manufacturing, boats for fishing, computers for telecommunications and so forth. These are the material goods or fixed assets that contribute to production rather than being the output itself.
- **Human capital** incorporates peoples' health, knowledge, skills, intellectual outputs, motivation and capacity for relationships. It is the talent that we carry around inside us. This ingenuity or skills is a product of many years of training and upbringing. People trade this talent for money, trust, or equity. We call this **human resources** or labour. Entrepreneurs must protect and enhance this renewable resource of human labour and personal creativity available to them through their employees and personal networks.
- **Social capital** is the value of a person's network. It consists of trusting relationships between individuals through families, communities, businesses, schools and voluntary organisations. Just as a screwdriver (physical capital) or a college education (human capital) can increase productivity (both individual and collective), so too social contacts affect the productivity of individuals and groups. Social capital 'refers to the collective value of all "social networks" and the inclinations that arise from these networks to do things for each other'.[4] Entrepreneurs must cultivate their own communities and networks and trustfully use those of others.
- **Natural capital** is the stock of natural ecosystems that entrepreneurs use to create goods or services for their markets. Natural capital is different from other forms of capital in that it cannot be produced by human activity.[5] Well-managed, natural capital can be indefinitely sustainable; for example, the ocean can provide a constant flow of fish for human consumption. Natural capital can also supply services like waste recycling in mangrove swamps, sinks that absorb greenhouse gases, or water supply and erosion control. The stock of natural capital functions interdependently. It requires a **whole systems approach** to diversity of the system.[6] Entrepreneurs must take care: (1) not to exceed the Earth's **carrying capacity** to disperse, absorb, recycle or otherwise neutralise their harmful effects; and (2) protect (even increase) the Earth's biological diversity and productivity.

FIGURE 8.1: 'THE FIVE CAPITALS' MODEL

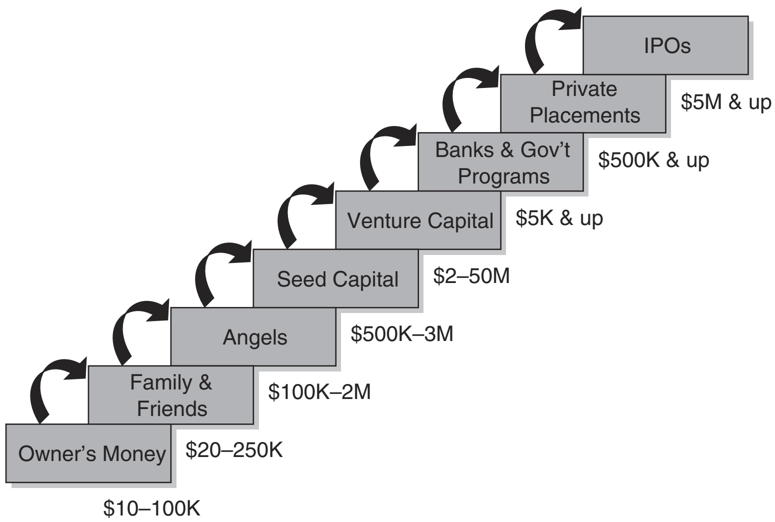


Source: Forum for the Future, www.forumforthefuture.org

FIGURE 8.2: WHO IS FUNDING ENTREPRENEURIAL START-UP COMPANIES?

Financing Continuum

The following diagram depicts the typical financing for start-up companies.



Source: 'Successful Angel Investing', Indiana Venture Center, March 2008

Every entrepreneur planning a new venture confronts the dilemma of where to find start-up capital – indeed, what type of capital to use and when. It is important, therefore, to understand not only the various sources of entrepreneurial capital, but also the expectations and requirements of these sources. Without this understanding, an entrepreneur may be frustrated with attempts to find appropriate start-up capital.

We now turn to the best known and perhaps most important form of capital for entrepreneurs: financial capital.

SOURCES OF FINANCIAL CAPITAL FOR ENTREPRENEURS Studies have investigated the various sources of finance preferred by entrepreneurs.[7] As illustrated in Figure 8.2, entrepreneurs have a number of sources of financial capital as their ventures develop. Notice that the level of risk and the stage of the firm's development should determine the appropriate source of financing for the entrepreneurial ventures.

STARTING UP WITH 'INFORMAL INVESTING' In Chapter 6, 'Pathways to entrepreneurial ventures', we started with a discussion of bootstrapping, the route that most entrepreneurs take to starting their new venture. In this chapter, we also start with a discussion of the method that most entrepreneurs use to raise their start-up capital. In fact, a lot of the start-up capital for new ventures does not usually come from banks or venture capitalists. It comes from the founders of the businesses and from those we call **informal investors**, or the **4Fs** – friends, family, founders and other 'foolhardy investors' (to that we could also add neighbours, work colleagues and even strangers).

These people use their own money and carry out their own (sometimes haphazard) **due diligence** to invest in the entrepreneurial opportunities of other entrepreneurs. In 2006, 4 per cent of adults around the world in the **Global Entrepreneurship Monitor (GEM)** survey were counted as informal investors (defined as providing funds for new business – excluding shares and mutual funds).[8] The rate varies wildly based on culture and other circumstances. India has an astounding rate of informal investing. Almost 14 per cent of Indians have provided funding to a new business within the last three years. In China, ask 13 people and you will find an informal investor. Ask 21 New Zealanders and you will find an investor.

The wealthier a nation, the higher the average annual amount of money that each informal investor puts into start-up companies. The amount ranges from $308 in the Philippines to $44 000 in the Netherlands.

Who are these informal investors? First and foremost, they are: close family relatives of the entrepreneurs (49.4 per cent), friends and neighbours (26.4 per cent), workmates (7.9 per cent), other relatives (9.4 per cent) and strangers (6.9 per cent).

What financial return do informal investors expect? GEM found that expected returns are affected by altruism because they increase as the relationship distance between the investor and the entrepreneur increases (that is, strangers expect higher returns than parents); that men expect higher returns than women; that entrepreneurs expect higher returns than non-entrepreneurs; that expected returns increase as the amount invested increases; that older persons expect lower returns than younger ones; and that entrepreneurs expect higher returns on investments in their own businesses than on their investments in others' businesses.[9]

Here is the bottom line for entrepreneurs – *by far the rarest source of capital for start-up entrepreneurs is classic venture capital*. Fewer than 37 out of every 100 000 companies will ever be backed by classic venture capital.[10] One could say that the attention paid to venture capital funding is inversely proportional to its importance to start-up entrepreneurs!

Meanwhile, informal investors spread their money all over the entrepreneurial landscape. In general, classic venture capital flows only to companies with superstar potential, while informal investment flows to companies in all segments. While almost every company begins with informal investment from the 4Fs, very few companies have formal venture capital at the outset. The paradox is that if there were no informal investment there would be virtually no new ventures. In contrast, if there were no venture capital, new ventures by the millions would still be getting off the ground!

How to get money from your family

You may have heard of the 'elevator pitch' for raising money from venture capital investors. But have you heard of the 'kitchen table pitch'? If you are thinking of raising money from someone close to you here are some tips:

- Know your investor's motivations. Some relatives and friends are truly into it for the altruism, but like all people your relatives and friends are also into it for the profit motive. When you are making the pitch around the kitchen table, be sure you list what is in it for them.
- Debt is better than equity for relatives and friends. Equity is 'funny money' to most people unless you intend to on-sell the business quickly. Let's say your sister invests $10 000 into your restaurant. The restaurant grows and her equity share grows too. However, if you divorce and have to split shares with your ex-husband, or the restaurant simply closes rather than being sold, your sister's investment is devalued or disappears.
- Make the pitch face-to-face, but follow-up with a written memo. Your relatives do not necessarily care about a formal business plan. But give them some documentation so there is no misunderstanding.[11]

WAYS TO FIND BOOTSTRAP CAPITAL

>>ENTREPRENEURSHIP IN PRACTICE

- >> **Build-out allowances from landlords**: Banks will often allow you to count build-out allowances as capital in your source and use of funds statement. While the money comes in and goes out, it does increase the overall cash flow and size of your deal.
- >> **Vertical integration**: Capital can often be raised from outside companies with a vested interest in developing either distribution channels, or assuring themselves of adequate product flow from cash-starved companies. Example: A distributor invested in his supplier in order to assure himself adequate inventory.
- >> **Professionals associated with the business**: Just present a way for investors to be more profitable in their own companies through the proposed investment. Law firms, advertising agencies, executive recruiters and professional consultants will often accept partial payment in stock, warrants or options in return for services. This is an excellent way to build a powerful team of professionals with a vested interest in your success and your success in raising capital. Many of these professionals are also angel investors, who can champion your cause with other private investors.
- >> **White knights**: If you are a retailer with poor credit and cannot get merchandise shipped without a direct payment, have someone with better credit buy the products and resell them to you. You may pay the white knight a few percentage points each month. If you have a high turnover ratio, it will allow you to re-establish cash flow and credit. Only a few specialists handle these types of operations, but you can find them through factoring companies.
- >> **Technical or professional expertise**: Many professionals are willing to reduce their fees in exchange for equity. Although the services will not be totally free, they are usually reduced by about 50 per cent. You may even be able to arrange options or warrants to avoid initial dilution. Moreover, you can provide the professional an exit strategy prior to an initial public offering if another large investor enters your market.
- >> **Sell licences or marketing rights**: Selling off rights to foreign or geographic markets or private labelling products is an excellent vehicle for young companies. You can use both exclusive and non-exclusive arrangements. All methods should have some type of quota and non-competition clauses. The downside is that later investors may feel that you have sold off too much of the potential, so they will not invest as readily.

Source: Adapted from Venture Planning Associates, '28 Ways to Finance your Venture', www.ventureplan.com/how.to.finance.your.venture.html

- Try to treat them as if they were strangers. Get some distance from the transaction. Have a friend present or have a lawyer prepare the promissory note.
- Try to avoid a repayment schedule. Tie your repayments to your cash flow. Give your relative a percentage of your operating cash flow until you have repaid the whole amount. If nothing else, this gives you a constant reminder of your obligation and is less likely to sour your personal relationships.
- Don't give voting stock. Often a family member or friend will be willing to finance your start-up, but also insists on a voting board seat. One thing you don't want is your 'rellies' looking over your shoulder and second-guessing every decision.[12]

DEBT VERSUS EQUITY Entrepreneurs need both debt financing and equity financing – all at the right time. Equity financing is best in the early start-up stages, especially during research and development and during product development. The use of debt to finance a new venture involves a payback of the funds plus a fee (interest) for the use of the money. Equity financing involves the sale of some of the ownership in the venture. Debt places a burden of repayment and

TABLE 8.1: HOW DIFFERENT FINANCE OPTIONS WILL AFFECT PROFITABILITY OR CASH FLOW

EQUITY FINANCING		DEBT FINANCING	
ADVANTAGES	**DISADVANTAGES**	**ADVANTAGES**	**DISADVANTAGES**
Can provide a large injection of capital	Capital is usually only available in very large amounts	Amount borrowed can vary according to your needs	It creates a debt obligation
No interest payments	It means ‘selling’ a part of your business	As long as it is repaid, it will not affect your ownership of the company	Interest will be charged – affecting profitability
No obligation to repay capital	Venture capitalists expect high returns on their investments (at least 25% pa)		Collateral is usually required and banks will value your assets conservatively
	Investors may require you to buy them out at a future point		If you borrow from friends or relatives it can sour relations if the business fails

Source: Adapted from Multimedia Development Corporation (Malaysia), ‘Funding Guide’, www.technopreneur.net.my/cms/AllProduct.asp?CatID=69

interest on the entrepreneurs, whereas equity financing forces the entrepreneur to relinquish some degree of control. In the extreme, the choice for the entrepreneur is: (1) to take on debt without giving up ownership in the venture, or (2) to relinquish a percentage of ownership in order to avoid having to borrow. In most cases, a combination of debt and equity proves most appropriate. Table 8.1 shows a summary of the differences between equity and debt financing.

Debt financing

Many new ventures find that **debt financing** is necessary. Short-term borrowing (one year or less) is often required for working capital and is repaid out of the proceeds from sales or other revenue. Long-term debt (term loans of one to five years or long-term loans maturing in more than five years) is used to finance the purchase of property or equipment, with the purchased asset serving as collateral for the loans. Commercial banks are the major source of debt financing for small business.[13]

Commercial banks

Although some banks will make unsecured short-term loans, most bank loans are secured by fixed assets, receivables (amount owed by customers), inventories, or other assets. Commercial banks also make a large number of intermediate-term loans with maturities of one to five years. In about 90 per cent of these cases, banks require collateral – generally consisting of stocks, machinery, equipment and real estate – and systematic payments over the life of the loan. Whether in Australia or the US, banks are not really interested in the entrepreneurs’ future prospects and do not really look at business plans indicating the viability of businesses and their capacity to meet debt repayments out of cash flow.

Yet these days entrepreneurs can actually expect more from a bank than just a loan. In the US, banks offer several services to a new venture, including computerised payroll preparation, letters of credit, international services, lease financing and money market accounts. Look for this trend to expand internationally. Asian banks outside of Singapore have been slow to expand their scope beyond credit to offer lucrative fee-based services, such as cash management, trade finance and treasury and risk management. More and more banks realise that fee-based products typically incur minimal or no charges for capital, making the returns far more attractive. Increasingly Asian banks recognise that everyone has individual needs and people come from different cultures and communities.

To secure a bank loan, an entrepreneur typically will have to answer five questions. Five of the most common, together with descriptive commentaries, are:

- **What do you plan to do with the money?** Do not plan to use funds for a high-risk venture. Banks seek the most secure venture possible.
- **How much do you need?** Some entrepreneurs go to their bank with no clear idea of how much money they need. All they know is that they want money. The more precisely the entrepreneur can answer this question, the more likely the loan will be granted.
- **When do you need it?** Never rush to the bank with immediate requests for money with no plan. Such a strategy shows that the entrepreneur is a poor planner and most lenders will not want to get involved.
- **How long will you need it?** The shorter the period of time the entrepreneur needs the money, the more likely they are to get the loan. The time at which the loan will be repaid should correspond to some important milestone in the business plan.
- **How will you repay the loan?** This is the most important question. What if plans go awry? Can other income be diverted to pay off the loan? Does collateral exist? Even if a quantity of fixed assets exists, the bank may be unimpressed because it knows from experience that assets sold at a liquidation auction bring only a fraction of their value. Five to 10 cents in the dollar is not unusual.[14]

Remember that banks are businesses too. They have **shareholders** to whom they must report and they are highly regulated by federal and state agencies. They may sometimes not lend to certain industries based on their corporate policy.

Debt financing has both advantages and disadvantages. On the plus side, you don't have to give up ownership of your company. More borrowing allows for potentially greater return on equity. And during periods of low interest rates, the **opportunity cost** is justified since the cost of borrowing is low. On the minus side, you will have regular (monthly) interest payments. Continual cash-flow problems can be intensified because of payback responsibility. Heavy use of debt can inhibit growth and development.

Other debt-financing sources

Banks are not the only source of debt financing. Sometimes a new venturer can obtain long-term financing for a particular piece of equipment from the manufacturer, who will take a portion of the purchase price in the form of a long-term note. Manufacturers are most willing to do this when an active market exists for their used equipment, so if the machines must be repossessed they can be resold. In addition, new ventures sometimes can obtain short-term debt financing by negotiating extending credit terms with suppliers. However, this kind of trade credit restricts the venture's flexibility with selecting suppliers and may reduce its ability to negotiate supplier prices.

Other debt-financing sources include trade credit, accounts receivable factoring, finance companies, leasing companies, mutual savings banks, savings and loan associations and insurance companies. Table 8.2 provides a summary of these sources, the business types they often finance and their financing terms.

Trade credit is credit given by suppliers who sell goods on account. This credit is reflected on the entrepreneur's balance sheet as accounts payable and in most cases it must be paid in 30 to 90 days. Many small, new businesses obtain this credit when no other form of financing is available to them. Suppliers typically offer this credit as a way of attracting new customers.

Accounts receivable financing is short-term financing that involves either the pledge of receivables as collateral for a loan or the sale of receivables (factoring). Accounts receivable loans are made by commercial banks, whereas factoring is done primarily by commercial finance companies and factoring concerns.

TABLE 8.2: COMMON DEBT SOURCES

	BUSINESS TYPE FINANCED		FINANCING TERM		
SOURCE	START-UP FIRM	EXISTING FIRM	SHORT TERM	INTERMEDIATE TERM	LONG TERM
Trade credit	Yes	Yes	Yes	No	No
Commercial banks	Sometimes, but only if strong capital or collateral exists	Yes	Frequently	Sometimes	Seldom
Finance companies	Seldom	Yes	Most frequent	Yes	Seldom
Factors	Seldom	Yes	Most frequent	Seldom	No
Hire purchase	Sometimes	Yes	No	Yes	Occasionally
Leasing companies	Seldom	Yes	No	Most frequent	Occasionally
Mutual savings banks and savings-and-loan associations	Seldom	Real estate ventures only	No	No	Real estate ventures only
Insurance companies	Rarely	Yes	No	No	Yes

Accounts receivable bank loans are made on a discounted value of the receivables pledged. A bank may make receivable loans on a notification or non-notification plan. Under the notification plan, purchasers of goods are informed that their accounts have been assigned to the bank. They then make payments directly to the bank, which credits them to the borrower's account. Under the non-notification plan, borrowers collect their accounts as usual and then pay off the bank loan.

Factoring is the sale of a business's accounts receivable. Under this arrangement the receivables are sold at a discounted value to a factoring company. Some commercial finance companies also do factoring. Under a standard arrangement the factor will buy the client's receivables outright, without recourse, as soon as the client creates them by shipment of goods to customers. Factoring fits some businesses better than others and it has become almost traditional in industries such as textiles, furniture manufacturing, clothing manufacturing, toys, shoes and plastics.

Hire purchase is an extended payment scheme entered into between the entrepreneur/hirer and the owner (equipment manufacturer or financial institution). Under the hire purchase the hirer only needs to pay a small deposit up front and then make regular instalment payments. Only on final instalment does the hirer acquire ownership.

Finance companies are asset-based lenders that lend money against assets such as receivables, inventory and equipment. The advantage of dealing with a commercial finance company is that it often will make loans that banks will not. The interest rate varies from 2 to 6 per cent over that charged by a bank. New ventures that are unable to raise money from banks and factors often turn to finance companies.

Other ways to raise cash include equity instruments (discussed in the next section), which give investors a share of the ownership. Here are examples:

- **Loan with warrants** provide the investor with the right to buy shares at a fixed price at some future date. Terms on the warrants are negotiable. The warrant customarily provides for the purchase of additional shares, such as up to 10 per cent of the total issue at 130 per cent of the original offering price within a five-year period following the offering date.
- **Convertible debentures** are unsecured loans that can be converted into shares. The conversion price, the interest rate and the provisions of the loan agreement are all areas for negotiation.

- **Preferred shares** are equity that give investors a preferred place among the creditors in the event the venture is dissolved. These shares also pay a dividend and can increase in price, thus giving investors an even greater return. Some preferred shares issues are convertible to common shares, a feature that can make them even more attractive.
- **Common shares** are the most basic form of ownership. These shares usually carry the right to vote for the board of directors. If a new venture does well, common-share investors often make a large return on their investment. These shares issues often are sold through public or **private offerings**.

Global entrepreneurs today are exposed to all kinds of potential losses. It is often wise to take out political risk insurance for losses resulting from risks associated with cross-border transactions, primarily in developing countries, including confiscation, expropriation, nationalisation, contract frustration, licence cancellation or the non-honouring of guarantees. It protects against physical damage to assets resulting from political violence, including war and civil uprisings. It can protect investments, plant and machinery, inventories and contracts. Political risk insurance also protects against actions of the entrepreneur's home government, such as embargo and forced cancellation.

EQUITY FINANCING

Equity financing is money invested in the venture with no legal obligation for entrepreneurs to repay the **principal** amount or pay interest on it. The use of equity funding thus requires no repayment in the form of debt. It does, however, require sharing the ownership and profits with the funding source. Since no repayment is required, equity capital can be much safer for new ventures than debt financing. Yet the entrepreneur must consciously decide to give up part of the ownership in return for this funding.[15]

Equity capital can be raised through two major sources: public share offerings and private placements. In both cases, entrepreneurs must follow the local laws pertaining to raising such funds. The entire process can be difficult, expensive and time-consuming. On the other hand, successful share offerings can help a fledgling enterprise raise a great deal of money. The smart entrepreneur will keep an eye on dual- or triple-tracking the firm. That means simultaneously preparing for an initial public offering, a trade sale or venture capital/private-equity round, depending on the balance of advantage.

Public offerings

During the last decade, many new ventures have sought capital through the public markets. The term **initial public offering (IPO)** is used to represent the registered public offering of a company's securities for the first time. *Going public* is a term used to refer to a corporation's raising capital through the sale of securities on the public markets. This is a company's first-ever sale of shares to the public. In many cases it is the first time people outside the company have the opportunity to buy its shares. That is why a company often is said to be 'going public' or 'floating' when it conducts an initial public offering. Here are some of the advantages to this approach:

- **Size of capital amount**: Selling securities is one of the fastest ways to raise large sums of capital in a short period.
- **Liquidity**: The public market provides liquidity for owners since they can readily sell their shares.
- **Value**: The marketplace puts a value on the company's shares, which in turn allows value to be placed on the corporation.
- **Image**: The image of a publicly traded corporation often is stronger in the eyes of suppliers, financiers and customers.[16]

The global initial public offering market has been a roller-coaster ride since the late 1990s. It still has not seen a full recovery back to pre-crash levels of 1998–2000. Global initial public offering (IPO) activity reached record levels in 2007, with China having the most number of listings in 2007 with 209 IPOs, ahead of Australia and the US with 189 and 178 respectively. Global IPO activity has decelerated sharply in the wake of the credit crunch and sustained financial turmoil.[17]

These figures reflect the tremendous *volatility* that exists within the market over the years and entrepreneurs should be aware of the concerns that confront them when they pursue an IPO. In addition, many new ventures have begun to recognise some other disadvantages of going public. Several of these follow:

- **Costs**: The expenses involved with a public offering are significantly higher than for other sources of capital. Accounting fees, legal fees and prospectus printing and distribution, as well as the cost of underwriting the shares, can result in high costs.
- **Disclosure**: Detailed disclosures of the company's affairs must be made public. New-venture firms often prefer to keep such information private.
- **Requirements**: The paperwork involved with government regulations, as well as continuing performance information, drains large amounts of time, energy and money from management. Many new ventures consider these elements better invested in helping the company grow.
- **Shareholder pressure**: Management decisions are sometimes short term in nature in order to maintain a good performance record for earnings and **dividends** to the shareholders. This pressure can lead to a failure to consider the company's long-term growth and improvement.[18]

The advantages and disadvantages of going public must be weighed carefully. If the decision is to undertake a public offering, then it is important the entrepreneur understand the process involved.

Private placements

Private placement is money invested in a company usually from private investors in the form of shares or sometimes bonds. It is sometimes possible to avoid issuing a prospectus, but rules will differ from country to country. In most cases, a placement agent (usually a share-broking firm or investment bank) will manage the process for a fee.

The ideal small-business candidate for private placement is a company looking for growth or expansion funding. A private placement is suitable when you need an injection of capital to jump to the next level of growth and you have a proven track record of profitability.

A *private placement memorandum* (PPM) is the document that discloses everything the investors need to know to make an informed investment decision about the direct public offering (DPO) being considered. This includes:

- the offering structure
- the share structure of the company
- disclosures about the securities being purchased
- company information
- information on company operations
- risks involved with the investment
- management information
- use of proceeds
- information on certain transactions that could affect the investor and investor suitability data.[19]

THE VENTURE CAPITAL MARKET

Venture capitalists are a valuable and powerful source of equity funding for new ventures. These experienced professionals provide a full range of financial services for new or growing ventures, including the following:

- capital for start-ups and expansion
- market research and strategy for businesses that do not have their own marketing departments
- management-consulting functions and management audit and evaluation
- contacts with prospective customers, suppliers and other important businesspeople
- assistance in negotiating technical agreements
- help in establishing management and accounting controls
- help in employee recruitment and development of employee agreements
- help in risk management and the establishment of an effective insurance program
- counselling and guidance in complying with a myriad of government regulations.

Here are the different stages of venture investing (see Figure 8.3):

- **Seed financing** provides the initial funds for a business concept to be developed. This may involve additional research, product development and initial marketing to reach out to early-adopter customers. The companies receiving funding at this stage may be in the process of just being incorporated or may have been in operations for a while.
- **Start-up financing** is where product development is completed and the market is trial-tested. Sales are still low and the company needs one year or less of expense money.
- **Early stage financing** is provided to companies that have completed the product development stage and test marketing as well, but require additional financing to expand commercial manufacturing and sales.
- **Expansion financing** is provided when the start-up company is poised to grow rapidly. The business is viable and is reaching break-even point. The funds may be used to increase production capacity, market or product development and/or provide additional working capital.

FIGURE 8.3: FUNDING STAGES

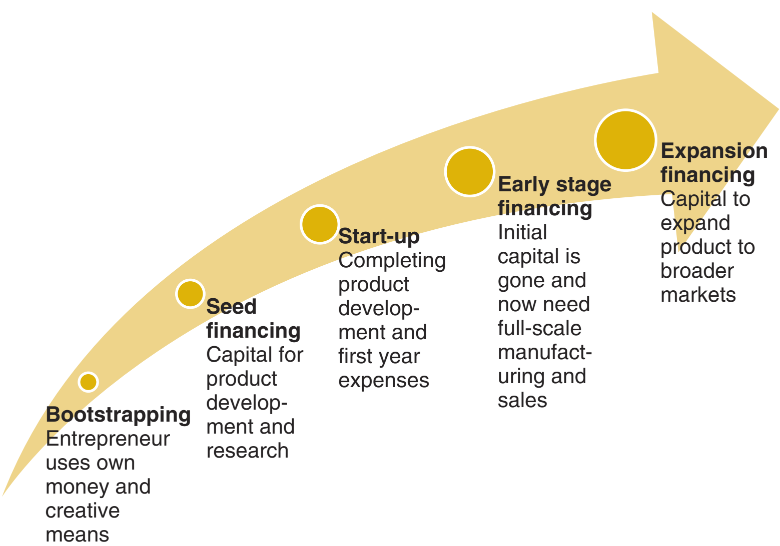
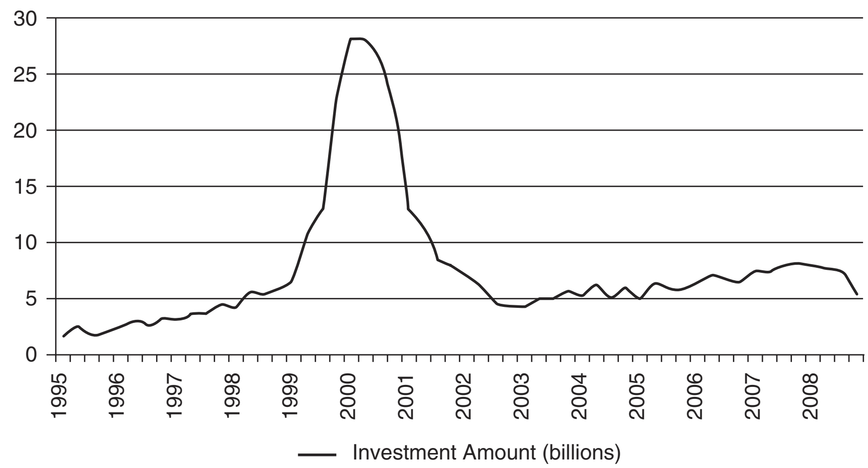


FIGURE 8.4: **TRENDS IN VENTURE CAPITAL RECEIVED BY US COMPANIES, 1995–2008**



Source: PriceWaterhouseCoopers, *MoneyTree™ Report*

- **Late-stage funding** refers to the pre-initial public offering investments in a company for strengthening the positioning of the company and gaining endorsements from the top venture capital firms as the company prepares for its listing.

Venture capital in the new era

Venture capital activity has indeed slowed. Many VC firms created during the Internet Bubble have collapsed because they were unprofitable. In 2000, at the height of the market, there were nearly 1200 venture capital firms in existence in the US investing as much as $28 billion annually in new ventures. By 2007 that number had dwindled to 844. Of the remaining firms, 244 did not even make a new investment in 2007 and the amount of VC invested by the end of 2008 was only $5.4 billion.[20] US National Venture Capital Association optimistically forecasted a recovery only in 2010 or beyond when the IPO market is expected to re-open and those strong companies and venture firms that weathered the storm will emerge in better shape than ever (see Figure 8.4).

However, to say venture capital has dried up is an exaggeration. Many venture capitalists say that a down market is actually the best time to invest because valuations are lower and competition is less intense. Canny investors are always on the lookout for solid businesses with strong management teams. Great ideas will still be funded – especially in sectors that have more insulated demand such as clean technology, life sciences, biotechnology and medical devices.[21]

The venture capital environment in the Asia–Pacific region is quite different from that in the US. To a certain extent Asia was partly insulated from the global crisis due to its unsophistication with exotic financial instruments such as one described on pages 85–6.[22] This was definitely a blessing in disguise! Some reports say that venture capital investments in China hit their highest levels ever in 2008. The information technology sector garnered the biggest share of the investments, 36 per cent, in 2008. Traditional Chinese companies such as retail, picked up 22 per cent of VC funds, while services companies garnered 18 per cent. Clean tech received 9 per cent, and biotech and healthcare companies picked up 7 per cent. Although China had the greatest amount and the most deals, the smaller markets such as Korea, Singapore and Hong Kong had the highest amounts per deal. The poorest performers here are New Zealand, Vietnam and Thailand.[23]

DISPELLING VENTURE CAPITAL MYTHS

>>ENTREPRENEURSHIP IN PRACTICE

Because many people have mistaken ideas about the role and function of venture capitalists, many myths have sprung up about venture capitalists. Some of these, along with their rebuttals, follow:[24]

>> **Myth 1**: Venture capital firms want to own control of your company and tell you how to run the business.

No venture capital firm intentionally sets out to own control of a small business. Venture capitalists have no desire to run the business. They do not want to tell entrepreneurs how to make day-to-day decisions and have the owner report to them daily. They want the entrepreneur and the management team to run the company profitably. They do want to be consulted on any major decision, but they want no say in daily business operations.

>> **Myth 2**: Venture capitalists are satisfied with a reasonable return on investments.

Venture capitalists expect very high, exorbitant, unreasonable returns. They can obtain reasonable returns from hundreds of publicly traded companies. They can obtain reasonable returns from many types of investments not having the degree of risk involved in financing a small business. Because every venture capital investment involves a high degree of risk it must have a correspondingly high return on investment.

>> **Myth 3**: Venture capitalists are quick to invest.

It takes a long time to raise venture capital. On average, it will take two to six months in the Australian venture capital industry from the initial contact to raise venture capital. If the entrepreneur has a well-prepared business plan the investor will be able to raise money in that time frame. A venture capitalist will see from 50 to 100 proposals a month. Out of that number, 10 will be of some interest. Out of those 10, two or three will receive a fair amount of analysis, negotiation and investigation. Of the two or three, one may be funded. This funnelling process of selecting one out of hundreds takes a great deal of time. Once the venture capitalist has found that one, they will spend a significant amount of time investigating possible outcomes before funding it.

>> **Myth 4**: Venture capitalists are interested in backing new ideas or high-technology inventions – management is a secondary consideration.

Venture capitalists back only good management. If an entrepreneur has a bright idea, but a poor managerial background and no experience in the industry, the entrepreneur should try to find someone in the industry to bring on to the team. The venture capitalist will have a hard time believing that an entrepreneur with no experience in that industry and no managerial ability in their background can follow through on a business plan. A good idea is important, but a good management team is even more important.

>> **Myth 5**: Venture capitalists need only basic summary information before they make an investment.

A detailed and well-organised business plan is the only way to gain a venture capital investor's attention and obtain funding. Every venture capitalist, before becoming involved, wants the entrepreneur to have thought out the entire business plan and to have written it down in detail.

Venture capitalists' objectives

Venture capitalists have different objectives from most others who provide capital to new ventures. Lenders, for example, are interested in security and payback. As partial owners of the companies they invest in, venture capitalists, however, are most concerned with return on investment. As a result they put a great deal of time into weighing the risk of a venture against the potential return. They carefully measure both the product/service and the management.

Venture capitalists are particularly interested in making a large return on investment (ROI). Table 8.3 provides some commonly sought targets. Of course, these targets are flexible. They would be reduced, for example, in cases where a company has a strong market potential, is able to generate good cash flow, or the management has invested a sizable portion of its own funds in the venture. However, an annual goal of 20–30 per cent ROI would not be considered too high, regardless of the risks involved.

TABLE 8.3: RETURNS ON INVESTMENT TYPICALLY SOUGHT BY VENTURE CAPITALIST

STAGE OF BUSINESS	EXPECTED ANNUAL RETURN ON INVESTMENT	EXPECTED INCREASE ON INITIAL INVESTMENT
Seed stage (idea stage)	60% +	10–15 x investment
First-stage financing (new business)	40–60%	6–12 x investment
Second-stage financing (development stage)	30–50%	4–8 x investment
Third-stage financing (expansion stage)	25–40%	3–6 x investment
Turnaround situation	50% +	8-15 x investment

Source: W. Keith Schilit, 'How to Obtain Venture Capital', *Business Horizons*, May/June 1987: 78.

Criteria for evaluating new-venture proposals

In addition to the evaluation of products ideas and management strength, numerous criteria are used to evaluate new-venture proposals. Researcher Dean A. Shepherd of Indiana University developed a list of eight critical factors that venture capitalists use in the valuation of new venture: (1) timing of entry, (2) key success factor stability, (3) education capability, (4) lead time, (5) competitive rivalry, (6) entry wedge imitation, (7) scope and (8) industry-related competence.[25] Each factor was defined from the high/low perspective (see Table 8.4 for definitions).

TABLE 8.4: FACTORS IN VENTURE CAPITALISTS' EVALUATION PROCESS

ATTRIBUTE	LEVEL	DEFINITION
Timing of entry	Pioneer	Enters a new industry first
	Late follower	Enters an industry late in the industry's stage of development
Key success factor stability	High	Requirements necessary for success will not change radically during industry development
	Low	Requirements necessary for success will change radically during industry development
Educational capability	High	Considerable resources and skills available to overcome market ignorance through education
	Low	Few resources or skills available to overcome market ignorance through education
Lead time	Long	An extended period of monopoly for the first entrant prior to competitors entering the industry
	Short	A minimal period of monopoly for the first entrant prior to competitors entering this industry
Competitive rivalry	High	Intense competition among industry members during industry development
	Low	Little competition among industry members during industry development
Entry wedge mimicry	High	Considerable imitation of the mechanisms used by other firms to enter this, or any other, industry – for example, a franchisee
	Low	Minimal imitation of the mechanisms used by other firms to enter this, or any other, industry – for example, introducing a new product
Scope	Broad	A firm that spreads its resources across a wide spectrum of the market – for example, many segments of the market
	Narrow	A firm that concentrates on intensively exploiting a small segment of the market – for example, targeting a niche
Industry-related competence	High	Venturer has considerable experience and knowledge with the industry being entered or a related industry
	Low	Venturer has minimal experience and knowledge with the industry being entered or related industry

Source: Dean A. Shepherd, 'Venture Capitalists' Introspection: A Comparison of "In Use" and "Espoused" Decision Policies', *Journal of Small Business Management*, April 1999: 76–87; 'Venture capitalists' assessment of new venture survival', *Management Science*, May 1999: 621–32. Reprinted by permission.

TABLE 8.5: VENTURE CAPITALISTS' SCREENING CRITERIA

Venture capital firm requirements	Must fit within lending guidelines of venture firm for stage and size of investment Proposed business must be within geographic area of interest Prefer proposals from someone known to venture capitalist Proposed industry is type of industry invested in by venture firm
Nature of the proposed business	Projected growth is relatively large within five years of investment Industry must be capable of long-term growth and profitability Economic environment of the proposed industry should be favourable to a new entrant
Proposed business strategy	Selection of distribution channel(s) must be feasible Product must demonstrate defendable competitive position Financial information on the proposed business must be timely Financial projections should be realistic
Proposal characteristics	Reasonable length, easy to scan, executive summary, professionally presented Proposal must contain a balanced presentation of risks and opportunities Use graphics and large print to emphasise key points
Entrepreneur/team characteristics	Must have relevant experience Should have a balanced management team in place Management must be willing to work with venture partners Entrepreneurs who have successfully started previous business are given special consideration

Source: John Hall and Charles W. Hofer, 'Venture Capitalists' Decision Criteria in New Venture Evaluation', *Journal of Business Venturing*, January 1993: 37

Other researchers have uncovered similar results. For example, one study examined the criteria venture capitalists use during a proposal screening and evaluation. Table 8.5 outlines the factors used in the study.[26] Their results showed that venture capitalists reached a go/no go decision in an average of six minutes on the initial screening and in less than 21 minutes on the overall proposal evaluation. They found that the venture capital firm's requirements and the long-term growth and profitability of the proposed venture's industry were the critical factors for initial screening. In the more-detailed evaluation the background of the entrepreneurs as well as the characteristics of the proposal itself were important.

The business plan is a critical element in a new-venture proposal and should be complete, clear and well presented. Venture capitalists will generally analyse five major aspects of the plan: (1) the proposal size, (2) financial projections, (3) investment recovery, (4) competitive advantage and (5) company management.

The evaluation process typically takes place in stages. The four most common stages are:

- **Stage 1**: Initial screening – a quick review of the basic venture to see if it meets the venture capitalist's particular interests.
- **Stage 2**: Evaluation of the business plan – a detailed reading of the plan is done in order to evaluate the factors mentioned earlier.
- **Stage 3**: Oral presentation – the entrepreneur verbally presents the plan to the venture capitalist.
- **Stage 4**: Final evaluation – after analysing the plan and visiting suppliers, customers, consultants and others, the venture capitalist makes a final decision.

This four-step process screens out approximately 98 per cent of all venture plans. The rest receive some degree of financial backing.

Evaluating the venture capitalist

The venture capitalist will evaluate the entrepreneur's proposal carefully and the entrepreneur should not hesitate to evaluate the venture capitalist. Does the venture capitalist understand the proposal? Is the individual familiar with the business? Is the person someone with whom the

>>ENTREPRENEURSHIP
IN PRACTICE

ASKING VENTURE CAPITALISTS THE RIGHT QUESTIONS

There are a number of important questions that entrepreneurs should ask of venture capitalists. Following are seven of the most important.

>> Does the venture capital firm in fact invest in your industry? How many deals has the firm actually done in your field?

>> What is it like to work with this venture capital firm?
Get references. (An unscreened list of referrals, including from CEOs of companies that the firm has been successful with as well as those it has not, can be very helpful.)

>> What experience does the partner doing your deal have and what is their clout within the firm?
Check out the experiences of other entrepreneurs.

>> How much time will the partner spend with your company if you run into trouble?
A seed-stage company should ask, 'You guys are a big fund and you say you can seed me a quarter of a million dollars. How often will you be able to see me?' The answer should be at least once a week.

>> How healthy is the venture capital fund and how much has been invested?
A venture firm with a lot of troubled investments will not have much time to spare. If most of the fund is invested there may not be much money available for your follow-on rounds.

>> Are the investment goals of the venture capitalists consistent with your own?

>> Have the venture firm and the partner championing your deal been through any economic downturns? A good venture capitalist won't panic when things get bad.

Source: Reprinted from Marie-Jeanne Juilland, 'What Do You Want from a Venture Capitalist?' *Venture*, August 1987, for Entrepreneurial Business Owners & Investors, by special permission. Copyright © 1987 Venture Magazine, Inc., 521 Fifth Ave., New York, NY 10175-0028

entrepreneur can work? If the answers reveal a poor fit it is best for the entrepreneur to look for a different venture capitalist.

One researcher found that venture capitalists do add value to an entrepreneurial firm beyond the money they supply, especially in high-innovation ventures. Because of this finding, entrepreneurs need to choose the appropriate venture capitalist at the outset and, most importantly, they must keep the communication channels open as the firm grows.[27]

On the other hand it is important to realise that the choice of a venture capitalist can be limited. Although funds are available today, they tend to be controlled by fewer groups and the quality of the venture must be promising. In addition, the trend towards concentration of venture capital under the control of a few firms is increasing.[28]

Nevertheless, the entrepreneur should not be deterred from evaluating prospective venture capitalists. The 'Entrepreneurship in practice' box headed 'Asking venture capitalists the right questions' provides a list of important questions that a prospective venture capital firm should answer.

TABLE 8.6: VENTURE CAPITAL WEB RESOURCES

Australian Venture Capital Association	www.avcal.com.au
Global Entrepreneurship Monitor Financial Reports	www.gemconsortium.org
Hong Kong Venture Capital Association Ltd	www.hkvca.com.hk
Malaysian Venture Capital Association	www.mvca.org.my
MSC Technopreneur Development	www.technopreneurdevelopment.net.my/cms/
New Zealand Venture Capital Association	www.nzvca.co.nz
Singapore Venture Capital Association	www.svca.org.sg
Taiwan Venture Capital Association	www.tvca.org.tw
Thai Venture Capital Association	www.venturecapital.or.th

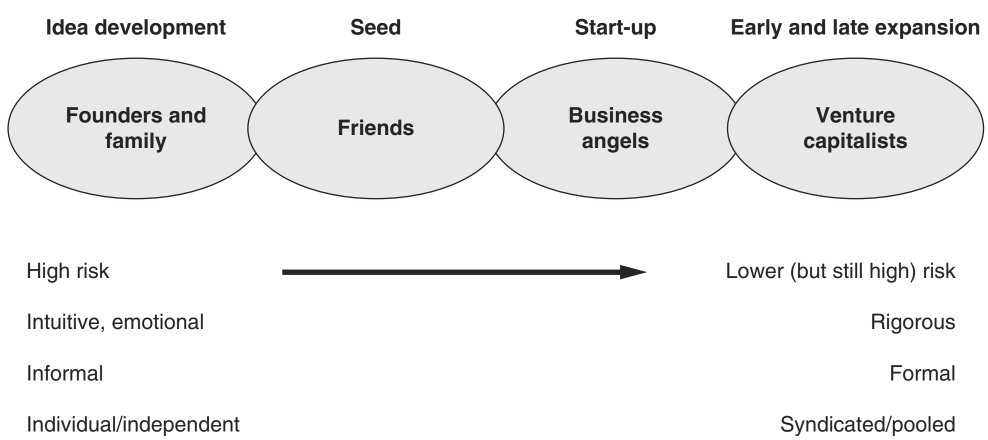
ANGEL FINANCING Many wealthy people are looking for investment opportunities. They are referred to as **business angels**. Here we distinguish business angels from the 4F informal investors – friends, family, founders and other 'foolhardy' investors – which we looked at earlier. The problem is that these angels are human too and their investment portfolios have been hammered in recent times just like everyone else. Further complicating matters is the fact that many angels are entrepreneurs themselves and may be more concerned with shoring up their companies than with helping you build yours. That means angels are looking for more control as well as lower valuations. Nevertheless, even in hard times, a smart angel will not pass up the chance to back a promising business.[29]

How big is the **angel capital** market? In 2007, in the US 258 200 angels pumped $26 billion into 57 120 companies making these wealthy individuals the single largest source of start-up capital. Studies in the US[30] and Scandinavia[31] suggest that the angel capital market is probably about 10 times the size of the venture capital market. Mason and Harrison estimate that angel capital investment in the UK is broadly equivalent to the amount of institutional venture capital provided to start-up and early stage ventures.[32] They also point out that the smaller average size of investments in the informal venture capital market is reflected in the fact that eight times more businesses raise finance from business angels than from institutional venture capital funds.

Business angels are active, in one way or another, in every country worldwide. To illustrate, the early expansion of The Body Shop was supported by an investment through a business angel whose £4000 investment was worth in excess of £140 million in the early 1990s.

Business angels tend not to have any previous relationship with the entrepreneur and therefore take a more objective approach to determining whether or not to invest. Angel investors range from those taking a passive approach (backing others' judgements) through to hands-on investors providing advice or direct management input to help the business become established. In many cases, the latter group of angel investors will take as rigorous an approach to their investing as some venture capitalists. A key difference between angel and venture investors is that angels tend to invest as individuals (often as part of a group) operating part-time, whereas venture capital generally comes via a company or fund with full-time managers and a board of directors, using formal analysis and investment procedures (see Figure 8.5).

FIGURE 8.5: WHERE ANGELS FIT IN THE MIX



A researcher in the field of angel capital has defined this type of investor as someone who already has made their money and now seeks out promising young ventures to support financially. 'Angels are typically entrepreneurs, retired corporate executives, or professionals who have a net worth of more than $100 000 a year. They are self-starters. And they're trying to perpetuate the system that made them successful.'[33] If entrepreneurs are looking for such an angel, Wetzel advises, 'Don't look very far away – within 50 miles or within a day's drive at most. And that's because this is not a full-time profession for them.'[34]

Why would individuals be interested in investing in a new venture from which professional venture capitalists see no powerful payoff? It may be, of course, that the reduced investment amount reduces the total risk involved in the investment. However, business angels seek other, non-financial returns, among them the creation of jobs in areas of high unemployment, development of technology for social needs (for example, medical or energy), local revitalisation, assistance to Indigenous peoples and personal satisfaction from assisting entrepreneurs.[35] Table 8.7 describes the major differences between business angels and venture capitalists.

How do informal investors find projects? Research studies indicate that they use a network of friends. Additionally, many localities are formulating venture capital networks, which attempt to link business angels with entrepreneurs and their new or growing ventures.

Types of angel investors

Angel investors can be classified into five basic groups:

- **Corporate angels**: Typically, so-called corporate angels are senior managers who have been laid off with generous severances or have taken early retirement. In addition to receiving the cash an entrepreneur may persuade the corporate angel to occupy some senior management position, such as in business development.
- **Entrepreneurial angels**: The most prevalent type of investors, most of these individuals own and operate highly successful businesses. Because these investors have other sources of income and perhaps significant wealth from initial public offerings or partial buyouts, they will take bigger risks and invest more capital. The best way to market your deal to these angels, therefore, is as a synergistic opportunity. Reflecting this orientation, entrepreneurial angels seldom look at companies outside of their own area of expertise and will participate in no more than a handful of investments at any one time. These investors usually take a seat on the board of directors, but rarely assume management duties. They will make fair-sized investments and invest more as the company progresses.
- **Enthusiast angels**: Whereas entrepreneurial angels tend to be somewhat calculating, enthusiasts simply like to be involved in deals. Most enthusiast angels are aged 65 or

TABLE 8.7: MAIN DIFFERENCES BETWEEN BUSINESS ANGELS AND VENTURE CAPITALISTS

MAIN DIFFERENCES	BUSINESS ANGELS	VENTURE CAPITALISTS
Personal	Entrepreneurs	Investors
Firms funded	Small, early-stage	Large, mature
Due diligence done	Minimal	Extensive
Location of investment	Of concern	Not important
Contract used	Simple	Comprehensive
Monitoring after investment	Active, hands-on	Strategic
Exiting the firm	Of lesser concern	Highly important
Rate of return	Of lesser concern	Highly important

Source: Osnabrugge and Robinson, *Angel Investing*, 111. This material is used by permission of John Wiley & Sons, Inc.

older, are independently wealthy from success in a business they started and have abbreviated work schedules. For them investing is a hobby. As a result they typically play no role in management and rarely seek to be placed on a board. Because they spread themselves across so many companies the size of their investments tends to be small.

- **Micro-management angels**: Micro-managers are very serious investors. Some of them were born wealthy, but the majority attained wealth through their own efforts. Unfortunately, this heritage makes them dangerous. Because most have successfully built a company, micro-managers attempt to impose the tactics that worked for them on their portfolio companies. Although they do not seek an active management role, micro-managers usually demand a seat on the board of directors. If business is not going well they will try to bring in new managers.
- **Professional angels**: The term 'professional' in this context refers to the investor's occupation, such as doctor, lawyer and, in rare instances, accountant. Professional angels like to invest in companies that offer a product or service with which they have some experience. They rarely seek a board seat, but they can be unpleasant to deal with when the going gets rough and may believe that a company is in trouble before it actually is. Professional angels will invest in several companies at one time.[36]

Another important consideration is that 60 per cent of *business angel investment* is devoted to seed and start-up business, as opposed to only 28 per cent of the *venture capitalist investment*. Of business angel investments, 82 per cent were for less than $500 000, whereas only 13 per cent of venture capital investors handled deals that small. The average size of a business angel investment is $250 000, which indicates the importance of informal risk capital to entrepreneurs seeking small amounts of start-up financing.[37] See Table 8.8 for some 'angel stats'. Obviously, informal networks are a major potential capital source for entrepreneurs. However, every entrepreneur should be careful and thorough in his or her approach to business angels – there are advantages and disadvantages associated with angel financing.

NEW FORMS OF ENTREPRENEURIAL CAPITAL

Most textbooks stop here. For them, entrepreneurial capital is simply cash money. As entrepreneurs enter the new millennium it is important to realise that there is more to capital-raising than venture capital or business angels. Yes, there are the creative sides of bootstrapping and the 4Fs, but there are also new modalities of funding that are emerging in our fast-changing world. Here we cover Islamic finance, micro-credit and natural capital. They are all part of the mix of entrepreneurial capital.

Islamic finance

Muslims and non-Muslims alike are taking advantage of a form of ethical investment with ancient roots, but greatly accelerated in the past 20 years in places such as Malaysia and Dubai. About one in four people in the world are Muslims and research is emerging about Islamic

TABLE 8.8: ANGEL STATS

Typical deal size	$250 000–$500 000
Typical recipient	Start-up firms
Cash-out time frame	Five to seven years
Expected return	35 to 500% a year
Ownership stake	Less than 50%

Source: William E. Wetzel, University of New Hampshire's Center for Venture Research, and the Indiana Venture Center, 2008.

entrepreneurs.[38] Muslims point to a long history of innovation, from arithmetic and chemistry to coffee to the fountain pen,[39] made possible by a culture that encouraged learning, research and invention (see also page 9).

Islamic entrepreneurs today operate in all modern economic sectors, the overwhelming majority being family-owned small and medium-sized enterprises (SMEs). Business is a normal part of Muslim life. Business is so ever-present that pilgrims are allowed to transact business during their pilgrimage to Mecca. Islam is indeed a wealth-creating society. A strict moral business code has left many Islamic banks unscathed by the credit crisis. While complex derivative products have left Western banks reeling from exposure to toxic assets, in contrast the more risk-averse Islamic finance system did not embrace this kind of deal.[40]

When it comes to new-venture financing we should not be surprised that Muslim entrepreneurs, for example, in Malaysia and Indonesia, do it differently.[41] Islamic entrepreneurs have very tight strictures on what they may and may not transact as business. Islamic finance is based on Islamic law, or **sharia**, which emphasises justice and partnership. In the world of entrepreneurial finance, this means that speculation (*gharar*) is forbidden as is the charging of interest (*riba*). It is well known that Islam forbids consumption, production and marketing of pork and alcohol. Muslims are also banned from gambling, prostitution and usury. They also may not engage in dishonesty, fraud, deception, or do anything that injures another. This rules out such modern-day business practices as hoarding, speculation, collusion, options and futures, day trading and commercial insurance. These are called *haram*, or 'forbidden' activities. *Halal* is an Arabic word that means 'permissible' and **halal finance** refers to types of banking and investing that are consistent with Islamic law.

The central concept that unites all of this is justice. Transactions that could be unjust for either the borrower or the lender are discouraged. In addition, for any financial undertaking, risks must be shared. In essence it is similar to the Western concepts of ethical or green investing.

These constraints affect Islamic financial assets (*Sakk* in singular, *Sukuk* in plural) and insurance products (*Takaful*), dictating their structures in accordance with Muslim law and ethics. In the end, Muslim entrepreneurs are no different from any other entrepreneurs in their desire to expand their business and increase their profit.

That may be why Islamic finance is one of the most rapidly growing areas of finance today (see Table 8.9). In Asia, Islamic finance enjoys double-digit growth. Sharia-compliant Islamic banking assets were worth $600 to $700 billion at the end of 2008 and the industry has been growing at just under 20 per cent a year.[42] Malaysia is one of the most entrepreneurial countries in the Asia–Pacific and has become a leader in this industry with more than $55 billion in sharia-compliant assets.[43] Indonesia, Thailand and Singapore also promote Islamic finance. Even little Brunei is a player with $32 billion in sharia-compliant assets.[44] Non-Muslims (for example, ethnic Chinese and Indian minorities in Malaysia) now make up a substantial portion of Islamic banking customers. The Dow Jones Islamic Market Indices were the first benchmarks to represent Islamic-compliant portfolios.

Sukuk are financial instruments designed to help both investors and entrepreneurs come to grips with these proscriptions and avoid interest and speculative risk.[45] What Sukuk do is securitise assets – packaged equity interests owned by a pool of investors who share the rents or profits. Let us say an entrepreneur wants to buy some capital equipment. In the West a conventional bond is a promise to repay a loan, but under Islam this can be a variety of deals. Islamic banks often lend money to companies with floating interest rates pegged to the company's performance. Alternatively, an agreement is made so that the entrepreneur will provide labour and the bank will provide financing, so that both profit and risk are shared. Such participatory arrangements between capital and labour reflect the Islamic view that the borrower must not bear all the risk/cost of a failure.[46] Here are three of those instruments:

TABLE 8.9: SHARIA-COMPLIANT RESOURCES IN ASIA, 2007, $BILLION

Pakistan	97.0
Indonesia	88.0
Bangladesh	83.0
Malaysia	55.0
Singapore	14.9
India	13.4
Philippines	5.0
Thailand	4.6
China	1.5
Australia	1.5
Korea	0.2

Source: 'Faith-based Finance', *The Economist*, 4 September 2008

- ***Sukuk Murabaha*** (Murabaha means 'profit'): The Murabaha plan is a cost-plus sale. The bank buys your machinery and then immediately sells it on to you for a profit. You then pay fixed monthly repayments on the higher price, but with no interest to pay back to the bank. So the bank might buy a property that costs $200 000 and sell it on to a customer for $250 000; the customer then pays that sum back over a fixed term. Murabaha essentially is undertaking a trade with a mark-up and is used for short-term financing, similar in form to purchase finance.
- ***Sukuk Al Ijara*** (Ijara means 'lease'): The Ijara plan is basically a lease-to-own plan. The bank purchases the property you want then leases it out to you. At the end of the term, the bank transfers ownership of the property to you. The bank would bear all the risk and a portion of the instalment payment goes towards the final purchase of the asset at the time of transfer of asset.
- ***Sukuk Al Musharaka*** (Musharaka means 'partnership'). Musharaka is similar to venture capital. Under a Musharaka plan, you buy the machinery jointly and gradually buy the bank out of it. So if you put down 10 per cent of the purchase price the bank will buy the remaining 90 per cent. You pay the bank monthly rent on the share you do not own as well as buying more shares in the property with each monthly payment with a view to owning the property outright at the end of the term. The cost of a share is based on the property's original cost price, not its present market value.[47]

Monitoring all of this is the Sharia Compliance Board, a committee of Muslim scholars that issues a ruling as to whether a particular undertaking is in accordance with sharia. Shariah Boards may have different interpretations and advise differently because, in Islam, there is no generally accepted codification of the jurisprudence or a formal clergy, per se.[48]

Sources of ethical capital

As the consequences of the economic crisis spread throughout the wider economy there is growing awareness that financial markets and the investor community may no longer desire the 'designer instruments of greed' that got the world into trouble. If there has been any unseen benefit within that massive financial cloud, it is the wake-up call for investors. They are now looking for new ways to invest in enterprises that prevent future market meltdowns and avoid catastrophic climate change. The Green Economy will need innovation and capital to generate jobs and energy independence. There could be millions of jobs in recycling, solar, wind, water and biofuels, as well as in energy conservation (homes and buildings) and greener transportation.

Whether you call it socially responsible investing (SRI), sustainable investing or ethical investing, there are investors out there who seek financial return just like traditional VC, but they also insist that this return serves the cause of social good. Socially minded entrepreneurs that have a demonstrable return on investment definitely have a chance with these funds. Socially responsible investing made up $2.7 trillion of the $25 trillion in assets under professional management in 2007, according to the Social Investment Forum.[49] That's $1 out of every $9. There are now more than 80 such funds in Australia with $4 billion in funds under management.[50] A fund such as Australian Ethical Investments Ltd has an interesting range of investments from Cochlear, the bionic ear maker, to Origin Energy. Even in a downturn, the fund reported a 9.3 per cent rise in value.[51] Academic research finds no evidence of significant differences in risk-adjusted returns between ethical and conventional funds. Socially and environmentally screened companies have the same if not greater financial performance for investors.[52] Though SRI has taken quite a hit in the wake of the credit crunch and global market volatility, there are many bright spots. Solar, wind, bio-fuels and fuel cells are experiencing a growth spurt not seen since the technology and computer revolutions of the 1990s.

Globally, the SRI movement has centred on the Principles for Responsible Investment (PRI), which provide a framework for incorporating environmental, social and governance (ESG) into investment decision-making and ownership practices.[53] Coordinated by the United Nations Environment Programme Finance Initiative and the UN Global Compact, the PRI were designed to align the goals of investors with the sustainable development objectives of the United Nations, in particular, addressing human rights, labour standards in the supply chain, environment and anti-corruption. The investors that are part of PRI pledge to:

- incorporate ESG issues into investment analysis and decision-making processes
- be active owners and incorporate ESG issues into our ownership policies and practices
- seek appropriate disclosure on ESG issues by the entities in which we invest
- promote acceptance and implementation of the Principles within the investment industry
- work together to enhance our effectiveness in implementing the Principles
- report on our activities and progress towards implementing the Principles.

SRI investors are actively looking for businesses with social missions that have solid business plans and proven profits as well. How do you find socially responsible investment for your venture? Be sure that your new venture can attract SRI by assessing your environmental, social and ethical policies. You will need to be able to prove that you embrace principles such as environmental sustainability, community activism and shareholder participation and that you have a positive work environment with employee benefits. Network around at VC and SRI conferences so that you can present your pitch to investors interested in socially responsible investing. You might also contact an accountant or funds manager that specialises in finding investors. Express your desires to focus on those individuals and companies investing in socially responsible ventures. Have a look at the previous investments of firms that invest in SRI. Table 8.10 shows criteria used by Australian SRI firms. Entrepreneurs will face two types of screening:

- *Negative or 'light green' screening*, similar to Islamic finance, rules out companies that produce or sell armaments, tobacco, alcohol, gambling, deforestation or uranium mining.
- *Positive or 'dark green' screening* tries to find companies that demonstrate such things as environmental protection, pollution control, renewable energy and sustainable waste.

Micro-credit

Micro-enterprise development programs give very small loans (micro-loans) to aspiring entrepreneurs who lack collateral to offer as security to a bank, who usually are not steadily employed, or have no credit history. **Micro-credit** (or loans to poor micro-enterprises) should

TABLE 8.10: CRITERIA USED BY SOCIALLY RESPONSIBLE INVESTMENT FUNDS

Environment	Positive screens for pollution reduction and environmental remediation and preservation. Avoids companies related to pollution and environmental degradation. Discourages pollution, greenhouse gas emissions, mining and pesticides. Support for renewable energy and water management.
Human rights	Avoids companies with human rights issues.
Workplace	Positive screens for industrial relations, corporate governance, corporate ethics and regulatory compliance. Support for occupational health and safety programs and good employee relations.
Arms	Companies that derive a material proportion of their revenue from uranium extraction or the manufacture of weapons or armaments.
Social health	Companies that derive a material proportion of their revenue from the manufacture or sale of alcohol or tobacco, the operation of gaming facilities or the manufacture of gambling equipment. Negative screen for social justice and positive screen for community development.
Corporate citizen	Positive screen for community awareness. Negative screen for product and advertising integrity and financial speculation.
Animal welfare	Seeks out companies involved with animal welfare.

not be confused with **micro-finance**, which addresses a full range of banking needs for poor people.

Entrepreneurs in the past had to rely on relatives or a local moneylender whose interest rates could be very high. An analysis of 28 studies of informal money lending rates in 14 countries in Asia, Latin America and Africa concluded that 76 per cent of moneylender rates exceeded 10 per cent per month, including 22 per cent that exceeded 100 per cent per month.[54] This was a costly exercise when expanding a business, buying land or equipment, or securing a contract requiring a large bribe.

It is difficult to benchmark the size of the micro-credit industry. The highest concentration is in India.[55] The current industry is generally considered to have originated with the Grameen Bank in Bangladesh. Grameen's micro-finance program has helped struggling entrepreneurs to build wealth and to exit from poverty.

Helms distinguishes between four types of microfinance providers:[56]

- **Informal financial service providers**: moneylenders, pawnbrokers, savings collectors and money-guard services can also be costly. Many people lose their money.
- **Member-owned organisations**: self-help groups, credit unions and a variety of hybrid organisations such as financial service associations. They are managed by poor people themselves, but they may have little financial skill.
- **Non-governmental organisation (NGOs)**: Grameen Bank was the forerunner in Bangladesh. They have proven very innovative, pioneering banking techniques like solidarity lending, village banking and mobile banking that have overcome barriers to serving poor populations.
- **Formal financial institutions**: commercial banks, state banks, agricultural development banks, savings banks, rural banks and non-bank financial institutions. They are regulated and supervised, but often are reluctant to adopt social missions. The banks now see the poor as well as start-up entrepreneurs as valuable 'pre-banking customers' who can be cultivated to become more affluent customers.

Micro-finance helps build micro- and mini-entrepreneurs and has become a tool for socioeconomic development. *Forbes* magazine ranked the world's top 50 micro-finance institutions. Many are little-known institutions outside of South Asia (see Table 8.11).[57]

Micro-credit on the Web

It is called many things – Banking 2.0, social network banking, peer-to-peer loans (P2P) and social lending. These terms all refer to a new type of lending transaction directly between individuals (peers) without any financial institution getting involved (see Table 8.12). P2P

TABLE 8.11: LEADING MICRO-FINANCE INSTITUTIONS IN ASIA

NAME	COUNTRY	SCALE
ASA	Bangladesh	www.asa.org.bd
Jagorani Chakra Foundation	Bangladesh	www.jcfbd.org
Grameen Bank	Bangladesh	www.grameen-info.org
Bangladesh Rural Advancement Committee	Bangladesh	www.brac.net
VisionFund	Cambodia	www.visionfund.com.kh
Credit Micro-finance Institution	Cambodia	www.credit.com.kh
Bandhan (Society and NBFC)	India	www.bandhanmf.com
Microcredit Foundation of India	India	www.microcreditindia.org
Saadhana Microfin Society	India	www.saadhana.org
Grameen Koota	India	www.grameenkoota.org
Sharada's Women's Association for Weaker Section	India	www.sccimicro-finance.com
Family Business Partners	Indonesia	www.mbk-ventura.com
Khan Bank (Agricultural Bank of Mongolia LLP)	Mongolia	www.khanbank.com
Search for all micro-finance institutions	USA	www.mixmarket.org/

Sources: TheMixMarket, www.mixmarket.org; Matthew Swibel, 'The World's Top 50 Micro-finance Institutions' *Forbes,* 20 December 2007, www.forbes.com/2007/12/20/micro-finance-philanthropy-credit-biz-cz_ms_1220micro-finance_table.html

TABLE 8.12: ASIA–PACIFIC INTERNET MICRO-LENDERS

Fosik	Australia	www.fosik.com.au/
iGrin	Australia	www.igrin.com.au
Lending Hub	Australia	http://lendinghub.com.au/
51Give	China	www.51give.com
PPDai	China	www.ppdai.com/
Wokai	China	www.wokai.org
Qifang	China	www.qifang.cn
dhanaX	India	www.dhanax.com
Rang De	India	www.rangde.org/
Unitedprosperity	India	www.unitedprosperity.org
Globefunder	India	www.globefunder.in/
Maneo	Japan	www.maneo.jp/
Zopa	Japan	www.zopa.com
Oneclick.com	Korea	www.oneclick.com
Donjoy	Korea	http://donjoy.net
Nexx	New Zealand	http://nexx.co.nz/
PeerMint	New Zealand, Australia	www.peermint.com

lending is spreading around the world, especially in the Asia–Pacific. P2P-Banking.com believes that approximately $740 million was funded through peer-to-peer lending/social lending services by 2008.[58] The difference with commercial lending lies in the fact that the process is transparent for both the lenders and borrowers. Borrowers can sometimes choose interest rates and a loan repayment schedule. Lenders typically are individuals and not businesses and usually have a lending cap in outstanding loans at a given point in time.

Raising natural capital

In this chapter, we have been talking about raising entrepreneurial capital. How does one actually raise natural capital? You will recall that **natural capital** is the stock of natural ecosystems that entrepreneurs use to create goods or services for their markets. These objects are distributed,

SOCIAL LENDING PROVIDES CAPITAL WHEN COMMERCIAL LENDERS WON'T

>>ENTREPRENEURSHIP IN PRACTICE

A new phenomenon that provides capital for both existing ventures and start-ups is social lending, also known as peer-to-peer (P2P) lending or Banking 2.0. Often, commercial lenders are unwilling to lend to unproven enterprises, leaving entrepreneurs little recourse when they are desperate for funding. Michael and Amy DeFabio netted a $15 000 loan through the social lending site Lending Club after struggling for three months to convince commercial lenders that their holistic healthcare business was financially viable.

As the movement has gained momentum, several social lending sites have sprung up, with Virgin Money, Prosper, Lending Club, Zopa and GlobeFunder being the most popular. Once thought of as an alternative funding option for entrepreneurs unable to qualify for a commercial loan, social lending has begun to offer established entrepreneurs quick capital without the administrative overhead required with traditional loans. Lending Club, Virgin Money and Prosper report that a minimum of 20 per cent of the loans made through their sites are for business purposes and consist of loans ranging from $9000 to $21 000.

Some analysts attribute the success of social lending to the weakening economy. Commercial lenders have been forced to be more conservative in their lending practices, which has led to a depleted pool of capital for entrepreneurs. Most of the businesses that utilise social lending sites are start-ups, largely because the most popular sites, with the exclusion of Virgin Money, set the maximum loan amount at $25 000. The relatively small loan amounts and the ease with which people can submit their ideas has led many individuals – who otherwise would have avoided pursuing their business venture due to a lack of confidence in their ability to obtain a commercial loan – to view social lending as a low-risk mechanism for getting started.

Social lending is very similar to other social networking phenomena in that it is largely dependent on the site provider's ability to provide a forum in which an open, trusting community can be built. Madeline Smith organised a community pet show in 2007, which led her to consider opening a pet boutique. She was leery about putting together a business plan and presenting the idea to commercial lenders. After a friend suggested that she post her concept on Prosper.com, Madeline was offered a $5000 loan within weeks. Interestingly, Madeline found that pursuing a social loan provided benefits beyond the capital. The lender, a woman who had also dreamt of opening a pet boutique, indicated that the reason for making the loan was so that she could experience the thrill of building a business through Madeline. The interaction between members of social lending communities provides psychological benefits that are not available through commercial lenders.

Another interesting result of social lending is that entrepreneurs who receive loans often become lenders. The sense of camaraderie and goodwill that is developed by helping others fulfil their dreams makes the lending process far more personal, for both the loan recipient and the lender. Despite the emotional benefits of working through social lending sites, the fact that businesses are taking on debt should not be dismissed. Chayah Masters, the owner of Gittel on the Go, Inc. – a staffing agency for part-time assistants based in Los Angeles – was in need of $5000 to revamp her company's website. When researching her funding options, she found Zopa; within days, she had the money in hand. Before starting the process of searching for the loan, Masters made sure to have her repayment plan in place, which consisted of paying back her loan with her upcoming tax return.

If the social lending movement continues, entrepreneurs will have an effective weapon in their arsenal to combat the cash-flow issues inherent in running a business. As should be done with all lenders, entrepreneurs need to carefully review the policies and procedures as well as the reputation for any social lender they are considering taking a loan through. For those individuals who have been putting their entrepreneurial aspirations on hold due to financial fears, social lending could provide the peace of mind needed for them to dust off their ideas and put them into action.

Source: Adapted from Kristin Edelhauser Chessman, 'Business Loans Get Personal', *Entrepreneur*, 19 March 2008, wwwentrepreneur.com/money/financing/articlel9l726.html

sold, used, discarded and then typically dumped back onto the ground. Entrepreneurial activity – like all economic activity – does not actually create or destroy the Earth's resources. It only changes the location, form and value (usually downgraded) of those resources. This **industrial metabolism** (collection of physical processes that convert raw materials into finished products and wastes) is exceedingly complex. Every product has a hidden history that we rarely appreciate (see Figure 3.8, page 89).

>>ENTREPRENEURSHIP IN PRACTICE

NATURAL CAPITAL IN A CAN OF COLA

The can itself is more costly and complicated to manufacture than the beverage. Bauxite is mined in Australia and trucked to a chemical reduction mill where a half-hour process purifies each ton of bauxite into a half ton of aluminium oxide. When enough of that is stockpiled, it is loaded on a giant ore carrier and sent to Sweden or Norway, where hydroelectric dams provide cheap electricity. After a month-long journey across two oceans, it usually sits at the smelter for as long as two months.

The smelter takes two hours to turn each half ton of aluminium oxide into a quarter ton of aluminium metal, in ingots 10 metres long. These are cured for two weeks before being shipped to roller mills in Sweden or Germany. There each ingot is heated to nearly five hundred degrees Celsius and rolled down to a thickness of an eighth of an inch. The resulting sheets are wrapped in 10-ton coils and transported to a warehouse, and then to a cold rolling mill in the same or another country, where they are rolled tenfold thinner, ready for fabrication. The aluminium is then sent to England, where sheets are punched and formed into cans, which are then washed, dried, painted with a base coat, and then painted again with specific product information. The cans are next lacquered, flanged (they are still topless), sprayed inside with a protective coating to prevent the cola from corroding the can, and inspected.

The cans are palletised, forklifted and warehoused until needed. They are then shipped to the bottler, where they are washed and cleaned once more, then filled with water mixed with flavoured syrup, phosphorus, caffeine and carbon dioxide gas. The sugar is harvested from beet fields in France and undergoes trucking, milling, refining and shipping. The phosphorus comes from Idaho, where it is excavated from deep open-pit mines – a process that also unearths cadmium and radioactive thorium. Round the clock, the mining company uses the same amount of electricity as a city of 1 000 000 people in order to reduce the phosphate to food-grade quality. The caffeine is shipped from a chemical manufacturer to the syrup manufacturer in England.

The filled cans are seated with an aluminium 'pop-top' lid at the rate of 1500 cans per minute, and then inserted into cardboard cartons printed with matching colour and promotional schemes. The cartons are made of forest pulp that may have originated anywhere from Sweden or Siberia to the old-growth, virgin forests of British Columbia that are the home of grizzly, wolverines, otters and eagles. Palletised again, the cans are shipped to a regional distribution warehouse, and shortly thereafter to a supermarket where a typical can is purchased within three days. The consumer buys 12 ounces of the phosphate – tinged, caffeine-impregnated, caramel-flavoured sugar water. Drinking takes a few minutes; throwing the can away takes a second.

Source: James Womack and Daniel Jones, *Lean Thinking: Banish Waste and Create Wealth in Your Corporation*, 2nd edn, Free Press; 2003: 38-40, as adapted by Paul Hawken, Amory Lovins, L. Hunter Lovins, *Natural Capitalism*, New York: Bay Back Books, 1999: 49–50

When the entrepreneur realises that material inputs are running low, they have to take action to keep the assembly lines running. Basically, they have to call upon the Earth's ecosystems so as not to decrease production. Whether it be oil or water, bauxite or fish, access to natural capital is essential. The entrepreneur has to compete with other companies to maintain access to these resources and 'The Tragedy of the Commons' (see page 80) ensues in which multiple entrepreneurs acting independently in their own self-interest can ultimately destroy a shared limited resource, even where it is clear that it is not in anyone's long-term interest for this to happen.[59] What this means is that abuser-entrepreneurs are imposing costs on the rest of the economy. Transportation entrepreneurs pollute everyone's atmosphere. Chemical entrepreneurs create pesticides found in creatures large and small. Paper entrepreneurs pollute streams that flow large distances downstream. Not only do these entrepreneurs get a free ride, but the rest of society is also supposed to pay for the clean up, depletion and loss (which encourages them even more).

In their own and everyone's interests, entrepreneurs of the 21st century will have to learn how not to liquidate natural capital. Entrepreneurs of the new era must learn how to conserve existing stocks of natural capital, but also to forego the subsidies and welfare system that society uses to clean up the mess. The reality is, as Interface CEO Ray Anderson said, 'there is not an industrial company on Earth that is sustainable in the sense of meeting its current needs without, in some measure, depriving future generations of the means of meeting their needs.'[60]

How can entrepreneurs raise natural capital? Perhaps we should restate the question. How can entrepreneurs have a positive impact on increasing the stock of natural capital? In the book called *Natural Capitalism,* Hawken, Lovins and Lovins see the world's economy as being within the larger economy of natural resources and ecosystem services that sustain us. This implies that we should attribute value not only to human intelligence but also to hydrocarbons, minerals, trees and microscopic fungi. The four principles they advocate to raise natural capital are:

- **Radical resource productivity**: get x times more from x times less resource – where x is a much bigger number than you would imagine
- **Biomimicry**: redesign industrial processes along biological lines, eliminate the whole idea of waste and grow rather than build products
- **Service and flow economy**: a shift from an economy based on goods and products to one based on a dynamic flow of economic services
- **Investing in natural capital**: put back more than you take out by reinvestment in sustaining, restoring and expanding stocks of the natural capital on which every business depends.

Adopting these principles can reduce environmental harm, generate entrepreneurial growth and increase meaningful employment (see also Chapter 3, 'Entrepreneurial Ecology', pages 88–94).

SUMMARY

This chapter has examined the various forms of entrepreneurial capital. Five forms of entrepreneurial capital were distinguished: financial capital, manufactured capital, human capital, social capital and natural capital.

Initial consideration was given to bootstrapping and informal investors, where budding entrepreneurs have their best chances of being funded. Next we discussed debt and equity financing in the form of commercial banks, trade credit, accounts receivable financing, factoring and finance companies and various forms of equity instruments.

Public share offerings have advantages and disadvantages as a source of equity capital. Although large amounts of money can be raised in short periods, the entrepreneur must sacrifice a degree of control and ownership. Private placements are an alternative means of raising equity capital for new ventures.

In recent years the venture capital market grew dramatically, but that has changed just as dramatically. A number of myths that have sprung up about these capitalists were discussed and refuted.

Venture capitalists use a number of different criteria when evaluating new-venture proposals. In the main these criteria focus on two areas: the entrepreneur and the investment potential of the venture. The evaluation process typically involves four stages: initial screening, business plan evaluation, oral presentation and final evaluation.

Business angels have begun to play an important role in new-venture financing. Everyone with money to invest in new ventures can be considered a source for this type of capital. Entrepreneurs who are unable to secure financing through banks or through public or private share offerings typically will turn to the business angel market by seeking out friends, associates and other contacts who may have (or know of someone who has) money to invest in a new venture.

We discussed the interesting emerging landscape of new forms of entrepreneurial capital. For many entrepreneurs in Asia, Islamic finance is a definite option. Islamic finance is based on Islamic law, or sharia, which emphasises justice and partnership.

Another important source of capital for entrepreneurs is SRI – socially responsible investors. We examined the size of the industry, the types of firms supported and the criteria used by the investors.

Micro-credit and social lending programs give small loans (micro-loans) to aspiring entrepreneurs who lack collateral to offer as security to a bank, who may not be steadily employed, or may have no credit history; or who simply need less money and want to know who their investors are.

Finally, we looked at the stock of natural capital and the dilemmas and opportunities that surround that concept. Multiple entrepreneurs acting independently in their own self-interest can ultimately destroy a shared, limited resource.

KEY TERMS & CONCEPTS

4Fs
accounts receivable financing
angel capital
bootstrapping
build-out allowances
business angel
capital
capital gains
capital structure
carrying capacity
classic venture capital
common shares
convertible debentures
corporate angels
debt financing
disclosure
dividends
due diligence
early stage financing
entrepreneurial angels
equity capital
equity financing
exit strategy
expansion financing
factoring
factors of production
finance company
financial capital
Five Capitals
Global Entrepreneurship Monitor (GEM)
halal financing
hire purchase
human capital
human resources
industrial metabolism
informal investors
initial public offering (IPO)
investment banker
late-stage funding
letter of credit
loan servicing
long-term debt
manufactured capital
market capitalisation
micro-credit
micro-finance
natural capital
opportunity cost
preferred shares
principal
private placements
prospectus
prototype development
seed financing
shareholder
shares
sharia
social capital
start-up financing
sukuk
trade credit
underwriter
venture capitalists
vertical integration
white knight
whole systems approach

REVIEW & DISCUSSION QUESTIONS

1 What are the five forms of entrepreneurial capital? Give examples of each that are not described in the book.
2 How widespread is informal investing? Which type of informal investors demand a higher ROI?
3 What are the 4Fs and can you identify 4F investors that you know?
4 What are some special considerations in approaching the 4Fs for entrepreneurial capital?
5 Using Figure 8.2, describe some of the sources of capital available to entrepreneurs and discuss how they correlate to the varying levels of risk involved with each stage of the venture.
6 What are the benefits and drawbacks of equity and of debt financing? Briefly discuss both.
7 Identify and describe four types of debt financing.
8 Why would a start-up company want to postpone debt and equity financing?
9 If a new venture has its choice between long-term debt and equity financing, which would you recommend? Why?
10 Why would a venture capitalist be more interested in buying a convertible debenture for $50,000 than in lending the new business $50 000 at a 10 per cent interest rate?
11 What are some of the advantages of going public? What are some of the disadvantages?
12 What are the funding stages that entrepreneurs usually traverse?
13 How large is the venture capital pool today? Is it growing or shrinking?
14 Is it easier or more difficult to get new-venture financing today? Why?
15 Some entrepreneurs do not like to seek new-venture financing because they feel that venture capitalists are greedy. In your opinion, is this true? Do these capitalists want too much?
16 Identify and describe three objectives of venture capitalists.

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17 Identify and describe four of the most common criteria venture capitalists use to evaluate a proposal.
18 Of what practical value is Table 8.4 to new-venture entrepreneurs?
19 In a new-venture evaluation, what are the four stages through which a proposal typically goes? Describe each in detail.
20 An entrepreneur is in the process of contacting three different venture capitalists and asking each to evaluate her new business proposal. What questions should she be able to answer about each of the three?
21 An entrepreneur of a new venture has had no success in getting financing from formal venture capitalists. He now has decided to turn to the informal risk capital market. Who is in this market? How would you recommend that the entrepreneur contact these individuals?
22 How likely is it that the angel capital market will grow during the next five years? Defend your answer.
23 How would you describe the typical business angel?
24 Which source of Islamic finance is most like venture capital?
25 What is the difference between halal and haram? What practices are forbidden in Islamic businesses?
26 Why do some entrepreneurs need micro-credit?
27 What impact has the Internet had on the availability of micro-credit?
28 What is the difference between social lending, halal finance, green investment and ethical investment, if at all?
29 What is natural capital and why do you think it has been excluded from consideration as entrepreneurial capital in the past?
30 What is industrial metabolism? Give an example.
31 Of all the sources of entrepreneurial capital, which is ideal? Why?

EXPERIENTIAL EXERCISE: ANALYSING THE FUNDING SOURCES

For each funding source, write down what the text says about its usefulness for small firms. Then seek out and interview a representative of each source to find out the person's point of view of their relationship to small firms.

SOURCE	WHAT THE TEXT SAYS	SOURCE'S POINT OF VIEW
Banks		
○ Long-term loans		
○ Short-term loans		
○ Intermediate-term loans		
Private placement		
Informal investing		
Public offerings (IPO)		
Finance company		
Factoring		
Trade credit		
Business angels		
Venture capitalists		
Islamic finance		
Ethical investment		
Micro-credit		
Natural capital		

EXPERIENTIAL EXERCISE:

ANGEL INVESTOR V. VENTURE CAPITALIST

DIRECTIONS:

Contact a local venture capital firm to schedule an interview with one of the partners. Then contact the local angel network to schedule an interview with an angel investor. If there is no local angel network, contact one of the respected law firms in your area and ask for a recommended source that could serve as an angel investor for the purposes of this exercise. For each interview, simply find out the answer to each component of the comparison table below.

TOTAL ANNUAL INVESTMENT IN START-UP VENTURES		
	ANGEL	VENTURE CAPITALIST
Total dollars		
Number of investments		
Number of investors		
Per round		
Entities per round		
INDIVIDUAL INVESTMENTS IN START-UP VENTURES		
Investment size per round		
Each investor		
Typical investment stage		

CASE 8.1:

LOOKING FOR CAPITAL IN MALAYSIA

When Ananda and Suda Kumar opened their bookstore one year ago in Malaysia, they estimated it would take them six months to break even. Because they had gone into the venture with enough capital to keep them afloat for nine months they were sure they would need no outside financing. However, sales have been slower than anticipated and most of their funds now have been used to purchase inventory or meet monthly expenses. On the other hand, the store is doing better each month and the Kumars are convinced they will be able to turn a profit within six months.

At present, Ananda and Suda want to secure additional financing. Specifically, they would like to raise $100 000 to expand their product line. The store currently focuses most heavily on how-to-do-it books and is developing a loyal customer following. However, this market is not large enough to carry the business. The Kumars feel that if they expand into an additional market such as cook books, they can develop two market segments that, when combined, would prove profitable. Suda is convinced that cook books are an important niche and she has saved clippings from national newspapers and magazines reporting that people who buy cook books tend to spend more money per month on these purchases than does the average book buyer. Additionally, customer loyalty among this group tends to be very high.

The Kumars own all of their inventory, which has a retail market value of $280 000. The merchandise cost them $140 000. They also have at a local bank a line of credit of $10 000, of which they have used $4000. Most of their monthly expenses are covered out of the initial capital with which they started the business ($180 000 in all). However, they will be out of money in three months if they are not able to get additional funding.

The owners have considered investigating a number of sources. The two primary ones are a loan from their bank and a private shares offering to investors. They know nothing about how to raise money and these are only general ideas they have been discussing with each other. However, they do have a meeting scheduled with their accountant, a friend, who they hope can advise them on how to raise more capital. For the moment, the Kumars are focusing on writing a business plan that spells out their short business history and objectives, and explains how much money they would like to raise and where it would be invested. They hope to have the plan completed before the end of the week and take it with them to the accountant. The biggest problem they are having in writing the plan is that they are unsure of how to

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direct their presentation. Should they aim it at a banker or a venture capitalist? After their meeting with the accountant, they plan to refine the plan and direct it towards the appropriate source.

Questions

1. Would a commercial banker be willing to lend money to the Kumars? How much? On what do you base your answer?
2. Would this venture have any appeal for a venture capitalist? Why or why not?
3. If you were advising the Kumars, how would you recommend they seek additional capital? Be complete in your answer.
4. Which form of Islamic finance would you recommend to them?

CASE 8.2: THE 120 MILLION BAHT VENTURE

The Friendly Market is a large supermarket in a Thai provincial city. 'Friendly's', as it is popularly known, has more sales per square metre than any of its competitors because it lives up to its name. The personnel go out of their way to be friendly and helpful. If someone asks for a particular brand-name item and the store does not carry it, the product will be ordered. If enough customers want a particular product, it is added to the regular line. Additionally, the store provides free delivery of groceries for elderly citizens and credit for those who have filled out the necessary application and have been accepted into the 'Friendly Credit' group.

The owner, Pacapol Anurit, believes that his marketing-oriented approach can be successfully used in any area of the country. He is therefore thinking about expanding and opening two new stores, one in the northern part of the same city and the other in a city located 50 kilometres east. Locations have been scouted and a detailed business plan has been drawn up. However, Pacapol has not approached anyone about providing the necessary capital. He estimates he will need about THB 120 million ($AUD4 million) to get both stores up and going. Any additional funding can come from the current operation, which has a cash flow of about THB 4 million monthly.

Pacapol first considers two avenues are available to him: debt and equity. His local banker has told him the bank would be willing to look over any business plan he submits and would give him an answer within five working days. Pacapol is convinced he can get the bank to lend him THB 120 million. However, he does not like the idea of owing that much money. He believes he would be better off selling shares to raise the needed capital. Doing so would require him to give up some ownership, but this is more agreeable to him than the alternative.

The big question now is: How can the company raise THB 120 million through a shares offering? Pacapol intends to check into this over the next four weeks and make a decision within eight weeks. A number of customers have approached him over the past year and have asked him if he would consider making a private shares offering. Pacapol is convinced he can get many of his customers to buy into the venture, although he is not sure he can raise the full THB 120 million this way. The other approach he sees as feasible is to raise the funds through an informal investor network connected with the ICC chain of food products. This might be the best way to get such a large sum, but Pacapol wonders how difficult it would be to limit his food range to ICC products on a long-term basis. In any event, as he said to his wife yesterday: 'If we're going to expand, we have to start looking into how we can raise more capital. I think the first step is to identify the best source. Then we can focus on the specifics of the deal'.

Questions

1. What would be the benefits of raising the THB 120 million through a private placement? What would be the benefits of raising the money through ICC? What are the risks and benefits of going through the bank?
2. Of these three approaches, which would be best for Pacapol? Why?
3. What would you recommend Pacapol do now? Briefly outline a plan of action he can use to get the financing process started.

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Road Map for Natural Capitalism

Publication date: 1 July 2007
Revision date: 29 November 2005
Author(s): Amory B. Lovins, L. Hunter Lovins, Paul Hawken
Product number: R0707P

No one would run a business without accounting for its capital outlays. Yet in 1999, when this article was originally published, most companies overlooked one major capital component – the value of the Earth's ecosystem services. It was a staggering omission. Calculations at that time placed the value of those services – water storage, atmosphere regulation, climate control and others – at $33 trillion per year. The authors maintain that not accounting for that cost has led to waste on a grand scale. This article shows how a few far-sighted companies, like DuPont and Xerox, were able to find powerful business opportunities in conserving resources on a similarly grand scale. Their early embrace of natural capitalism is even more important to emulate today. Natural capitalism comprises four major shifts in business practices. The first involves dramatically increasing the productivity of natural resources – by as much as a hundredfold. In the second stage, companies adopt closed-loop production systems that yield no waste or toxicity. The third stage requires a fundamental change of business model – from selling products to delivering services. For example, instead of selling light bulbs, a manufacturer sells lighting services, with both the seller and the customer benefiting from the development of extremely efficient, durable bulbs. The last stage involves reinvesting in natural capital to restore, sustain and expand the planet's ecosystem. Because natural capitalism is both necessary and profitable, it will subsume traditional industrialism, the authors argue, just as industrialism subsumed agrarianism. And the companies that are furthest down the road will have the competitive edge.

Gobi Partners

Publication date: 18 January 2005
Revision date: 29 November 2005
Author(s): G. Felda Hardymon, Ann Leamon
Product number: 9-805-090

The general partners of Gobi Partners, a venture fund located in Shanghai, are trying to decide the best way to raise money for their first fund without either abandoning the strategy that has won them a measure of success in such a short time or bringing on more strategic investors with goals that might conflict with those currently in the fund.

LesConcierges

Publication date: 12 December 2007
Author(s): John Glynn, Bethany Coates
Product number: 9-E28-0

New Zealander Linda Jenkinson, Chairman and CEO of luxury personal services company, LesConcierges (LC), hung up the phone after checking her voicemail in July 2007. She had just received a message from Randy Haykin, an angel investor and board member who had participated in the Series C round that Jenkinson recently raised. After an initial 'honeymoon period', she and Haykin had started disagreeing on internal matters, most recently about whether to hire an interim CFO while the company took time to source a permanent candidate. Jenkinson began to wonder whether Haykin had been the best choice for the board and if there was anything she could do to work with him more effectively. Unbeknown to Jenkinson, Haykin was simultaneously considering whether his investment in LesConcierges would turn out to be the 'home run' that he had originally anticipated. He also questioned how he could help solve the challenges facing the company's CEO without damaging their relationship in the process..

Alibaba.com

Publication date: 26 June 2008
Author(s): Ricky Lai, Ali Farhoomand
Product number: 9-HKU-776

On 6 November 2007, Alibaba.com debuted on the Hong Kong Stock Exchange, raising US$1.5 billion to become the world's biggest Internet offering since Google's initial public offering in 2004. A frenzied purchase of the stock pushed prices up by 193 per cent on the first trading day, making it the fourth-largest first-day gain in Hong Kong's stock exchange in three years. The closing price of US$5.09 per share valued Alibaba.com at about US$25.6 billion and made it the fifth-largest among global Internet companies and the largest in Asia outside Japan. It also made the company one of the most expensive stocks in Hong Kong, trading at 306 times the company's projected 2007 earnings. In contrast, globally recognised brand names such as Yahoo and Japan's Softbank, both major stockholders of Alibaba.com, were trading at only 60 times their projected earnings. Shareholders were therefore displaying extreme optimism towards Alibaba.com's earning prospect by paying a significant premium to own the company's shares. As observers and venture capitalists have remarked, China is becoming a centre of technology and a major pole for innovation. Many successful dotcom strategies in the West have been copied and refined by Chinese technological gurus who have honed their technical and entrepreneurial skills in the West. These 'sea turtles' are beating international giants likes Google and eBay in the burgeoning Chinese market and have their sights set on global domination. Armed with proceeds from a record-breaking IPO, Alibaba.com is poised to stay ahead in the increasingly competitive online B2B market in China. What strategies can the company pursue and what pitfalls must it avoid?

AsiaInfo: The IPO Decision

Publication date: 4 May 2004
Author(s): Michael J. Roberts, Donald N. Sull
Product number: 9-804-183

The co-founder and CEO of AsiaInfo, a Chinese system integrator that built 70 per cent of China's Internet backbone, must decide whether to list equity in the US to fund future growth. This case describes the company and its decision.

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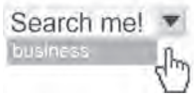

angel capital
business angel
capital
capital gains
carrying capacity
common shares
convertible debentures
debt financing
disclosure
dividends
due diligence
equity capital
equity financing
exit strategy
factoring
Global Entrepreneurship Monitor (GEM)
halal
human capital
human resources
initial public offering
investment banker
letter of credit
loan servicing
long-term debt
market capitalisation
micro-credit
opportunity cost
preferred shares
shareholder
shares
sharia
social capital
sukuk
underwriter
venture capitalist

TURNING A GREEN IDEA INTO A GREEN BUSINESS – GREEN CABS

Jodyanne Kirkwood and Sara Walton

Green Cabs is an environmentally friendly taxi company in New Zealand which was founded in late 2007 by Callum Brown and three other partners. Green Cabs now operates a multi-million dollar business in three main centres of New Zealand – Auckland, Wellington and Christchurch. The company is also contemplating expanding into other areas with its distinctive bright green taxis. Callum Brown is the primary inspiration behind Green Cabs. However, you could argue that Al Gore provided the initial spark for Callum to start thinking about being more environmentally conscious personally. Callum is in his 30s and has spent 10 years working in information technology for various government departments and private sector companies as a business analyst. He grew up close to nature and enjoyed activities such as surfing and tramping. All these things kept Callum close to nature. Despite his love affair with nature, Callum was quite sceptical of climate change. He explains:

> I thought – how can you tell that there is global warming when we've only been taking recordings on temperature for the past whatever, how many years.

Hence, it could be seen as fairly surprising that Callum founded a green business!

TURNING AN IDEA INTO A BUSINESS This personal awakening was a direct result of watching Al Gore's documentary, *An Inconvenient Truth*. Little did he know at this stage that a major business opportunity would come from his new environmental consciousness. The impetus for the business idea came when Callum was at work. He travelled extensively for work and consequently found himself catching a lot of taxis. It was on one such overnight trip to Auckland that he became aware of the huge amount of carbon emissions he was generating through travel. He elaborates:

> I sat there watching all the taxis come and drop people off and thought about the emissions and everything they were producing; there's got to be a better way than this. Why is there no eco-friendly option and that was the light bulb moment, and saying, ah, why not?

Following this light bulb moment, Callum contacted a former colleague who was also a taxi driver. Together the pair set about establishing an environmentally conscious taxi service with two other partners. They struck the New Zealand taxi industry at what they called a lucky time. The government had just tightened legislation to make it consistent for all operators. The Land and Transport Authority was supportive and helpful in making sure everything the emerging Green Cabs did was in line with the new legislation. The Authority too was excited by what Green Cabs was hoping to achieve. Once started, Green Cabs experienced rapid growth and within six months had approximately 85 cabs and self-employed drivers and employed 15 support staff (mostly in its 24-hour call centre).

Callum never had aspirations to become an entrepreneur, nor any experience in business ownership, but his extensive work background as a business analyst made him feel he was well equipped to investigate whether the Green Cabs idea would be successful. In fact, prior to coming up with the business idea Callum felt afraid of the risk involved in having his own business. However, once he had the idea, these risks vanished:

> I was so passionate about Green Cabs, once I had the idea, there were no perceivable risks for me. That was how strong the drive was to do it . . . It's like I've never doubted for a moment that Green Cabs was going to succeed. It has.

Any concerns Callum had about risk were dissipated when he took on a number of business partners to share the risk. These business partners all understood and were sympathetic to the worsening state of the environment and to Callum's vision for the company.

GREEN CABS BUSINESS MODEL Callum's vision resulted in a company which entered the taxi industry with the goal of achieving much more than a traditional taxi firm. Green Cabs wanted to force change, to preserve the environment and inform the public about climate

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change. This meant a whole new way of thinking about business and the principles of the business founders were intertwined with the business model.

Green Cabs offers the same basic service as any other taxi company. The key difference is that it is an environmentally conscious company. The main means of the company being environmentally friendly is that its vehicles are hybrids (Toyota Prius). There are substantially fewer ongoing running costs in providing the service. Green Cabs passes these savings onto consumers and is therefore able to offer considerably lower prices than its competitors. It already is forcing change in the taxi industry with many competitors rapidly switching to hybrids because they can see they will save on emissions and fuel costs. The difference between these competitors and Green Cabs is that those changing due to lower running costs do not necessarily have environmental concerns at the forefront of their decision making as does Green Cabs. Indeed, sceptics could argue that the competition is switching because it is losing market share to Green Cabs and is attempting to imitate the service. Therefore, Green Cabs has been successful in changing behaviour in the industry to being more environmentally friendly, but this has come at a cost to the business, as Callum explains:

> I have had such an impact on the market that I had planned, that they (competitors) are now switching. Now, from an environmental point of view, it's fantastic that I could have that impact, but from a business point of view it's not good.

However, competitors are still failing to offset their carbon emissions whereas Green Cabs prides itself on being carbon neutral. To achieve this Green Cabs drives only the Toyota Prius, the car it considers to be the best option for lessening the impact on the environment. The remainder of its carbon emissions are 'paid for' by providing funding for trees to be planted (predominantly in the developing world). Green Cabs donates to 'Trees for the Future', an organisation that has already organised the planting of 50 million trees, which retrieve approximately a million tonnes of carbon from the atmosphere annually (www.greencabs.co.nz). Green Cabs also 'pays off' its carbon debt prior to its accrual. That is, it calculates its future carbon footprint (down to the number of squares of toilet paper used) for the next year and funds the planting of sufficient trees to offset this before it emits the carbon. Although this is one of the key environmental strategies Green Cabs carries out, it actually is sceptical of buying carbon credits. This is because this carbon strategy essentially dispatches the problem to someone else; it does not help reduce the carbon in the atmosphere. As such, Green Cabs aims to both reduce carbon and offset before it accumulates.

The business model of Green Cabs is based on the premise that the customer has a greater connection with the product or service. By using Green Cabs customers will feel part of a greater commitment to the environment and they will choose Green Cabs product over the competitors. As Callum notes, the business model is win-win for both consumers and the environment:

> It is cheaper, it's eco-friendly, it's quieter, you've got a pleasant driver, we do a whole lot of feel good stuff as well. Give me a reason why you wouldn't take a Green Cab.

Green Cabs target market is the corporate sector and government departments. However, they pay tribute to the 'grassroots' support they have received. This is from people who have seen what Green Cabs are doing and even if their company has no agreement with Green Cabs, when they take a taxi they want it to be a Green Cab. Callum has also noted that younger people are more environmentally aware and appreciate the choice they are being offered in Green Cabs.

One future development is for Green Cabs to install roof signs on their vehicles to promote the environment. These will not be advertising signs for businesses but to say something individuals can do for the environment. Green Cabs intend to use advertising space on their vehicles to promote the environment, not fizzy drinks or the like!

FINDING BALANCE BETWEEN THE ENVIRONMENT AND PROFIT

> 'For me anyway, it's not just about turning a profit.' – Callum Brown

Finding a balance between profit and the environment can be a difficult one. To be successful in Callum's view, you have to understand and have faith that doing things and sticking closely to the set of values that the company started with is what is going to bring success. Too much compromise for business then you will compromise the overall success of the business. The business might

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still be profitable but will not captivate the public into changing their behaviour regarding the environment. These environmental values are held firm by Green Cabs and are an underlying part of their distinctive business model. Callum elaborates:

> If we compromise on those values then that puts us at risk of just being like any other taxi company out there and doesn't set us apart.

Following through on their commitment to the environment easy for Green Cabs and they suggest that other should look at the environment differently in their businesses. For example, Callum is frustrated by talk about how much it costs to offset carbon emissions. He suggests people fail to see that the whole process is a cost saving exercise. In becoming sustainable, businesses look at ways of reducing electricity, travel and so forth. All of these areas can reduce a company's carbon footprint while also reducing their overall costs.

Their commitment to the environment is one side of the equation in Green Cab's business model. The business must be sustainable and there are investors, franchisees and employees who expect returns from their input into the business. Callum is conscious of this need to make a profit, but he has some boundaries:

> I want to make some money but at the end of the day, I don't even need a million dollars a year to live on . . . I really like my life in New Zealand, I like the things that I do and the things that I do don't cost a lot of money.

Callum has found that as the business has grown, more investors (such as potential franchisees) are becoming better aligned with his personal views on the environment. However, that is not necessarily the case for all employees of the company, as Callum notes:

> I have people working for me who don't have necessarily the same value set. I mean they've got good values and wouldn't be here if they didn't but to the degree where mine are – no, they're not anywhere near there.

THE FUTURE? In April 2009, Green Cabs has grown to 16 employees and 104 drivers. The business has many opportunities to grow their business into other location and other services (e.g. courier services). As the business continues to grow Green Cabs are looking towards carbon neutral certification, and implementing ISO 14001 and 14064 certifications. The ongoing financial success of the company is also attracting more interest from other investors who are not necessarily focused primarily on the environment, but see Green Cabs as a solid investment opportunity.

DISCUSSION QUESTIONS

1. What kind of entrepreneurs described in Part I most apply to Callum Brown? Is he a social entrepreneur or a business entrepreneur? Is he an ecopreneur? What other kind of -preneur could he be?
2. Debate which values Callum Brown holds at the forefront in his decision making – environmental values or the concern for economic success of the business?
3. Green Cabs have seen numerous opportunities for growing into other locations and into other services (such as couriers). They have resisted these opportunities to date.
   Should Green Cabs be taking these growth opportunities? Why or why not?
4. What potential difficulties do you think might emerge as Green Cabs continues to grow (personal philosophy, management and structure of the business, environmental impact)?
5. What strategies could they employ to ensure that there is a good balance between environmental and economic outcomes for the company?
6. Callum Brown was a visionary and a 'first mover', but often 'second movers' in an industry have an advantage. The lesson here is always to be a 'first mover'. What could Callum Brown do next to capture 'first mover advantage'.

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Source: Reproduced with permission of Callum Brown, Green Cabs

PART THREE:
DEVELOPING THE ENTREPRENEURIAL PLAN

CHAPTER

9 ASSESSMENT AND COMMERCIALISATION OF ENTREPRENEURIAL OPPORTUNITIES

> The reason a lot of people do not recognise opportunity is because it usually goes around wearing overalls looking like hard work.
>
> Thomas Edison

chapter objectives

- **01** To understand various techniques used for spotting opportunities
- **02** To distinguish Internet opportunities from other opportunities
- **03** To recognise common pitfalls in taking new venture ideas to the marketplace
- **04** To identify critical factors involved in new venture development
- **05** To examine why new ventures fail
- **06** To compare the evaluation process methods: critical questions analysis, profile analysis, feasibility criteria approach and comprehensive feasibility method
- **07** To assess the industry environment from a competitive market analysis and strategic point of view
- **08** To examine Porter's five forces model of competitive market analysis
- **09** To learn the basic principles of commercialisation
- **10** To understand the concept of a national innovation system.

In this chapter we are interested in how an entrepreneur assesses an opportunity. Success depends on a complex triad of key factors: (1) characteristics of the entrepreneur – personal reasons for start-up; (2) the environment around the entrepreneur – risks, market size, resources availability; and (3) the nature of the venture itself – differing scalability, growth potential and performance.[1] This complexity often makes assessment, evaluation and ultimate commercialisation of new ventures very tricky to analyse in advance. But it is 'do-able' and this chapter reveals some of the tried and tested ways to make sure an opportunity ends up as a commercialised product in the marketplace (see Figure 9.1).

Kirzner's theory of alertness asserts that entrepreneurs are more alert to new opportunities than other people.[2] The entrepreneur is an *opportunity identifier* who can spot unexploited market niches in advance of other people. Entrepreneurs depend on a broad range of sources of ideas, networks and relationships from which to draw knowledge about future markets and technologies. They are highly opportunistic and need to move quickly to realise an opportunity before it is lost. The problem is that opportunities differ across markets and technologies. Therefore, the budding entrepreneur must understand how to assess new ideas and opportunities.

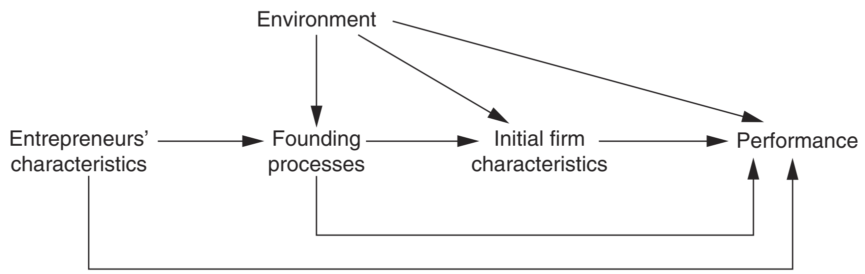
HOW TO ASSESS AN OPPORTUNITY

Ideas are 'a dime a dozen' as they say in the US. That means ideas are common and easy to find. They are everywhere. You see them standing at a bus stop, or you think of them in the shower. But viable opportunities are not easily found. Rarer still are highly viable commercial opportunities.

What is an **opportunity**? An opportunity comes more often from the creative process and from intuition than from scientific analysis. An opportunity is something that an entrepreneur recognises as solving a real problem or adding value for people. The best business opportunities may well be the ones that solve the problems of everyday life. If the idea solves a problem or adds value then it becomes an opportunity.[3]

We are learning more about opportunity recognition through research. We know that people find opportunities more often in industries with which they are familiar.[4] There seems also to be a correlation between *weak ties* (networks outside of friends and family) and the number of ideas that an entrepreneur recognises.[5] Some researchers see it both as a planned activity and as a serendipitous phenomenon.[6]

FIGURE 9.1: THE ELEMENTS AFFECTING NEW VENTURE PERFORMANCE



Source: Arnold C. Cooper, 'Challenges in predicting new firm performance', *Journal of Business Venturing*, May 1993: 243. Reprinted with permission

TABLE 9.1: THE DIFFERENCE BETWEEN VERTICAL AND LATERAL THINKING STYLES

VERTICAL THINKING	LATERAL THINKING
Looking for the right approach	Looking for as many approaches as possible
Rightness	Richness
Proceeds if there is a direction	Proceeds to generate direction
Is analytical	Is provocative
Is sequential	Can make jumps
One must be correct at every step	One does not have to be correct at every step
Uses negative to block off certain pathways	There is no negative
Excludes what is irrelevant	Welcomes chance intrusions
Fixed categories/labels	Labels may change
Explores most likely paths	Explores least likely paths
Is a finite process	Is a 'probabilistic' process

Source: 'Vertical Thinking vs. Lateral Thinking', www.thestudentroom.co.uk/wiki/Revision:Vertical_Thinking_Vs._Lateral_Thinking

What is the difference between a mere idea and a viable opportunity? To tell that difference the entrepreneur needs both vertical and lateral thinking:

- **Lateral thinking** is problem-solving that approaches problems indirectly at diverse angles (some say 'out of the box') instead of concentrating on one approach.[7]
- **Vertical thinking** is analytical and sequential and it uses fixed categories and labels.

The entrepreneur needs cross-functional expertise in both types of thinking so that no new idea will be wasted. The wider the net, the greater the catch. True opportunity spotters identify opportunities laterally (through intuition and gut feeling), but they analyse them vertically (through science and commercialisation processes).

So, how do you spot those special (highly profitable and viable) opportunities? There are certain tried and tested techniques:[8]

- Choose a suitable, exploitable market. Do not go after the software operating system market unless you can beat Microsoft. Similarly, the search engine market may well be occupied. Mainstream markets are difficult for entrepreneurs to break into.
- Choose niche markets that cater for specialist needs. The Body Shop started up by appealing to environmentally aware cosmetics customers. Patagonia adopted an 'organic cotton only' policy before others were thinking about sustainability.
- Open new markets. The smartest entrepreneurs see emerging trends early and manoeuvre themselves into the cash flow. David Hall says, 'I have a rule of thumb: Find any market growing at 25 per cent a year or more and you can be sure there are many new niche markets continuously being created'.
- Steer clear of overcrowded marketplaces. Look for pickings elsewhere. Become a big fish in a small pond.
- The reverse is also true. Small fish in a really big pond have the opportunity to capture market share.
- Offer a unique product or service. Though infrequent, the entrepreneur may discover some technical breakthrough protected by a patent.

Peter Drucker came up with the sources of opportunities shown in Table 9.2.

TABLE 9.2: SOURCES OF ENTREPRENEURIAL OPPORTUNITIES

INTERNAL SOURCES OF OPPORTUNITIES	EXTERNAL SOURCES OF OPPORTUNITIES
The unexpected – the unexpected success, the unexpected failure, the unexpected outside event	Demographic changes caused by things like wars, migrations, medical developments
The incongruity – between reality as it actually is and reality as it is assumed to be or as it 'ought to be'	Changes in perception and fashion brought about by changes in the economy
Innovation based on process need; any inadequacy in a business process that is taken for granted	Changes in awareness caused by new knowledge
Changes in industry structure or market structure that catch everyone unawares	'Why?' and 'What if?' questions:
	Why do we always do things this way? What if we do it differently?
	Why should we limit ourselves to getting better in what we are doing? What if we change things radically?
	Why should I look at this risk as a problem? What if I try to convert risks into opportunities?
	Why don't we challenge our big competitor's market leadership position? What if we create a new market segment?
	Why should we look at cross-cultural differences as a problem? What if we try to leverage the power of our diversity?

Source: Peter F. Drucker, *Innovation and Entrepreneurship: Practice and Principles,* New York: Harper & Row, 1985

>>ENTREPRENEURIAL EDGE

NICHE SPOTTING

JIM'S MOWERS

A great example of niche spotting and opportunity exploitation is Jim's Mowers, based in Melbourne, Australia. Jim Penman noticed two social trends: 70 per cent of Australian women of childbearing age are in the workforce; and the average work week is 45 hours. Australians are busy people, he reasoned, and they spend billions a year outsourcing home services – everything from lawn mowing to childcare – simply because they are too preoccupied with their working lives. So Jim decided to move into that niche. Jim was a 'necessity entrepreneur' who started 'with $24 and an urgent need to pay the rent' in 1982. He now owns the largest lawn-mowing franchise in the world with around 2200 franchisees in Australia, New Zealand and Canada. Jim's brand now adorns 30 different business systems, from antennas and appliance repairs to wardrobes and window cleaning. The distinctive 'Jim's' brand and customer management systems made famous in lawn-mowing have been cleverly leveraged into other home services applications in a way and to an extent that is unique in the world.

Source: For more information on the Jim's Group visit the website at www.jims.net

KIMBOS PET WEAR

A New Zealand company has designed a range of dog products that target a very narrow niche. The company designed a range of necklaces that allows your dog to step out in style. It offers 'bitches britches', cooling products for dogs, doggie life jackets, designer coats and even saddle bags for the camping dog. There are even 'crystal collars' known for their natural healing powers.

Source: 'Cleaver Niche Spotting' *NZ Business*, 17(11), December 2003/January 2004: 7–10; *Business Source Premier*, www.ebscohost.com, accessed 19 December 2008

OHMYNEWS

South Korean OhMyNews is an online newspaper that works with 26 000 citizen reporters, who send in stories and pictures which make up 80 per cent of all content. OhMyNews pays up to $US20 per article, though for many citizen reporters, getting their name in the paper is the real reward. Fiercely outspoken, OhMyNews has successfully challenged the traditionally conservative press in South Korea. OhMyNews opened a citizen journalism school to serve as a 'collaborative knowledge center' for classes in journalism, digital cameras and photojournalism.

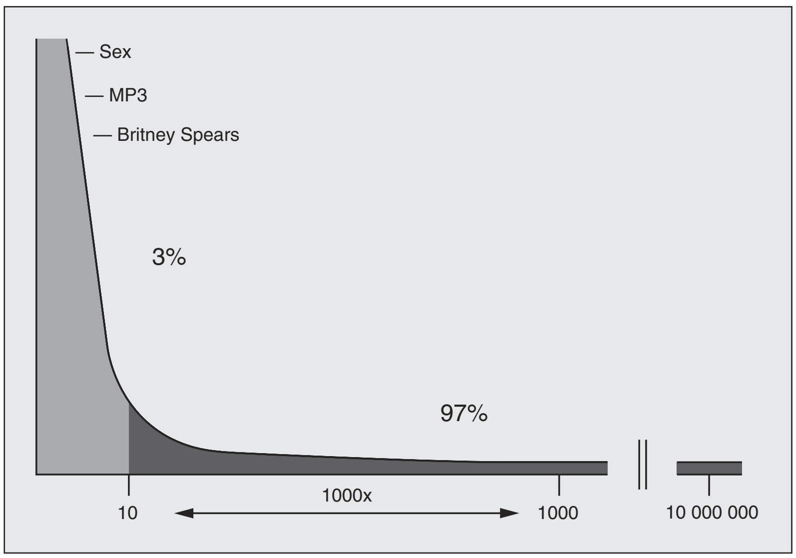
Source: Lev Grossman, 'Kim Hye Won', *Time*, 16 December 2006

There is a lot of talk these days about the Internet. In the information age, opportunities may actually have a different character. Joe Krause, the founder of Excite search engine (one of the dotcoms of the 1990s and the subject of Figure 9.2), talks about how to spot opportunities on the net:

> The most popular searches (things like sex, MP3s and the bare midriff female singer du jour) were vastly more popular than the 1000th most popular search. For example, 'sex' was on the order of 100 000 times more popular than the 1000th most popular search (whatever that was). Said another way, there were a handful of extraordinarily common queries and millions of far less popular queries.
>
> In fact, the frequency of the average query was 1.2 searches per day for the entire world! That means if you wrote each of the millions and millions of search engine queries on a slip of paper, put them all in a fish bowl and grabbed one at random, there was a high likelihood that this query was asked only once during the day. The most interesting statistic, however, was that the top 10 searches were thousands of times more popular than the average search, yet these top 10 searches represented only 3 per cent of our total volume. Ninety-seven per cent of our traffic came from the 'long tail' – queries asked once a day.[9]

This is where the smart entrepreneur comes in. The big companies and traditional business people go after those *dozens of markets of millions* of people, but the smart entrepreneur turns it on its head and goes after the *millions of markets of dozens*. These are called 'long-tail markets' because they exist way out to the right on the graph (see Figure 9.2). Google, eBay,

FIGURE 9.2: EXCITE QUERY DISTRIBUTION



Source: 'The Long Tail of Software. Millions of Markets of Dozens', http://bnoopy.typepad.com/bnoopy/2005/03/the_long_tail_o.html

Amazon, Rhapsody, Netflix and iTunes – what do they have in common? They all work the 'long tail' and they're all radically changing the dynamics of their more traditional businesses. What's the next big trend? As this book goes to press, it's Web 2.0.

PITFALLS IN SELECTING NEW IDEAS AND OPPORTUNITIES The first key area of analysis is the selection of a new venture. This stage of transition – from an idea to a potential venture – can be the most critical for understanding new-venture development. Following are six of the most important pitfalls commonly encountered in the process of selecting a new venture opportunity.

- **Lack of objective evaluation**: Many entrepreneurs lack objectivity. Engineers and technically trained people are particularly prone to falling in love with an idea for a product or service. They seem unaware of the need for the scrutiny they would give to a design or project in the ordinary course of their professional work. The way to avoid this pitfall is to subject all ideas to rigorous study and investigation.[10]
- **No real insight into the market**: Many entrepreneurs do not realise the importance of developing a marketing approach in laying the foundation for a new venture. They show a managerial short-sightedness.[11] In addition, they do not understand the life cycle that must be considered when introducing a new product or service. No product is instantaneously profitable, nor does its success endure indefinitely. Entrepreneurs must not only forecast the life cycle of the new product, but also recognise that introducing the product at the right time is important to its success. Timing is critical. Action taken too soon or too late will often result in failure.
- **Inadequate understanding of technical requirements**: The development of a new product often involves new techniques. Failure to anticipate the technical difficulties with developing or producing a product can sink a new venture. Entrepreneurs cannot be too thorough when studying the project before initiating it. Encountering unexpected technical difficulties frequently poses time-consuming and costly problems.
- **Poor financial understanding**: A common difficulty with the development of a new product is an overly optimistic estimate of the funds required to carry the project to completion. Sometimes entrepreneurs are ignorant of costs, or are victims of inadequate research and planning. Quite often, they tend to underestimate development costs by wide margins. It is not unusual for estimates to be less than half of what is eventually required.
- **Lack of venture uniqueness**: A new venture should be unique. **Uniqueness** is the special characteristics and design concepts that should draw the customer to the venture and should provide performance or service superior to competitive offerings. The best way to ensure customer awareness of differences between the company's product and competitors' products is through product differentiation. Pricing becomes less of a problem when the customer sees the product as superior to its competitors. A product that is unique in a significant way can gain the advantage of differentiation.
- **Ignorance of legal and regulatory issues**: Business is subject to many legal and regulatory requirements. One is the need to make the workplace safe for employees. A second is to provide reliable and safe products and services. A third is the necessity for patents, trademarks and copyrights to protect one's inventions and products. A fourth is to take into account the varying regulatory environments in which Asia–Pacific entrepreneurs operate. When legal and regulatory issues are overlooked, major problems can result.

eBAY ENTREPRENEURS

>>ENTREPRENEURSHIP IN PRACTICE

Fledgling entrepreneurs are flocking to eBay because of the ease with which the site's users can start a business. Currently, more than 247 million registered users do business on eBay, which has led to $60 billion in sales annually. Taking the following nine steps will get you well on your way to starting a successful eBay business.

- **Start with used items**. Given most people's access to used items in their homes, cleaning out storage is a natural way to get started selling. The problem with such an approach can be the time that it takes to find and clean merchandise; however, the low costs and risks associated with selling used products, at least in the beginning, far outweigh the time commitment required.
- **Develop a specialty**. The more specialised your business becomes, the more confidence your customers will have in your offerings and the less time you will spend addressing questions about the random products you found in your basement. Most sellers start by selling used items, but eventually, the successful eBay seller will develop a niche to allow for greater economies of scale.
- **Research the market**. Selling on eBay does not excuse you from the usual legwork involved in starting a business. In order to determine the right market for you, conduct research on how much items in a given category are selling for on eBay as well as elsewhere. Marketplace Research is a subscription-based tool available through eBay that allows you to view historical pricing information for products.
- **Access assistance**. You will certainly make mistakes as you build your eBay business, but many of your questions can be answered by accessing eBay's help files or by reading the discussion boards, through which successful sellers provide feedback and advice.
- **Invest in your business**. If you plan to start your eBay business by selling off old items lying around your home, you will not need to invest much, if any, up-front capital; however, as your business grows, a few items will come in handy. First, designating a computer to be used solely for your eBay transactions will allow you to fully deduct it on your taxes. Second, a regulation postal scale will save you several hours waiting in line at the post office. Finally, a decent camera is a must. Posting poor-quality photos of your merchandise will lead your customers to wonder about the quality of the rest of your business.
- **Develop a system**. As with any business, policies and procedures become increasingly important the larger your business becomes. Standardising your templates or buying some through eBay's Seller Tools section will help to streamline the process. In addition, establishing a routine for corresponding with your customers regarding their questions and concerns will enable you to prevent any minor issues from escalating into major problems.
- **Find a reliable product source**. In order for your business to grow, you will need to gain access to a reliable source of consistent products. Starting with garage sales might work at first, but each product you post will likely be one of a kind, which makes posting and shipping the products time consuming. Developing a relationship with a manufacturer or a master distributor is required to develop a reasonable profit margin; however, avoid overstocking when trying to take advantage of cheap merchandise. Stick to what you know and grow your business slowly to avoid losing track of your customer base.
- **Manage customer expectations**. Make sure to under-promise and over-deliver to guarantee that your customers will not be disappointed when your product is described as 'new' but arrives with a mild scratch. Be as forthright as possible. If you notice an imperfection, your customer surely will as well.
- **Know your numbers**. eBay charges listing and final value fees, which can add up if you have to post your merchandise multiple times; however, the cost of gaining access to eBay's customer base is insignificant when compared to the cost of using traditional advertising channels. If you expect your product to take several auctions to sell, cover your costs by charging higher seller fees.
- **Never misrepresent your products**. Customers who have been misled will likely take the issue to eBay for reconciliation, which will most likely

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result in you reimbursing the customer and potentially being reprimanded.

- **Offer an unconditional guarantee.** This puts the buyer at ease and avoids any complications due to damage during shipping or the customer claiming product misrepresentation.
- **Offer PayPal**. As an accepted form of payment, an estimated 93 to 95 per cent of buyers prefer to pay online. Although less popular, some customers might prefer to pay with personal cheques and money orders, so allowing these forms of payment can make those customers less familiar with online shopping more comfortable.

Source: Adapted from Marcia Layton Turner, 'Get Sold on Bay', *Entrepreneur*, March 2008, www.entrepreneur.com/magazine/entrepreneur/2008/march/190186.html

CRITICAL FACTORS IN NEW-VENTURE DEVELOPMENT

You cannot evaluate what you do not measure. The old adage 'that which gets measured gets done' is no less true of opportunity evaluation. A number of **critical factors** are important for new-venture assessment. One is to have a checklist that provides data to weigh up the value proposition as well as to forewarn of problems and to illuminate alternatives. In most cases, however, such a questionnaire approach is too general. The assessment must be tailor-made for the specific venture.

A new venture goes through three specific phases: pre-start-up, start-up and post-start-up. The pre-start-up phase begins with an idea for the venture and ends when the doors are opened for business. The start-up phase commences with the initiation of sales activity and the delivery of products and services, and ends when the business is firmly established and beyond short-term threats to survival. The post-start-up phase lasts until the venture is terminated or the surviving organisational entity is no longer controlled by an entrepreneur.

The major focus in this chapter is on the pre-start-up and start-up phases, because these are the critical segments for entrepreneurs. During these phases, five factors are critical: (1) the relative uniqueness of the venture, (2) the relative investment size at start-up, (3) the expected growth of sales and/or profits as the venture moves through its start-up phase, (4) the availability of products during the pre-start-up and start-up phases and (5) the availability of customers during the pre-start-up and start-up phases.

Uniqueness

A new venture's range of uniqueness can be considerable, extending from fairly routine to highly non-routine. What separates the routine from the non-routine venture is the amount of innovation required during pre-start-up. This distinction is based on the need for new process technology to produce services or products and on the need to service new market segments. Venture uniqueness is further characterised by the length of time a non-routine venture will remain non-routine. For instance, will new products, new technology and new markets be required on a continuing basis? Or will the venture be able to 'settle down' after the start-up period and use existing products, technologies and markets?

Investment

The capital investment required to start a new venture can vary considerably. In some industries less than $50 000 may be required, whereas in other industries millions of dollars are necessary. Moreover, in some industries only large-scale start-ups are feasible. For example, in the publishing industry one can start a small venture that can remain small or grow into a larger venture. By contrast, an entrepreneur attempting to break into the airline industry will need a considerable up-front investment.

Another finance-related critical issue is the extent and timing of funds needed to move through the venture process. To determine the amount of needed investment, entrepreneurs must answer questions such as:

- Will industry growth be sufficient to maintain break-even sales to cover a high fixed-cost structure during the start-up period?
- Do the principal entrepreneurs have access to substantial financial reserves to protect a large initial investment?
- Do the entrepreneurs have the appropriate contacts to take advantage of various environmental opportunities?
- Do the entrepreneurs have both industry and entrepreneurial track records that justify the financial risk of a large-scale start-up?[12]

Growth of sales

The growth of sales through the start-up phase is another critical factor. Key questions are:

- What is the growth pattern anticipated for new-venture sales and profits?
- Are sales and profits expected to grow slowly or level off shortly after start-up?
- Are large profits expected at some point with only small or moderate sales growth? Or are both high sales growth and high profit growth likely? Or will initial profits be limited with eventual high profit growth over a multi-year period?

In answering these questions, it is important to remember that most ventures fit into one of the three following classifications.

A **lifestyle venture** appears to have independence, autonomy and control as their primary driving forces. Neither large sales nor profits are deemed important beyond providing a sufficient and comfortable living for the entrepreneur.

In a small profitable venture, financial considerations play a major role. Additionally, autonomy and control are important in the sense that the entrepreneur does not want venture sales (and employment) to become so large that they must relinquish equity or an ownership position and thus give up control over cash flow and profits, which, it is hoped, will be substantial.

In a **high-growth venture**, significant sales and profit growth are expected to the extent that it may be possible to attract venture capital money and funds raised through public or private placements.[13]

Product availability

Essential to the success of any venture is **product availability**, the availability of a saleable good or service, at the time the venture opens its doors. Some ventures have problems in this regard because the product or service is still in development and needs further modification or testing. Other ventures find that because they bring their product to market too soon, it must be recalled for further work. A typical example is the software firm that rushes the development of its product and is then besieged by customers who find bugs in the program. Lack of product availability in finished form can affect the company's image and its bottom line.

Customer availability

If the product is available before the venture is started, the likelihood of venture success is considerably better than otherwise. Similarly, venture risk is affected by **customer availability** for start-up. At one end of the risk continuum is the situation where customers are willing to pay cash for products or services before delivery. At the other end of the continuum is the enterprise that gets started without knowing exactly who will buy its product. A critical consideration is how long it will take to determine who the customers are and what their buying habits are. As Ronstadt notes:

> The decision to ignore the market is an extremely risky one. There are, after all, two fundamental criteria for entrepreneurial success. The first is having a customer who is willing to pay you a profitable price for a product or a service. The second is that you must actually produce and deliver the product or service. The farther a venture removes itself from certainty about these two rules, the greater the risk and the greater the time required to offset this risk as the venture moves through the pre-start-up and start-up periods.[14]

WHY NEW VENTURES FAIL Start-ups are high-risk, high-mortality ventures. According to Massey University research, 25 per cent of New Zealand companies founded in 1997 had failed by 2004.[15] Research in Australia finds a five-year failure rate of 39 per cent.[16] So it is important to recognise the warning signals that tell us a business is about to tip over the edge. According to Australian accountants, up to 90 per cent of small businesses make the same financial mistakes leading to high failure rates.[17] Here are the top 10 blunders:

- **Insufficient capital**: Most small and medium enterprises (SMEs) are undercapitalised, with no buffer for quieter times or unexpected expenses. This problem is compounded when they do not have arrangements in place with their banks.
- **No business plan**: Statistics show that the top businesses are likely to have a business plan in place. As the majority of SMEs do not have a business plan, they tend to lose focus and are too easily distracted from the right strategic course for the business. It also means they do not have a yardstick by which to measure their business performance.
- **No managerial focus**: Many people who establish small businesses fall into the trap of believing that because they are good at what the business does they will be good at running that type of business. Their time is so taken up with what they are doing they never have time to effectively manage the business.
- **Inadequate records**: Too often, the paperwork is forgotten; this can lead to trouble with the tax office or other government agencies and also make it difficult for the business manager to measure the firm's performance.
- **Lack of profit focus**: Many businesses do not plan for profits or adequate profits, focusing simply on survival. This leaves them with no funds in reserve and no way to fund growth. Good businesses know how much profit they need to be making and organise their business around that figure.
- **Cash flow**: Management of SMEs often get into trouble because they run out of cash. They do not differentiate between profits and cash flow and they do not understand the cycles that occur in their business cash flows. Cash flow management requires strong discipline and control over debtors and stock.
- **Inadequate systems**: Many SMEs do not have operating systems in place and are overly dependent on the owners' personal abilities. A lack of systems can cause differential standards and an inability to provide consistency within the business.
- **Failure to plan for taxation**: A business has to manage, fund and plan for a wide range of tax responsibilities. Failing to manage these can severely damage a business.
- **Inadequate resource management**: Business has a whole range of resources to manage – time, people, plant and equipment, cash, etc. It is necessary to know how to balance each and combine resources effectively.

- **Break-even point**: One of the most critical pieces of information for any business is to know and understand the break-even point, to allow for effective pricing and costing decisions. Too often, businesses get into trouble because they trade under their break-even point.

Research in Singapore finds that there are six critical factors that are internal to the firm and that they are things entrepreneurs can do something about. These include: high operating expenses, lack of capital, short-sighted view of the future, lack of control over cash, lack of knowledge of the company's product(s) and inappropriate marketing strategy. The most important external variable is high taxes, but external factors are way behind the internal ones.[18]

THE EVALUATION PROCESS

A critical task of starting a new business enterprise is conducting solid analysis and evaluation of the feasibility of the product/service idea getting off the ground. Entrepreneurs must put their ideas through this analysis to discover if the proposals contain any fatal flaws. In the next sections of this chapter we examine ways to evaluate ideas and assess the competitive landscape.

Profile analysis

A single strategic variable seldom shapes the ultimate success or failure of a new venture. In most situations, a combination of variables influences the outcome. Thus, it is important to identify and investigate these variables before the new idea is put into practice. The results of such a **profile analysis** enable the entrepreneur to judge the business's potential.

The internal profile analysis in one of the experiential exercises at the end of this chapter is one method of determining the resources available to a new venture. This checklist approach

MALCOLM BRICKLIN KEEPS ON TRYING

>>ENTREPRENEURSHIP IN PRACTICE

As an entrepreneur, Malcolm Bricklin, 65, is best known for his bold failures. He began importing Subaru cars to the US in 1968 but left in 1972 before Subaru's sales ignited. His attempt at manufacturing his own car – the gorgeous, gull-winged Bricklin – failed before even 3000 were built. And then he brought the notoriously gimpy Yugo to the US in the 1980s. Undaunted, he declared in 2002 that his new company, Zastrava Motor Works, would import a different car from the former Yugoslavia. Luckily for him, it never happened. Now Bricklin tells *FSB* that his Manhattan-based company, today called Visionary Vehicles, plans to start hawking five models from China's Chery Automobile Co. for 30 per cent less than the price of comparable vehicles.

Ian Mount interviews Malcolm Bricklin:

Mount: What happened to Zastrava?

Bricklin: When we formed Zastrava, we went to see a factory in Serbia and realised that the cost to update it would make it impossible. NATO had fired five missiles into it during the war, so it was challenged, to say the least.

Mount: Why will the Chery succeed where the Bricklin and Yugo crapped out?

Bricklin: In the Bricklin case I had to build a factory, so I went to a place that would give me money – Canada – not to a place that was good at building cars. In Canada at that time, you could work for three months and go on the dole (unemployment benefit) for a year, so every three months we were getting about 80 per cent turnover. With the Yugo, we took a car that was a 20-year-old Fiat and made 528 changes in 14 months and colour was about the only option we offered. To sell 50 000 of those cars a year for three years was impressive. Then the country imploded.

Mount: Did you learn anything from all this?

Bricklin: Don't do business with a factory that can't do as good a job as we can in the US. The one in Yugoslavia was built in the 1950s. The difference this time is that we're doing business with a factory that is state of the art. And it's in a country I hope won't blow up.

Source: Ian Mount, 'Wild Ride', *FSB: Fortune Small Business*, 15(2), March 2005: 24

allows entrepreneurs to identify major strengths and weaknesses in the financial, marketing, organisational and human resource factors needed for the venture to progress successfully. In this manner entrepreneurs can prepare for possible weaknesses that may inhibit the growth of their venture. More important, many of the reasons cited for venture failure earlier in this chapter can be avoided through a careful profile analysis (see the Experiential Exercise, page 329).

Feasibility criteria approach

Another method, the **feasibility criteria approach**, was developed as a criteria selection list from which entrepreneurs can gain insights into the viability of their venture; this approach is based on answering the following questions:

- *Is it proprietary?* The product does not have to be patented, but it should be sufficiently proprietary to permit a long head start against competitors and a period of extraordinary profits early in the venture to offset start-up costs.
- *Are the initial production costs realistic?* Most estimates are too low. A careful, detailed analysis should be made so no large, unexpected expenses arise.
- *Are the initial marketing costs realistic?* This answer requires the venture to identify target markets, market channels and promotional strategy.
- *Does the product have potential for very high margins?* This is almost a necessity for a fledgling company. Gross margins are one thing the financial community understands. Without them, funding can be difficult.
- *Is the time required to get to market and to reach the break-even point realistic?* In most cases, the faster the better. In all cases, the venture plan will be tied to this answer and an error here can spell trouble later on.
- *Is the potential market large?* In determining the potential market, entrepreneurs must look three to five years into the future because some markets take this long to emerge. The mobile telephone, for example, had an annual demand of approximately 400 000 units in 1982. However, by the late 1990s this market was estimated be growing by at least 45 per cent annually.
- *Is the product the first of a growing family?* If it is, the venture is more attractive to investors. If they do not realise a large return on the first product, they might on the second, third, or fourth.
- *Does an initial customer exist?* It is certainly impressive to financial backers when a venture can list its first 10 customers by name. This pent-up demand also means the first quarter's results are likely to be good and the focus of attention can be directed to later quarters.
- *Are the development costs and calendar times realistic?* Preferably, they are zero. A ready-to-go product gives the venture a big advantage over competitors. If costs exist, they should be complete, detailed and tied to a month-by-month schedule.
- *Is this a growing industry?* This is not absolutely essential if the profits and company growth are there, but it means less room for mistakes. In a growing industry, good companies do even better.
- *Can the product – and the need for it – be understood by the financial community?* If the financiers can grasp the concept and its value, the chances for funding will increase. For example, a portable heart-monitoring system for post-coronary monitoring is a product many will understand. Undoubtedly, some of those hearing the presentation will have already had coronaries or heart problems of some sort.[19]

The criteria selection approach provides a means of analysing the internal strengths and weaknesses that exist in a new venture by focusing on the marketing and industry potential critical to assessment. If the new venture meets fewer than six of these acceptance criteria questions, it typically lacks feasibility for funding. If the new venture meets seven or more of the acceptance criteria, it may stand a good chance of being funded.

Comprehensive feasibility approach

The most comprehensive and systematic feasibility analysis, the **comprehensive feasibility approach**, incorporates external factors in addition to those in the feasibility criteria approach questions. Figure 9.3 presents a breakdown of the factors involved in a comprehensive feasibility study of a new venture – technical, market, financial, organisational and competitive. A more detailed feasibility analysis guide is provided in Table 9.3, which identifies the specific activities involved in each feasibility area. Although all five of the areas presented in Figure 9.3 are important, two merit special attention: technical and market (see Appendix 9a, page 336, for a complete Feasibility Plan Outline).

FIGURE 9.3: KEY AREAS FOR ASSESSING THE FEASIBILITY OF A NEW VENTURE

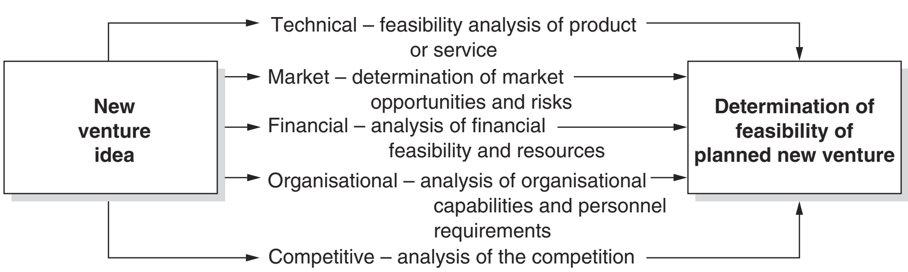


TABLE 9.3: SPECIFIC ACTIVITIES OF FEASIBILITY ANALYSES

TECHNICAL FEASIBILITY ANALYSIS	MARKET FEASIBILITY ANALYSIS	FINANCIAL FEASIBILITY ANALYSIS	ANALYSIS OF ORGANISATIONAL CAPABILITIES	COMPETITIVE ANALYSIS
Crucial technical specifications	*Market potential*	*Required financial resources for*:	*Personnel requirements*	*Existing competitors*
Design	Identification of potential customers and their dominant characteristics (e.g. age, income level, buying habits)	Fixed assets	Required skill levels and other personal characteristics of potential employees	Size, financial resources, market entrenchment
Durability	Potential market share (as affected by competitive situation)	Current assets	Managerial requirements	Potential reaction of competitors to newcomer by means of price cutting, aggressive advertising, introduction of new products and other actions
Reliability	Potential sales volume	Necessary working capital	Determination of individual responsibilities	Potential new competitors
Product safety	Sales price projections	*Available financial resources*	Determination of required organisational relationships	
Standardisation	*Market testing*	Required borrowing	Potential organisational development	
Engineering requirements	Selection of test	Potential sources for funds	Competitive analysis	
Machines	Actual market test	Cost of borrowing		
Tools	Analysis of market	Repayment conditions		
Instruments	*Marketing planning issues*	Operation cost analysis		
Work flow	Preferred channels of distribution, impact of promotional efforts, required distribution points (warehouses), packaging considerations, price differentiation	Fixed costs		
Product development		Variable costs		
Blueprints		Projected cash flow		
Models		Projected profitability		
Prototypes				
Product testing				
Lab testing				
Field testing				
Plant location				
Desirable characteristics of plant site (proximity to suppliers, customers), environmental regulations				

Source: Hans Schollhammer and Arthur H. Kuriloff, *Entrepreneurship and Small Business Management*, New York: John Wiley & Sons, 1979: 56. Copyright © 1979 by John Wiley & Sons, Inc. Reprinted by permission of John Wiley & Sons, Inc.

Technical feasibility

The evaluation of a new venture idea should start with identifying the **technical feasibility**. This analysis includes an assessment of the technical requirements for producing a product or service that will satisfy the expectations of potential customers. The most important of these are:

- functional design of the product and attractiveness in appearance
- flexibility, permitting ready modification of the external features of the product to meet customer demands or technological and competitive changes
- durability of the materials from which the product is made
- reliability, ensuring performance as expected under normal operating conditions
- product safety, posing no potential dangers under normal operating conditions
- reasonable utility – an acceptable rate of obsolescence
- ease and low cost of maintenance
- standardisation through elimination of unnecessary variety among potentially interchangeable parts
- ease of processing or manufacture
- ease in handling and use.[20]

The results of this investigation provide a basis for deciding whether a new venture is feasible from a technical viewpoint.

Marketability

Assembling and analysing relevant information about the **marketability** of a new venture are vital for judging its potential success. Three major areas in this type of analysis are: (1) investigating the full market potential and identifying customers (or users) for the goods or service, (2) analysing the extent to which the enterprise might exploit this potential market and (3) using market analysis to determine the opportunities and risks associated with the venture.

To address these areas, a variety of informational sources must be found and used. For a market feasibility analysis, general sources would include:

- *general economic trends* – various economic indicators such as new orders, housing starts, inventories and consumer spending
- *market data* – customers, customer demand patterns (for example, seasonal variations in demand, governmental regulations affecting demand)
- *pricing data* – range of prices for the same, complementary and substitute products; base prices; and discount structures
- *competitive data* – major competitors and their competitive strength.

More attention is given to marketing issues in Chapter 10. At this point, it is important to note the value of marketing research in the overall assessment and evaluation of a new venture.[21] Thus, as demonstrated by Table 9.3, the comprehensive feasibility analysis approach is closely related to the preparation of a thorough business plan (covered in detail in Chapter 12). The approach clearly illustrates the need to evaluate each segment of the venture before initiating the business or presenting it to capital sources.

ASSESSING THE INDUSTRY ENVIRONMENT

We now move on to noted strategist Michael E. Porter's approach to assessing opportunities. First, what is the structure of your industry and how is it likely to evolve over time? If the entrepreneur's business is not in an attractive industry – and we will show how to measure its attractiveness – then the person may want to get out of it or redefine it.

Porter's second question is, What is the company's relative position in the industry? No matter how attractive the game is, entrepreneurs will not do well if their company does not hold a good position in it. Conversely, the business can be in a lacklustre industry with low average

FACING YOUR FEARS!

>>ENTREPRENEURSHIP
IN PRACTICE

The inner journey to the creation of an entrepreneurial venture can be even more fearful than the external process of developing a business plan and searching for capital. Building up the courage to quit a job and start a new venture can sound easy and yet pose enormous emotional challenges when the actual events are about to unfold. One consultant, Suzanne Mulvehill – author of *Employee to Entrepreneur* and host of her own radio talk show – suggests particular strategies to follow when confronting the emotional challenges of entrepreneurial start-ups. She coined the term 'emotional endurance' to signify the inner strength that is needed to make the jump from job to venture. Following are a few of the more significant strategies that may help entrepreneurs move through the emotional journey.

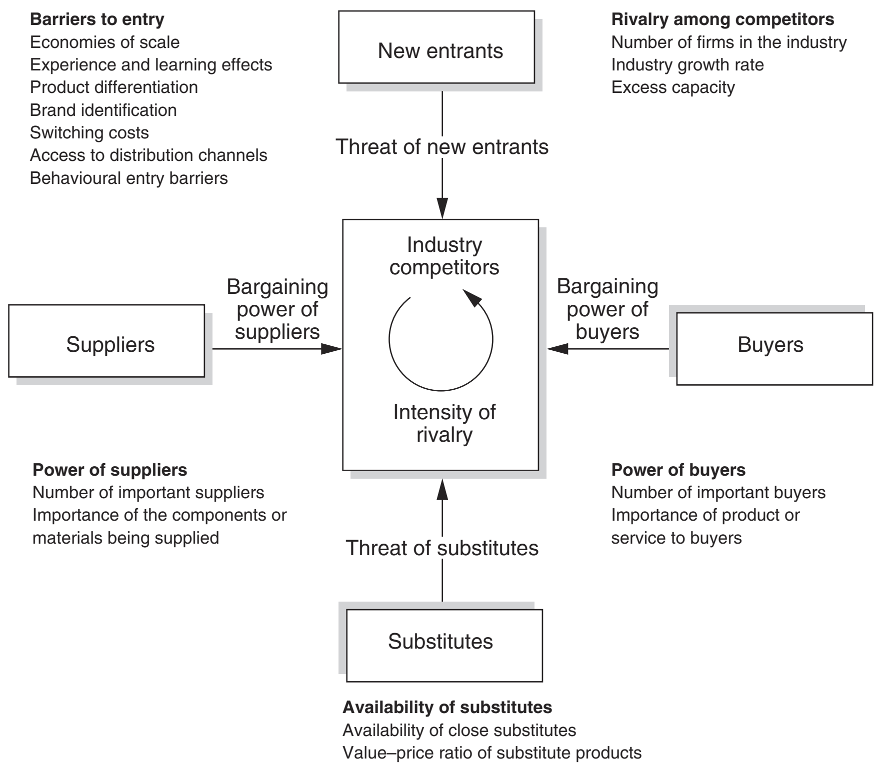
1. **Say yes to your yearning**. In other words, acknowledge the desire you are experiencing to venture out on your own. It all begins with accepting the possibility that it could happen.
2. **Visualise your success**. Creating a vision of what could be may be a powerful motivator to what will be. It is important to write down this vision so it has tangible reality in this early stage.
3. **Evaluate your beliefs**. On a sheet of paper, list all of your beliefs about money, business and yourself. Then, in a similar column, write down how you would like to view money, business and yourself. Compare these beliefs and decide how far apart they are and why.
4. **Do what you love**. There is no replacement for passion. What you love is what will drive you to succeed, even in the tough times. Develop your business ideas around the types of things that you absolutely love to do.
5. **Get educated**. Avoid the myths that education saps out any desire to be an entrepreneur. That may have been true 20 years ago, but we have come a long way in our approaches to business education. Entrepreneurship education is the hottest subject in universities worldwide. Remember, knowledge is power.
6. **Eliminate excuses**. Whenever you hear yourself make an excuse for not doing something, write it down and examine it later. Become aware of common excuses you may be using that have no real foundation. Turn your 'I can'ts' into open-ended questions that allow you to explore the possibilities rather than shut the door.
7. **Know that there is no 'right time'**. Waiting for the proverbial perfect time is a trap that many people fall into, only to find later that time passed them by. The only guarantee we have about time is that it continues, with or without us. Rather than wait, you need to proactively move on your idea.
8. **Start small**. It is always better to be realistic and reach for what you can accomplish in the near future. The longer-term future may hold greater things for the venture, but at the beginning you need to avoid being overwhelmed.
9. **Answer the 'what ifs'**. Stop for a moment and write down all of the 'what ifs' that you question yourself with. See if you can begin to logically answer the questions. It's amazing how much courage will be gained by analysing these contingencies.
10. **Ask for help**. Reach out and find help. The maverick entrepreneur is a myth of the past. Today, there is so much assistance available if you are willing to seek it. Ignorance is not asking questions; rather, ignorance is being arrogant enough to think you have all the answers.

Source: Adapted from Suzanne Mulvehill, 'Fear Factor', *Entrepreneur*, April 2005: 104–11

profitability, yet if it occupies exactly the right niche it can perform well. 'Most small companies, of course, cannot change an industry's structure. What they can do, however, is establish a good position in the industry, a position based on sustainable competitive advantage', Porter says.[22]

So, evaluating the **industry environment** is another critical step in the overall economic assessment of a new venture. In determining how to achieve a competitive advantage, Porter suggests that you start with an overall strategy. Porter's **five forces model** of industry analysis, depicted in Figure 9.4, has been widely used.[23] The five forces analysis is designed to help companies understand how profitable an industry is and also what they can do to mitigate negative forces and thereby improve profitability.

FIGURE 9.4: PORTER'S FIVE INDUSTRY FORCES MODEL



Source: Michael E. Porter, *Competitive Advantage: Creating and Sustaining Superior Performance*, The Free Press, 1985; 1998: 6. Copyright © 1985, 1998 by Michael E. Porter. Adapted with permission of The Free Press, an imprint of Simon & Schuster Adult Publishing Group

According to Porter, five forces determine the competitive environment of an industry: threat of new entrants; bargaining power of buyers; bargaining power of suppliers; threat of substitutes; and rivalry among the existing competitors. The combined power of these five forces has a decisive effect on the success of an organisation. These forces influence prices, costs and required investment of the competitors in an industry. Using this model, entrepreneurs can assess an entire industry structure. Figure 9.5 presents questions that must be answered concerning each of the five forces.[24]

Common characteristics of new and emerging industries

Although industries vary in size and development, certain characteristics are common to new and emerging industries that today's entrepreneurs will consider. The most important of these are discussed next.

- **Technological uncertainty:** A great deal of uncertainty usually exists about the technology in an emerging industry: Which product configuration will ultimately prove to be the best? Which production technology will prove to be the most efficient? How difficult will it be to develop this technology? How difficult will it be to copy technological breakthroughs in the industry?

FIGURE 9.5: USING THE FIVE FORCES MODEL FOR INDUSTRY ANALYSIS

New entrants

- What are the barriers to entry? Are we able to raise them? What factors are tending to lower them?
- What firms are potential or imminent new entrants? What are their characteristics (size, number, growth, customer base and so on)?
- What are the entrants' competitive strategies likely to be? How might the new entrants and their strategies reshape the industry?
- When will they enter our market(s)?

Suppliers

- What firms are suppliers, and how large or concentrated are they?
- How concentrated is our industry (their buyers) relative to them? That is, how many of us buy what percentage of the output?
- Can firms in the industry switch suppliers easily?
- What percentage of their total output is purchased by our industry? How large are the quantities?
- How important is their product or service to the quality of ours?
- How much of our cost does their product or service represent?
- What is the threat of forward integration by each supplier? (Conversely, what is the opportunity for backward integration by one or more of us?)
- What is their relative bargaining power over us?

Industry competitors

- What firms are the major competitors (today)? What are their basic characteristics (size, growth, product lines, customer base, geographic coverage and so on)?
- What are their relative positions in the industry?
- What is the competitive advantage of each? (What 'switching costs' or strategies does each use?)
- How do they compete? What 'weapons' or strategies does each use?
- What form does competition take – open warfare, polite détente, secrecy, open signalling?
- How is product differentiation achieved?
- How competitive is the industry? Are any competitors attempting to shape the industry? How?

Buyers

- What firms are the customers for this industry? How concentrated are they?
- How fast is demand growing overall and in different segments? What is the potential for finding or creating new markets or niches?
- What are the switching costs? How high are they?
- How price sensitive is each customer segment for each of the industry's services?
- How large is the threat of backward integration (that is, buyers' self-supplying our products or services)?
- What is the customer's relative bargaining power?

Substitutes

- What are the substitutes or alternatives for our product or service?
- How big an impact will the substitutes have? (That is, how viable are they as direct replacements for our product or service?)
- How quickly will they penetrate?
- Which players in the industry will consider substitutes as an opportunity for diversification?

Source: Michael E. Porter, 'How Competitive Forces Shape Strategy', *Harvard Business Review*, February 1979: 137–45. Copyright © 1979 by Harvard Business School Publishing Corporation; all rights reserved. Adapted and reprinted by permission of *Harvard Business Review*

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- **Strategic uncertainty:** Related to technological uncertainty is a wide variety of strategic approaches often tried by industry participants. Since no 'right' strategy has been clearly identified, industry participants will formulate different approaches to product positioning, advertising, pricing and the like, as well as different product configurations or production technologies.
- **First-time buyers**: Buyers of an emerging industry's products or services are perfectionist first-time buyers. The marketing task is thus one of substitution, or getting the buyer to make the initial purchase of the new product or service.
- **Short time horizons**: In many emerging industries, the pressure to develop customers or produce products to meet demand is so great that bottlenecks and problems are dealt with expediently rather than on the basis of an analysis of future conditions. Short-run results are often given major attention, while long-run results are given little consideration.

Barriers to entry

An additional feasibility tool is the analysis of **barriers to entry**. These barriers may include proprietary technology (expensive to access), access to distribution channels (limited or closed to newcomers), access to raw materials and other inputs (for example, skilled labour), cost disadvantages due to lack of experience (magnified with the technological and competitive uncertainties), or risk (which raises the effective opportunity cost of capital). Other barriers to entry are presented in Table 9.4. Some of these barriers will decline or disappear as the industry develops. However, it is still important for entrepreneurs to deal with each of them in their preparation.

TABLE 9.4: POSSIBLE MARKET ENTRY BARRIERS THAT A NEW VENTURE COULD FACE

CONSTRAINT	EXPLANATION
Inability to obtain raw materials and components	The development of an emerging industry requires that new suppliers be established or existing suppliers expand output or modify raw materials and components to meet the industry's needs. In the process, severe shortages of raw materials and components are common.
Period of rapid escalation of raw materials prices	Because of burgeoning demand and inadequate supply, prices for key raw materials often skyrocket in the early phases of an emerging industry. This situation is partly the simple economics of supply and demand and partly the result of suppliers realising the value of their products to the desperate industry.
Absence of infrastructure	Emerging industries are often faced with difficulties, such as those of material supply, caused by the lack of appropriate infrastructure – distribution channels, service facilities, trained mechanics and complementary products.
Perceived likelihood of obsolescence	An emerging industry's growth will be impeded if buyers perceive that second- or third-generation technologies will significantly make currently available products obsolete. Buyers will wait instead for the pace of technological progress to slow down and prices to fall as a consequence.
Erratic product quality	For many newly established firms, the lack of standards and technological uncertainty often cause erratic product quality in emerging industries. This erratic quality, even if caused by only a few firms, can negatively affect the image and credibility of the entire industry.
Image and credibility with the financial community	As a result of newness, the high level of uncertainty, customer confusion and erratic quality, the emerging industry's image and credibility with the financial community may be poor. This result can affect not only the ability of firms to secure low-cost financing, but also the ability of buyers to obtain credit.

Source: Michael E. Porter, *Competitive Strategy: Techniques for Analyzing Industries and Competitors*, The Free Press, 1980; 1998: 221–4. Copyright © 1980, 1998 by The Free Press. Adapted with permission of The Free Press, an imprint of Simon & Schuster Adult Publishing Group

Competitor analysis

There is nothing more important than a thorough analysis of your competition.[25] This **competitor analysis** involves consideration of the number of competitors as well as the strength of each. Figure 9.6 provides an illustrative grid that can be used to analyse the competition.

Figure 9.7 illustrates the components of a competitor analysis from the standpoint of:

- what drives the competition, and
- what the competition can do.

The competition's current strategy and future goals will help dictate its response. So too, will the assumptions that each competitor has about itself as well as its perceived strengths and weaknesses.

FIGURE 9.6: COMPETITIVE PROFILE ANALYSIS

Instructions

Place an *X* to denote any competitive factor that a competitor has or can provide/perform better than you. Write your analysis using your X's as an outline.

	Competitive Firms			
Competitive Factor	Company A	Company B	Company C	Your Company
Product uniqueness				
Relative product quality				
Price				
Service				
Availability/convenience				
Reputation/image				
Location				
Advertising and promotional policies/ effectiveness				
Product design				
Calibre of personnel				
Raw material cost				
Financial condition				
Production capability				
R&D position				
Variety/selection				

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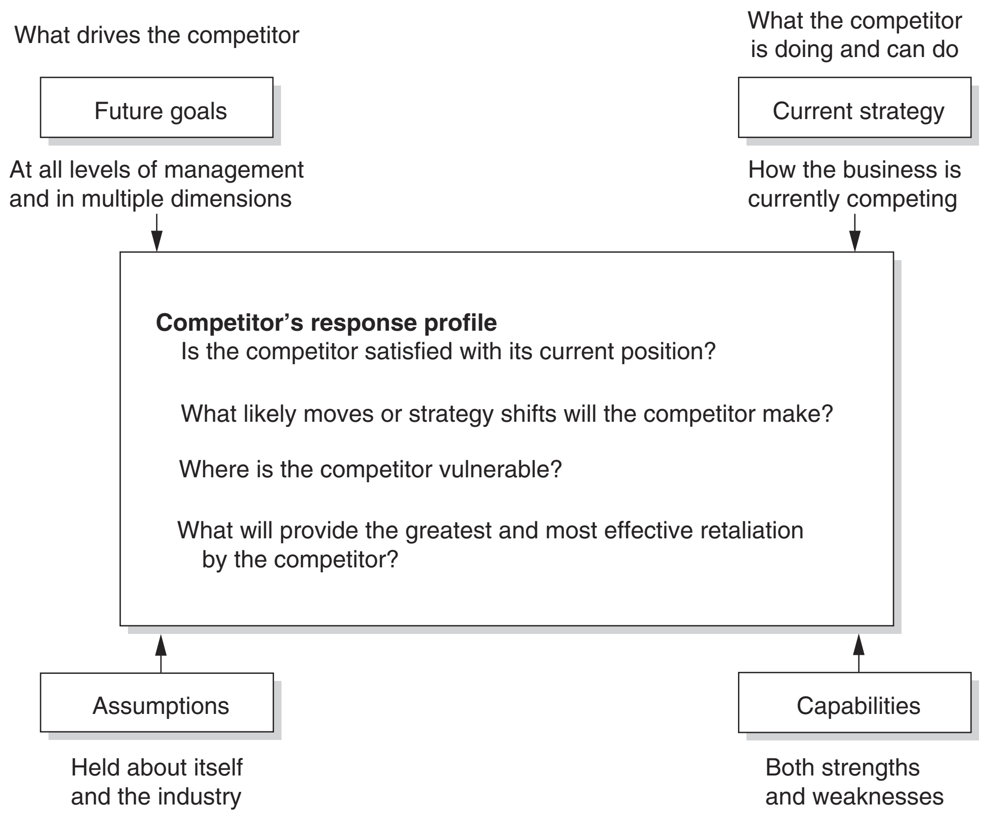
FIGURE 9.7: COMPONENTS OF A COMPETITIVE ANALYSIS



Source: Michael E. Porter, *Competitive Strategy: Technique for Analyzing Industries and Competition*, The Free Press 1980; 1998: 49. Copyright © 1980, 1998 by Michael E. Porter. Adapted with permission of The Free Press, an imprint of Simon & Schuster Adult Publishing Group

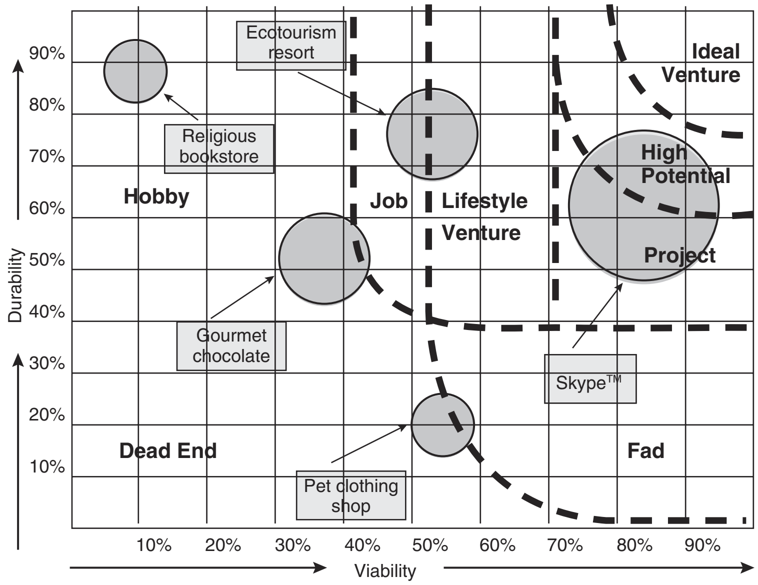
VIQ™ (Venture Intelligence Quotient)

The VIQ™ (Venture Intelligence Quotient) was developed by Australian Professor Kevin Hindle with Canadian and European colleagues to systematically evaluate and visualise opportunities. (You can actually carry this out with the Experiential Exercise 'Hindle's VIQ Scorecard', pp. 330–1.) Viability (X-axis) measures the venture's ability to generate revenue and profit. Durability (Y-axis) measures the venture's ability to sustain over time. Credibility (size of circle) measures the ability of the venture's founders and management team to exploit the opportunity.

The VIQ™ Positioning Model comprises seven kinds of ventures:

- **Dead End**: Ventures of this type have a low chance of successfully entering the market (making a sale), and sustaining their position in the industry (among competitors).
- **Hobby**: Usually is subsidised by personal income and endures only with outside financial support.
- **Project**: Solves a narrowly defined problem. Many scientific inventions fall into this category.
- **Job**: Provides a salary but cannot scale up. Does not create wealth for others.

FIGURE 9.8: VENTURE PROFILE ANALYSIS



- **Lifestyle venture**: May not create wealth beyond initial shareholders.
- **High potential**: Offers innovative products well aligned with customer needs but must innovate constantly in order to keep ahead of competitors.
- **Ideal venture**: Has market acceptance, potential for sustainable growth and defendable market share.

COMMERCIALISING NEW VENTURE OPPORTUNITIES

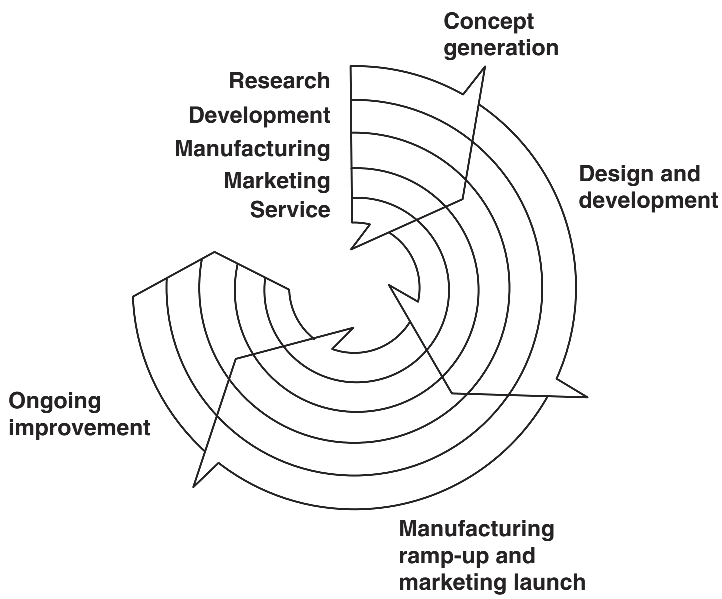
The assessment process and the feasibility analysis that we have been discussing are basically the first hurdles of a complex procedure called commercialisation. Having assessed and evaluated a new venture opportunity, the next step is to develop it for the marketplace. Commercialisation is the sequence of actions necessary to achieve market entry and general market competitiveness of new services, processes and products. Commercialisation has been the subject of serious study and elaboration for more than 20 years.[26]

Nevens and his team at Harvard University outlined the best practice model shown in Figure 9.9.[27] They see it as a series of overlapping and concurrent phases that involve many business functions simultaneously. The process begins when a business has assessed and determined as feasible a novel product or service. The process continues through design, development, manufacturing ramp-up and marketing and includes later efforts to improve the product. Other models have seen commercialisation as a linear process with stages and gates (hurdles) through which the new product or service has to pass from one phase to another.

The steps follow the progression of start-up companies through pre-seed, seed and venture or other investment capital funding. These steps are:

- **Research phase**: Much of this is conducted in universities, research institutes and corporate labs. The ideas and concepts emerging from the discovery process may yield possible commercialisable products.

FIGURE 9.9: THE COMMERCIALISATION PROCESS



Source: T. Michael Nevens, Gregory Summe and Bro Uttal, 'Commercialising Technology: What the Best Companies Do', *Harvard Business Review on Entrepreneurship*, Harvard Business School, 1990: 175–204

- **Technology phase**: Ideas make a transition from the research lab to the 'proof of concept' stage. Possible new, unanticipated applications are scoped out. Attention is paid to protecting the intellectual property through patents or copyrights.
- **Opportunity definition phase**: 'Pre-seed' activities begin in earnest. The key here is understanding how the idea will work in the marketplace. Fatal flaws must be identified. Competitor and marketplace analysis help determine the business options.
- **Opportunity development phase**: Deeper understanding is gained about market access. A positioning strategy vis-à-vis competitors is elaborated. Thought is given to how to capture or legally monopolise the market through the product's intellectual property (IP) position. The concept moves now into the seed stage where an angel investor might become interested.
- **Business definition phase**: A team now progresses the seed stage to develop business models and define the value proposition. Staffing requirements need to match skill requirements.
- **Investment-ready phase**: The executive team prepares a full business plan that describes the cash generation engine and market opportunities in detail. Staff recruitment is completed. The team takes the business's case on a road show into the capital markets.
- **Series A investments**: Series A investors typically obtain a percentage of the equity based on the business's valuation, market prospects and IP value. Series A investors demand milestones for phased funding. The executive team together with the board and investors make decision points on go/no-go decisions and test the product with customers.

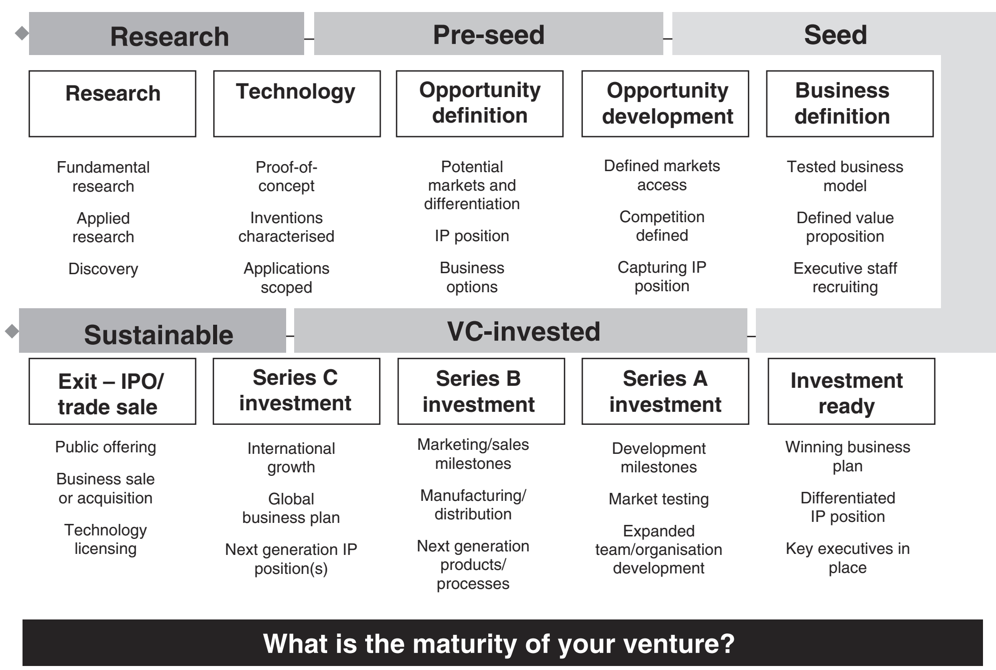
- **Series B investments**: Based on the success of the A phase, series B investors will demand a further equity percentage based on the same factors as in the A series.
- **Series C investments**: Further rounds help sustain the business's growing profitability. During this phase there may be considerable dilution of equity share interests held by the founders. At this stage, many Australian and New Zealand companies migrate their operations and intellectual property to the US or Europe.
- **Exit – initial public offering (IPO) or trade sale**: Investors and founders may wish to capture the value of the company and on-sell it or take it public. A hot company may well be acquired by a larger competitor. Other businesses grow to their limits and ultimately are sold at market rates. The most successful companies may offer shares to the public through the stock exchange to raise additional capital in order to grow and expand.

The stage-gate process of innovation

For scientists, engineers, project planners and diligent entrepreneurs, one well-known way to understand the commercialisation innovation, which after all is entrepreneurship, is through a metaphor called the **stage-gate process**. It divides the process into distinct time-sequenced stages separated by management decision gates. The innovator must successfully complete a set of related tasks in each stage in order to proceed to the next stage.

Cooper has described the innovation process as stages and gates.[28] Of course, it is not a lock-step process and many times the innovator has to go back and repeat steps. Innovation is

FIGURE 9.10: COMMERCIALISATION PROGRESSION MODEL



Source: T. Michael Nevens, Gregory Summe and Bro Uttal, 'Commercialising Technology: What the Best Companies Do', *Harvard Business Review on Entrepreneurship*, Harvard Business School, 1990: 175–204

>>ENTREPRENEURSHIP IN PRACTICE

FIVE TYPES OF INNOVATORS

There are many kinds of innovators. They are all pioneers in some way. In every field of life endeavour there are people who open up a new line of research or technology or art. Here are some of them.

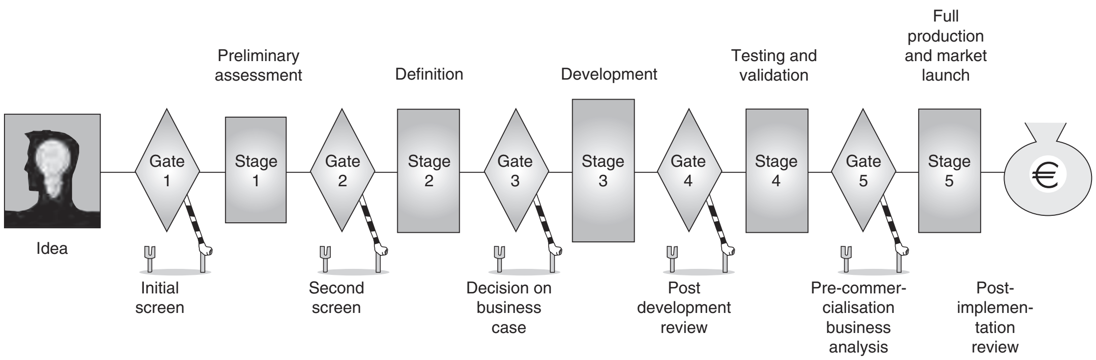
- >> **Gatekeepers**: These people collect and channel information about changes in the technical environment. They stay current with events and ideas through personal contacts, professional meetings and the news media. When gatekeepers find relevant information, they send it to the appropriate person or unit for follow-up.
- >> **Idea generators**: This role involves analysis of information about new technologies, products, or procedures in order to yield a new idea for the company. The fresh idea may be an innovative solution to an existing problem in product or business development or the identification of a new marketplace opportunity.
- >> **Champions**: Champions advocate and push for the new idea. This role involves obtaining and applying the resources and staff to demonstrate the idea's feasibility. Champions are concerned about results, not risk and do not spend time studying the consequences of failure. Their mission is to remove obstacles.
- >> **Project managers**: Someone has to draw up schedules and budgets; arrange periodic information sessions and status reports; coordinate labour, equipment and other resources; and monitor progress against the plan. Project managers integrate and administer the tasks, people and physical resources necessary to move an idea into practice.
- >> **Coaches**: This function addresses the technical and interpersonal aspects of the work in the innovation process. Coaches provide technical training related to new developments and help people work together to turn an idea into a tangible result.

Source: Mark Frohman and Perry Pascarella, 'Achieving Purpose-Driven Innovation', *Industry Week*, 19 March 1990: 20–6

often an iterative process, meaning a procedure that repeats until some condition is satisfied that permits movement to the next stage.

- **Gate 1: Initial screen**: A gentle screen – a flickering green light – that gives birth to the project, if it meets a handful of key must-meet and should-meet criteria of strategic alignment, project feasibility, magnitude of the opportunity, differential advantage, synergy with the firm's core business and resources and market attractiveness. A checklist is used for the must-meet criteria and a scoring model with weighted rating scales are employed for the should-meet criteria.
- **Stage 1: Preliminary assessment**: Quick and simple assessments are made by gathering market and technical information. Market assessment involves a library search, contacts with key users, focus groups and possibly quick concept tests with some potential users to determine market size, market potential and likely market acceptance. Technical assessment is a quick and preliminary in-house appraisal of the proposed product to assess development and manufacturing feasibility and costs and times to execute.
- **Gate 2: Second screen**: Based on the new information, the project is subjected to the same must-meet and should-meet criteria as at gate 1, but with a few additional should-meet criteria dealing with the sales force and customer reactions to the proposed product. The financial return is assessed with quick and simple calculations, such as pay-back period.
- **Stage 2: Definition**: The final stage before heavy spending involved in development, the project is clearly defined at this stage. Market research studies are carried out to

FIGURE 9.11: THE STAGE-GATE PROCESS



determine customer needs, wants and preferences in order to define the winning product. Concept testing assesses customer acceptance. Competitive analysis is also a vital part of an assessment of the attractiveness of the product and its market. Technical appraisal focuses on the ability to carry through the project successfully. Customer needs and wishes are translated into technically and economically feasible solutions and possibly minor preliminary design or laboratory work. Operations appraisal looks into the product's manufacturability, costs to manufacture and investment required. Legal, patent or copyright issues may need to be examined. Finally, a detailed financial analysis using discounted cash flow and sensitivity analysis is carried out as input to gate 3.

- **Gate 3: Decision on business case**: This is the last chance to kill the project before development – approval at this gate essentially means 'go to heavy spend'. The project is assessed using the complete set of must-meet and should-meet criteria, a review is undertaken of the activities carried out during stage 2 to check if the quality of execution was sound and the results positive, and the financial analysis is scrutinised. The project is defined including target market, product concept, product positioning strategy, delineation of product benefits to be delivered and essential and desired product features, attributes and specifications. Plans are reviewed and approved for development activities as well as preliminary operations and marketing activities.
- **Stage 3: Development**: The product is developed concurrently with detailed tests as well as marketing and operations planning. Financial analysis is updated and legal, patent or copyright issues are resolved.
- **Gate 4: Post-development review**: Project progress and continued attractiveness is reviewed. Development work is checked to ensure that it was completed in a quality fashion. Economic questions are revisited with a financial analysis using the latest and most accurate data. Plans for the next stage of testing and validation are approved and detailed future marketing and operations plans are reviewed.
- **Stage 4: Testing and validation**: Viability of the whole project is tested, including the product, the production process, likely customer acceptance and the economics of the project. In-house product tests check product quality and performance. User or field trials verify that the product functions under actual use conditions and gauge customer reactions. Trial or pilot production tests debug the production process and determine

precise production costs. Market pre-tests, tests and trial sells gauge customer reactions, assess the launch plan and forecast market share and revenues. Revised financial analysis checks the continued economic viability of the project using more detailed and accurate revenue and cost data.

- **Gate 5: Pre-commercialisation decision**: If the project passes this final gate, the door is opened to full commercialisation. The focus is on the quality and results of validation activities. Positive financial projections are vital to get the final go-ahead. Operations and marketing plans are reviewed and approved progression to stage 5 is commenced.
- **Stage 5: Commercialisation**: The marketing launch plan and operations plan developed during stage 4 are implemented.
- **Post-implementation review**: At some point after commercialisation, the new product project team is disbanded and the product becomes a regular product in the firm's product lines. The project and product performance is reviewed. Latest data on revenues, costs, expenditures, profits and timing are held up against projections. Final post-audit is carried out to assess project strengths and weaknesses and to derive key learnings from the project for future projects.

NATIONAL INNOVATION SYSTEMS

A financial and policy framework that supports innovation is crucial to the continued nurturing of creative activity. In many countries there is a whole infrastructure of support for innovation. Since it is widely accepted that innovation is the key to success for the modern economy, governments have begun stepping in to help the other players in the innovation system. The **national innovation system (NIS)** is the flow of technology and information among people, enterprises and institutions, which is key to the innovative process on the national level.[29] According to innovation system theory, innovation and technology development are results of a complex set of relationships among actors in the system, which includes enterprises, universities and government research institutes. The road to establishing a national innovation system has been rocky in many developing countries of the Asia–Pacific, but Australia, New Zealand, Singapore and Korea have distinguished themselves.[30]

Figure 9.12 shows how the Japanese Ministry of Education, Culture, Sports, Science and Technology conceives their national innovation system.

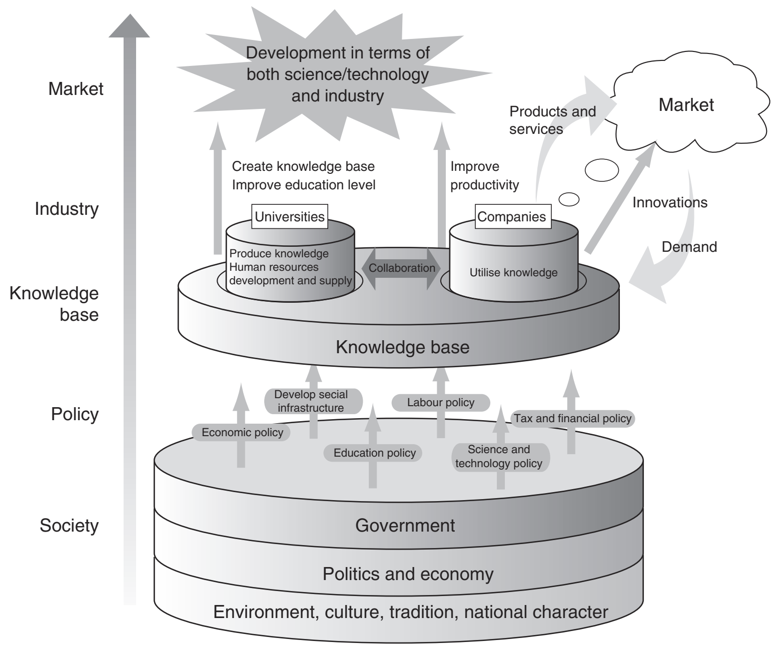
The Singapore Government early on led with the Enterprise Challenge (TEC) initiative, which funds innovative and risky proposals that have the potential to create new value or significant improvements to the delivery of public service. Projects are chosen by a board that includes business entrepreneurs, area experts and senior public servants.[31]

In 2007–09, Australia underwent a thoroughgoing review of its national innovation system as a step in 'harnessing the potential of innovation and putting it to work for the benefit of all Australians'.[32] The review panel's recommendations range across a number of key themes including innovation in business, strengthening people and skills, excellence in national research, information and market design and taxation. This is particularly important for Australia when it sees India and China transforming themselves into economic giants. As the report says:

> Innovation is about far more than the funding of research and science, or even of that and commercialisation. Australia thrives only if a critical mass of business enterprises and workplaces are consistently innovating – not just with next generation products, inventions and technologies, but in their operations, organisation, relationships and business models.[33]

Entrepreneurial activity plays a critical role in deploying new ideas or inventions within the marketplace. It is not enough to just introduce something new. To be successful, the novel

FIGURE 9.12: **NATIONAL INNOVATION SYSTEM OF JAPAN**



Source: Ministry of Education, Culture, Sports, Science and Technology, 'Annual Report on the Promotion of Science and Technology 2002', www.mext.go.jp/b_menu/hakusho/html/hpag200201/index.html

product or service must attract the support of customers and end users, either displacing previous solutions or providing the means to do something not previously possible. Innovators succeed when what they do translates into increased productivity or out-competes others for the hearts or wallets of customers and other beneficiaries (see Figure 9.13).

Australia monitors its position in respect to important indicators of the national innovation system. Figure 9.14 presents the results of the OECD's Science and Innovation statistics.[34]

Australia's recent innovation performance has been uneven. Proceeding from the top clockwise, there are some notable strengths where Australia is higher than the OECD average.

Australia is higher in:

1 patents with foreign co-inventors (273% of the OECD average)
2 venture capital as a proportion of GDP (175%)
3 scientific publications per capita (142%)
4 human resources in science and technology (HRST) (125%)
5 the number of researchers in employment (115%).

Where Australia comes up short is:

6 the number of new science and engineering degrees (89%)
7 gross domestic expenditure on R&D (GERD) (79%)

FIGURE 9.13: AUSTRALIA'S INNOVATION LANDSCAPE

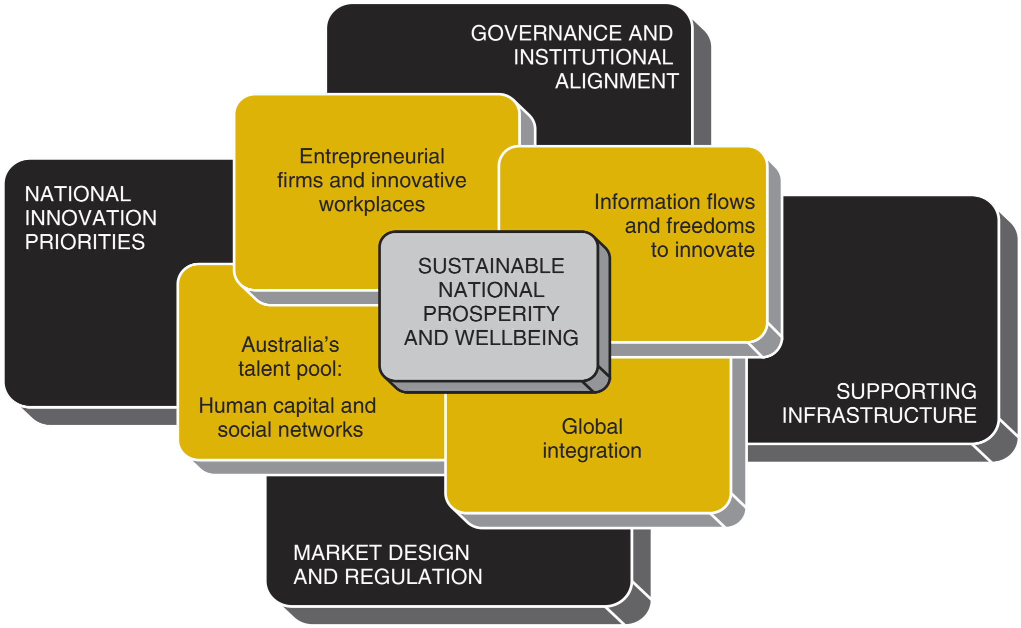
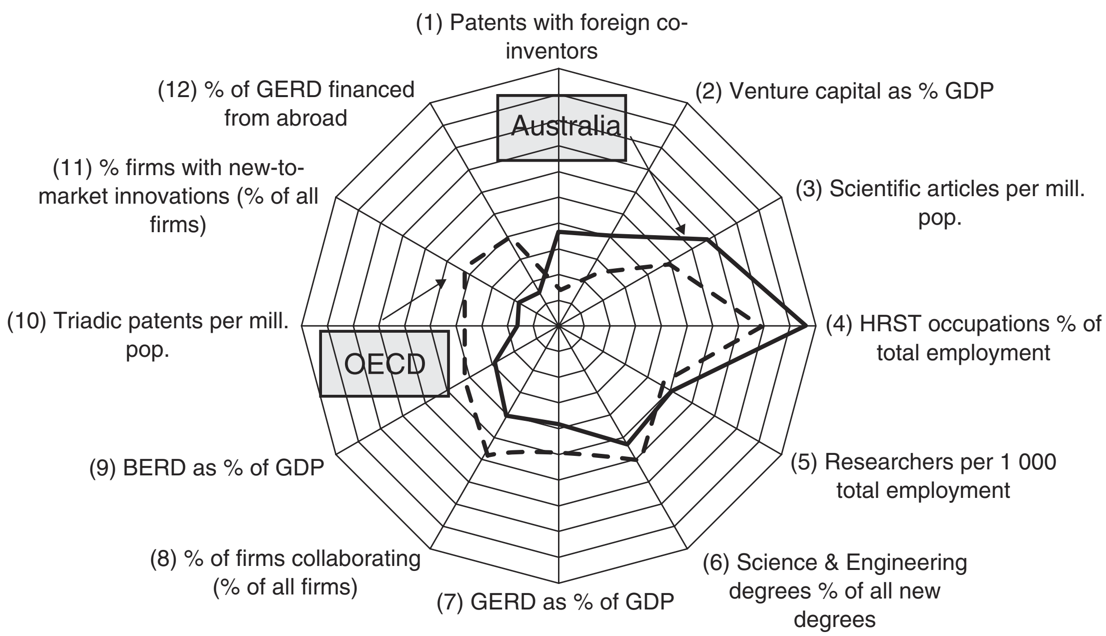


FIGURE 9.14: AUSTRALIA'S INNOVATION RANKING SCORECARD



8 firms cooperating with external partners in their innovation activities (71%), and
9 business expenditure on R&D (BERD) (67%).

Australia falls to the lower leagues in:
10 triadic patent families (granted by the three big patent authorities in Europe, the US and Japan to the same invention)
11 proportion of Australian firms introducing new-to-market innovations (41%), and
12 GERD financed from abroad (38%).

Sources of data for assessing entrepreneurial opportunities

Global entrepreneurs supplement their information with selected sources of data. Table 9.5 describes some of these sources.

TABLE 9.5: SELECTED SOURCES OF DATA FOR START-UP ENTREPRENEURS

Almanac of Policy Issues: Environment	www.policyalmanac.org/environment/index.shtml
Central Banks around the world	www.bis.org/cbanks.htm
CIA World Factbook	www.cia.gov/cia/publications/factbook
Country Risk and Economic Analysis	www.businessmonitor.co.uk/index.html
Country Risk Gradings	www.efic.gov.au/static/efi/cra.htm
Earth Trends	www.earthtrends.wri.org
Economist Country Briefings	www.economist.com/countries/index.cfm
EcoEarth.Info: Environment Portal & Search Engine	www.ecoearth.info
EnviroLink Environmental Resources	www.envirolink.org
EUROPA > European Commission > Environment	http://ec.europa.eu/environment/index_en.htm
Export.gov Market Research	www.export.gov/mrktresearch/index.asp
Federation of International Trade Associations	www.fita.org
Google > International Business and Trade	http://directory.google.com/Top/Business/International_Business_and_Trade
International Monetary Fund	www.imf.org
Library of Congress Country Studies	http://lcweb2.loc.gov/frd/cs/cshome.html
Organisation for Economic Cooperation and Development	www.oecd.org
United Nations	www.un.org
United Nations Human Development Report	http://hdr.undp.org
University of Michigan Global Edge	http://globaledge.msu.edu
US Department of State Background Notes	www.state.gov/r/pa/ei/bgn
Wikipedia	www.wikipedia.org
World Bank	www.worldbank.org
World Bank's annual World Development Report	www.worldbank.org/wdr
World Trade Organisation	www.wto.org
Yahoo > Business and Economy > Trade > Government Agencies	http://dir.yahoo.com/Business_and_Economy/Trade/Government_Agencies
Yahoo > Regional > Countries	www.yahoo.com/Regional/Countries

SUMMARY

This chapter reviewed tried and tested ways to assess the profit potential of a new business idea. Both high growth and lifestyle entrepreneurs must make decisions about the feasibility and commercial value of new ventures.

The complexity of factors involved in new venture start-up (as shown in Figure 9.1) makes it difficult to clearly assess and evaluate each one. In addition, the difficulty of obtaining reliable data on failed firms adds to this dilemma.

Opportunity assessment means determining whether an idea has commercialisable value. The entrepreneur needs both vertical and lateral thinking to make this judgement. There are a number of methods for assessing whether a mere idea can become a viable opportunity. In the age of the Internet, opportunity assessment may have an entirely different character. Here we are more interested in finding 'millions of markets of dozens' rather than 'dozens of markets of millions'.

A number of pitfalls may occur in the selection of a new venture: lack of an objective evaluation of the venture, lack of insight into the market, inadequate understanding of technical requirements, poor financial understanding, lack of venture uniqueness and failure to be aware of legal issues.

Assessment is more rigorous than evaluation. When assessing a new venture, an entrepreneur needs to consider several critical factors: the uniqueness of the good or service, the amount of capital investment required to start the venture, the growth of sales and the availability of the product.

Some major reasons new ventures fail are inadequate knowledge of the market, faulty product performance, ineffective marketing and sales effort, inadequate awareness of competitive pressures, rapid product obsolescence, poor timing and undercapitalisation.

The evaluation process leads the entrepreneur through a series of critical decision points. The feasibility of the entrepreneur's product or service can be assessed by asking the right questions, by making a profile analysis of the venture and by carrying out a comprehensive feasibility study.

Michael Porter's work on competition and strategy provides the basis for entrepreneurs to grasp what is needed in doing a competitive analysis of the industry.

The stage-gate process of innovation was described in detail and the structure and function of national innovation systems in the Asia–Pacific were depicted.

KEY TERMS & CONCEPTS

barriers to entry
competitor analysis
comprehensive feasibility approach
critical factors
customer availability
feasibility criteria approach
five forces model
growth of sales
high-growth venture
industry environment
lateral thinking
lifestyle venture
Long Tail
marketability
national innovation system (NIS)
opportunity
product availability
profile analysis
small profitable venture
stage-gate process
strategic uncertainty
technical feasibility
technical uncertainty
uniqueness
vertical thinking

REVIEW & DISCUSSION QUESTIONS

1. Describe some of the key factors involved in new-venture performance (use Figure 9.1).
2. What are the two types of thinking that an entrepreneur needs to assess an opportunity? Give your own examples.
3. What are some techniques to examine highly profitable business opportunities?
4. What does Drucker mean by internal and external sources of opportunities?
5. Many entrepreneurs lack objectivity and have no real insight into the market. Why are these characteristics considered pitfalls when selecting new ventures?

6 What are the top reasons for ventures failing?
7 What are ways to evaluate new-venture opportunities?
8 Explain how a feasibility criteria approach works.
9 Explain how a comprehensive feasibility approach works.
10 What are barriers to entry? How do they affect new-venture assessment?
11 How could an entrepreneur use Figure 9.3 to conduct a competitive profile analysis? What would the results provide? What types of decisions could the individual make from the analysis?
12 Identify and describe four of the steps to take when making an industry assessment.
13 What is the stage-gate process of innovation and how does it systematise product development?
14 What is the function of a national innovation system?

EXPERIENTIAL EXERCISE

INTERNAL PROFILE ANALYSIS

Choose any emerging company with which you are familiar. If you are not familiar with any, consult magazines such as the American ones (*Entrepreneur*, *Forbes*, *Fortune* and *Business Week*), Asia–Pacific ones (*Australian Financial Review*, *Business Review Weekly*, *Her Business*, *National Business Review*, *Unlimited*), or international magazines (*Economist*, *Far Eastern Economic Review*, *Financial Times*, *AsiaWeek*, *Asian Wall Street Journal*). Gather information on one firm. Then complete the following internal profile analysis by placing a tick (√) in the appropriate column.

INTERNAL RESOURCE	STRONG WEAKNESS	SLIGHT WEAKNESS	NEUTRAL	SLIGHT STRENGTH	STRONG STRENGTH
Financial					
Overall performance	---------	---------	---------	---------	---------
Ability to raise capital	---------	---------	---------	---------	---------
Working capital	---------	---------	---------	---------	---------
Position	---------	---------	---------	---------	---------
Marketing					
Market performance	---------	---------	---------	---------	---------
Knowledge of markets	---------	---------	---------	---------	---------
Product	---------	---------	---------	---------	---------
Advertising and promotion	---------	---------	---------	---------	---------
Price	---------	---------	---------	---------	---------
Distribution	---------	---------	---------	---------	---------
Organisational and technical					
Location	---------	---------	---------	---------	---------
Production	---------	---------	---------	---------	---------
Facilities	---------	---------	---------	---------	---------
Access to suppliers	---------	---------	---------	---------	---------
Inventory control	---------	---------	---------	---------	---------
Quality control	---------	---------	---------	---------	---------
Organisational structure	---------	---------	---------	---------	---------
Rules, policies and procedures	---------	---------	---------	---------	---------
Company image	---------	---------	---------	---------	---------
Human					
Number of employees	---------	---------	---------	---------	---------
Relevancy of skills	---------	---------	---------	---------	---------
Morale	---------	---------	---------	---------	---------
Compensation package	---------	---------	---------	---------	---------

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Based on your analysis, what three recommendations would you make to the company's management?

1 ____

____

2 ____

____

3 ____

____

EXPERIENTIAL EXERCISE: HINDLE'S VIQ SCORECARD

Hindle et al. have developed a suite of software called VIQT (Venture Intelligence Quotient) of which the most basic product is called CoreSmartT (www.viqcoresmart.com). The following is one of VIQ's tools for systematic evaluation of business ideas. The essential VIQT approach looks at three elements of the business - idea assessment, concept development and implementation of the project - and computes a score. Here is an idea evaluation tool that forms part of the VIQ kit.[35]

IDEA-VIQ™ ASSESSMENT TOOL

ELEMENT	QUESTION	LOW	MEDIUM	HIGH
POSSIBLE SCORE		1, 2, 3	4, 5, 6	7, 8, 9
Product	Is this really a product or process innovation?	Not new to the industry	An incremental improvement over what exists and maintains the industry now	Provides radical improvement over what exists and/or is disruptive to the industry
	Can the intellectual property be legally protected?	Legal protection is either unattainable or not viable	Some legal protection is attainable (narrow scope patents, trademarks and copyright)	Strong broad patents apply to the invention
Market	Are customers receptive? Does this solve a problem?	The problem is minor, and the currently available competitive products or product substitutes are effective (door-in-the-face)	The problem is moderately urgent, and currently available competitive products or product substitutes are somewhat effective (cold interest)	The problem is extremely urgent, and the currently available competitive products or product substitutes are inadequate (open arms)
Industry	Is the industry attractive?	Unattractive. Need a summary of the characteristic evaluated	Neutral	Attractive
People	Does the venture's mission fit the personal aspirations of the entrepreneur(s), their willingness to take the risks and give up control?	There are discrepancies between the venture's mission and the entrepreneurs' personal aspirations and their willingness to take risks and give up control	The mission of the new venture is in line with the entrepreneurs; personal aspirations, but it is inconsistent with their willingness to take risks and give up control	There is alignment between the new venture's mission, entrepreneurs; personal aspirations and their willingness to take risks and give up control
	Is the entrepreneurial team sufficiently connected up, down and across the value chain?	The entrepreneurial team has no personal or professional ties with customers, suppliers and competitors	The entrepreneurial team has some personal or professional ties with customers, suppliers and competitors	The entrepreneurial team has deep-rooted personal or professional ties with customers, suppliers and competitors
Money	Are the gross or operating margins satisfactory given the typical industry cost structure?	Venture's gross or operating margins are lower than typical for the industry	Venture's gross or operating margins are typical for the industry	Venture's gross or operating margins are higher than typical for the industry
	Are operating and cash cycles optimised?	Inventory is ineffective. Venture must prepay suppliers. Little control on accounts payable. Possible bad debts	The venture has optimised some components of the cash and operating cycles	Inventory period is shortened. Effective just in time. Or no inventory needed. No need to pay suppliers until product sells. Or customer prepays the product.
	Does the venture's revenue model entail customer repeat sales or recurring revenue?	The ventures has no recurring revenue generated through repeat sales or subscriptions	Some limited revenue generated through repeat sales and/or subscriptions	Revenue continuously generated through customers' repeat sales or subscriptions
Total scores				

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Maximum score on nine questions is nine points, thus 81 points is the maximum.

A (Less than 24 points) **Dead-end business**: Ventures of this type have no chance of returning any money to their shareholders. These ventures have a low chance of successfully entering the market (making a sale) and sustaining their position in the industry (among competitors).

B (24–34 points) **Hobby business**: This can be subsidised by personal income from other activities (employment, self-employment, business or investment). Cannot endure without outside financial support. Lacks elements for reaching a viable market. Not worthy of serious investment.

C (35–44 points) **Likely fundable project**: This venture can provide an effective point solution to a narrowly defined problem. Many scientific inventions fall into this category. Opportunity here means possible grants, favourable alliances and licence agreements to build a more complete end-customer solution.

D (45–54 points) **A good job for someone**: Self-employed individuals and small business owners can generate income to pay themselves and some employees. Can persist over time, but is not positioned well to scale upward. Great personal choice when compared to unemployment or escape a desk job. Only big enough for one person or family; does not create wealth for others.

E (55–64 points) **Niche leader**: 'Big fish in a small pond'. This venture has a captive or loyal clientele in their niche markets. Can potentially keep other fish out of the pond. Scalability is the biggest challenge for new investors, since this venture may not be able to create wealth for many beyond its initial shareholders.

F (65–74 points) **Go into an incubator**: This venture has innovative products well aligned to customer needs. Needs stamina to sustain innovation over time. Needs to learn how to stay ahead of competitors. Could position itself for an early buyout by a larger firm and produce lucrative returns to its shareholders.

G (75–81 points) **Power house**: This venture is characterised by proven market acceptance, potential for sustainable growth, and a defendable market share. Viability, durability and credibility factors are well balanced. Alignment of all key elements of venture success and denotes a high probability of success.

CASE 9.1

EXAMINING THE INDUSTRY

John Hargan and Rita Maylor decided to launch a new business to produce and distribute non-carbonated, high-quality soft drinks. They decided on a location in Victoria, Australia, partly because they believed access to high-quality, pure water would provide them with a competitive edge. A business consultant recommended they construct a comprehensive business plan that would include a clear and thorough assessment of the beverage industry. This exercise should help them understand their challenges and help position this new product. The two partners have spent two months of their spare time (since they both work for another employer full-time) trying to gather research to validate their idea. Because their current employer is not in the beverage industry, they are struggling to find sources of information. John and Rita realise that before any type of viable business plan can be developed, the beverage industry needs to be assessed. The specific elements of this type of assessment are unclear to both of them, however.

Questions

1. What elements of the industry should John and Rita examine?
2. How would the five forces model help them?
3. Describe what potential barriers to entry they might encounter.

CASE 9.2:

FOREIGN ENTREPRENEURS FLYING SOLO IN CHINA

When Harry Yu set out to sell Bikram and Ashtanga yoga to yuppies in Shanghai, he followed all the usual steps that foreigners have traditionally taken when starting a business in China, except one: finding a local business partner.

On his own, Yu scoured the city for a studio location, navigating a maze of zoning regulations to finally nail down a beautiful, colonial-style home in the city's historic French Concession area where he could install showers. He then hired staff and renovated the interior to look like a New York-style loft.

Increasingly, entrepreneurs such as Yu are skipping what was a required cornerstone, but often just a big headache, to doing business in China. Instead of spending time and money to identify contacts and nurture business relationships with Chinese companies, they are flying solo into the market. Forgoing joint-venture partners, they are establishing so-called wholly owned foreign enterprises (WOFEs) or more colloquially, 'woofies'.

Woofies 'have become the investment vehicle of choice for the international investor in China . . . as they negate the need for a Chinese partner', according to Beijing-based accountancy firm Dezan Shira. Partly, these woofies have emerged following China joining the World Trade Organization.

The rise of woofies could be an important milestone. China's large and low-cost market has promised riches since it was opened to foreign interests in the late 1970s. Unfortunately, the track record of overseas companies making money there is blighted with many cases of bungled and bitterly contested joint-venture partnerships. Individual entrepreneurs and weighty corporations alike have been duped by everything from phantom partners who turn out not to exist or not to have certain connections or assets, to very real partners who use local know-how not to pave the way, but to strongarm deals and siphon off profits.

Woofies are thriving, but the limited controls aren't without some of the same old challenges of trying to figure out how to do business locally.

First, says Yu, it was difficult to sign up real estate. 'I thought, I have capital and a business plan. How difficult can it be to get some real estate agents and start renovations? It took me nine months and a lot of formal and informal channels.'

Another problem is copycats. Local investors, flush with private capital, don't have many channels because they are restricted to the local stock market and limited other options. So they like to back small businesses.

'Many aren't too innovative; they just imitate and pour cash', says Yu.

Competing with multinationals that pay big salaries for skilled staff trained in Western-style service and management is also tough. 'We are going after the same staff that hotels and spas want', says Yu.

Still, the 35-year-old entrepreneur isn't looking back. He chose Shanghai because, as China's most international city, it 'embraces Western ideas quickly'.

In July, his Y+ Yoga Centre will open a second studio in Shanghai. This one will be 10 000 square feet, three times the size of his current one.

The building will include retail space, a Thai massage outlet and a health deli.

Source: Joanne Lee-Young, 'Foreign entrepreneurs flying solo in China: A local partner is no longer required for many businesses', *Vancouver Sun* (British Columbia), 18 April 2005

Questions

1 Is it such a misstep not to find a local business partner in China?
2 What are some of the challenges that 'woofies' face in doing business in China?
3 How would you go about finding a local business partner in China?

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RECOMMENDED CASES FROM HARVARD BUSINESS SCHOOL ONLINE

The Bird-In-Hand Principle: Who I am, what I know and whom I know

Publication date: 18 January 2007
Author(s): Saras Sarasvathy
Product number: 9-UV0-843

This technical note explores a framework by which entrepreneurs can evaluate their ideas before going forward based on who they are, what they know and whom they know. It draws on frameworks presented in textbooks, trade books, journal articles, periodicals and on websites that claim to predict the feasibility and value of new-venture ideas. Figure 1 depicts a simple and useful summary of four key concepts at the heart of many of these frameworks: Is it do-able? Is it worth doing? Can I do it? Do I want to do it? These questions address feasibility from a technical, market, financial, organisational and motivational standpoint.

The Globalisation of East Asian Pop Music

Publication date: 18 February 2008
Author(s): Jordan Siegel, Yi Kwan Chu
Product number: 9-708-479

This case on the globalisation of East Asian pop music is useful for teaching concepts of regional business strategy and also of cultural arbitrage. Music companies in the case must examine why certain markets are clearly more profitable than others. They must also decide whether to expand internationally with a regional focus on East Asia or, alternatively, a focus on the US and other Western markets.

Should you Invest in The Long Tail?

Publication date: 1 July 2008
Author(s): Anita Elberse
Product number: R0807H

The blockbuster strategy is a time-honoured approach, particularly in media and entertainment. When space is limited on store shelves and in traditional distribution channels, producers tend to focus on a few likely best sellers, hoping that one or two big hits will carry the rest of their lists. But online retailing and the digitisation of information goods have changed the commercial landscape: Virtual shelf space is infinite, consumers can search through innumerable options and the marginal cost of reproducing and distributing products is low. What does that mean for the blockbuster strategy? In his 2006 book, *The Long Tail: Why the Future of Business Is Selling Less of More*, Chris Anderson, editor of *Wired* magazine, argues that the sudden availability of niche offerings more closely tailored to their tastes will lure consumers away from homogenised hits. The 'tail' of the sales distribution curve, he says, will become longer, fatter and more profitable. Elberse, a professor at Harvard Business School, set out to investigate whether Anderson's long-tail theory is actually playing out in today's markets. She focused on the music and home-video industries – two markets that Anderson and others frequently hold up as examples of the long tail in action – reviewing sales data from Nielsen SoundScan, Nielsen VideoScan, the online music service Rhapsody and the Australian DVD-by-mail service Quickflix. What she found may surprise you: Blockbusters are capturing even more of the market than they used to, and consumers in the tail don't really like niche products much. Elberse outlines the implications of her research for producers and retailers, and offers strategic advice to both groups.

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SEARCH ME!

Search me!
business

barriers to entry
lateral thinking
marketability
national innovation system
opportunity
product availability
profile analysis
stage-gate process

APPENDIX 9A: FEASIBILITY PLAN OUTLINE

This outline provides the needed aspects of a complete feasibility plan. Each section has some of the key material that needs to be included. Following this outline will help the entrepreneur recognise the actual feasibility of the proposed venture as well as the areas that need to be further developed before the concept could ever be considered for potential funding.

TITLE PAGE

Name of proposed company: ______________________________

Names and titles of the founding team members:

____

Relevant contact information (name, title, address, phone, email):

____

TABLE OF CONTENTS

Make sure that all of the contents in the feasibility plan have page numbers and are listed carefully in the table of contents.

I Executive summary

II The business concept

III Industry/market analysis

IV Management team

V Product/service development analysis

VI Financial analysis

VII Timeline

VIII Bibliography

THE SECTIONS OF A FEASIBILITY PLAN

Executive summary

Explanation: Include the most important highlights from each section of the feasibility study. Be sure to include a clear and concise description of the venture, whatever proprietary aspects it may possess, the target market, the amount of financing needed and the type of financing that is being requested.

The business concept

Explanation: Using the following directions, articulate a compelling story for why this is an excellent concept. This section allows the reader to understand what concept is being proposed and why it has true potential in the marketplace. It also provides an opportunity for the entrepreneur to prove that he or she can articulate this concept in clear and comprehensible terms to people outside their circle of friends and close associates.

KEY CONCEPTS

Describe whether the proposed concept is a retail, wholesale, manufacturing, or service business. Identify the current stage of development for the venture (concept stage, start-up, initial operations, or expansion).

Include a clear description of the targeted customer, the value proposition (in terms of benefits gained) for that customer and the potential growth opportunities.

Summarise any proprietary rights associated with this concept, whether that be patents, copyrights, licences, royalties, distribution rights, or franchise agreements.

Industry/market analysis

Explanation: The industry/market analysis is critical. Is there a market for the product or service resulting from the venture? What are the current trends in this industry? What are the predicted trends for this industry? Can any of this be substantiated? The market for the product/service may be obvious, yet the feasibility analysis must validate its existence. In the venture feasibility analysis, it may be enough to prove that a sufficient market exists for the venture and that no further in-depth research is warranted. However, entrepreneurs should always study their competitors in the marketplace. Lessons learned from competitors provide opportunities for entrepreneurs to find the unique distinctions in their own concept.

KEY CONCEPTS

Explain the industry that this concept focuses on, as well as whatever trends may exist in that particular industry today.

Discuss the target market analysis that has been used and what specific market niche that has produced. In addition, identify the market size, its growth potential and your plan for market penetration based on research.

Explain the customer profile in terms of who the specific customer is and – again – what value proposition (in terms of benefits) is being offered to the customer.

Finally, be sure to include a competitor analysis that describes thoroughly the competition existing today and how specifically your concept will match up or exceed the competition and why.

Management team

Explanation: Keep in mind that all new ventures must stand the scrutiny of whether the founding team can really move this idea to market. The experience of the management team may end up being one of the most critical factors to outside investors. Many times, venture capitalists have expressed their belief that they prefer a 'B' idea with an 'A' team as opposed to an 'A' idea with a 'B' team. In other words, there is a real concern about the implementation phase of a proposed concept. Does this founding team have the background, experience, skills and networks to make the concept operationally successfully?

KEY CONCEPTS

Identify the founding team members and the key personnel in place to guide the proposed company.

Explain the team's qualifications and how the critical tasks are being assigned. Also include any board of directors/advisors that are in place.

Finally, outline any 'gaps' in the management team (in terms of skills and abilities) and explain how those will be addressed.

Product/service development analysis

Explanation: Before going any further with a conceptual idea, the entrepreneur must determine whether the concept has any practical feasibility. One of the most important questions in this section of the feasibility analysis would be: 'What unique features distinguish your product/service?' The more unique the features of a product or service, the better chance the business concept has of being successful.

KEY CONCEPTS

Provide a detailed description of the proposed concept, including any unique features that make it distinctive.

Explain the current status of the project and include a clear timeline of the key tasks to complete.

Identify any intellectual property involved with this potential venture, and discuss the proprietary protection that exists. Any proposed or completed prototype testing should be described here as well.

Finally, identify any anticipated critical risks in terms of potential product liability, governmental regulations, or raw material issues that may hinder this project at any stage.

Financial analysis

Explanation: Summarise the critical assumptions upon which the financial information is based; in other words, show how the numbers have been derived. A pro forma income statement and a statement of cash flows are the two most critical financial documents to add here – even though they may include preliminary outside sources needed to get some idea of the generation of revenue and the cash position of the venture during the first three years. If possible, provide a break-even analysis to demonstrate where the venture moves from survival to growth.

KEY CONCEPTS

Assumptions:

Pro forma income statement:

Pro forma cash-flow statement:

Break-even analysis:

Timeline

Explanation: Use a graphic representation of the dates and the related tasks in order of their completion until actual concept launch.

Bibliography

Explanation: Provide any key endnotes, footnotes, sources, or extra information that would be critical for a funding source to see in relation to the work you performed in creating this feasibility study.

10

MARKETING CHALLENGES FOR ENTREPRENEURIAL VENTURES

Emerson said that if you build a better mousetrap the world will beat a path to your door, and that may have been true then . . . but it's not true now. No one will come. You have to package and promote that mousetrap. Then they will come.

Attributed to Charles Gillette, Gillette Razors

chapter objectives

- **01** To review the importance of entrepreneurial marketing and associated research for new ventures
- **02** To identify the key elements of an effective market survey
- **03** To distinguish entrepreneurial marketing and guerrilla marketing from ordinary marketing
- **04** To outline the processes of undertaking marketing research
- **05** To present factors that inhibit the use of marketing
- **06** To examine the entrepreneurial marketing concept – philosophy, segmentation and consumer orientation
- **07** To establish the areas vital to a marketing plan
- **08** To characterise the marketing stages of growing ventures
- **09** To examine entrepreneurial marketing on the Internet
- **10** To differentiate green marketing from traditional marketing practice
- **11** To discuss the key features of a pricing strategy.

Marketing is just as critical to new businesses as it is for established ones. But for start-ups it is particularly important because the entrepreneur must be intimately in touch with customers and with their needs. A sound **entrepreneurial marketing plan** provides a strong foundation for growth. Marketing is civilised warfare. It takes products and 'drive[s] them to commanding positions in defensible market segments'.[1]

For the entrepreneur, a **market** is a group of consumers (potential customers) who have purchasing power and unsatisfied needs.[2] A new venture will survive only if a market exists for its product or service.[3] This is so obvious that it would seem every entrepreneur would thoroughly prepare the market analysis needed for establishing a target market. However, many entrepreneurs know very little about their market. They even attempt to launch new ventures without identifying any market. (See Table 10.1 concerning the marketing skills of great entrepreneurs.)

A number of techniques and strategies can assist entrepreneurs to effectively analyse a potential market. By using them, entrepreneurs can gain in-depth knowledge about the specific market and can translate this knowledge into a well-formulated business plan. Effective marketing analysis also can help a new venture position itself and make changes that will result in increased sales.[4]

Entrepreneurial marketing defined

Entrepreneurial marketing is 'the proactive identification and exploitation of opportunities for acquiring and retaining profitable customers through innovative approaches to risk management, resource leveraging and value creation'.[5] Entrepreneurial marketing is the restless pursuit of opportunity, the obsession with the customer and a focus on sales above all else. It is the

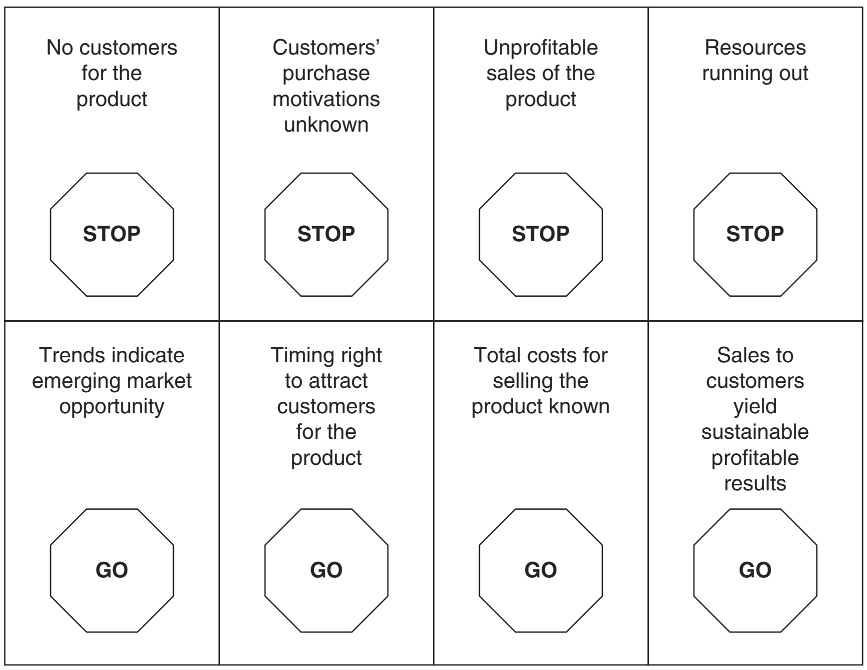
TABLE 10.1: MARKETING SKILLS OF GREAT ENTREPRENEURS

1. They possess unique environmental insight, which they use to spot opportunities that others overlook or view as problems.
2. They develop new marketing strategies that draw on their unique insights. They view the status quo and conventional wisdom as something to be challenged.
3. They take risks that others, lacking their vision, consider foolish.
4. They live in fear of being pre-empted in the market.
5. They are fiercely competitive.
6. They think through the implications of any proposed strategy, screening it against their knowledge of how the marketplace functions. They identify and solve problems that others do not even recognize.
7. They are meticulous about details and are always in search of new competitive advantages in quality and cost reduction, however small.
8. They lead from the front, executing their management strategies enthusiastically and autocratically. They maintain close information control when they delegate.
9. They drive themselves and their subordinates.
10. They are prepared to adapt their strategies quickly and to keep adapting them until they work. They persevere long after others have given up.
11. They have clear visions of what they want to achieve next. They can see further down the road than the average manager can see.

Source: Peter R. Dickson, *Marketing Management*, (Fort Worth, TX: The Dryden Press, 1994), 8. Reprinted with permission of South-Western, a division of Cengage Learning: http://permission.cengage.com/permissions application of creative approaches to risk management, resource leveraging and value creation. Instead of concentrating on brand recognition or market share, the entrepreneurial marketer has to concentrate on sales. Traditional marketing is 'cost driven'; entrepreneurial marketing is 'revenue driven'. Investors care more whether an entrepreneur can demonstrate demand and is bringing in the cash than if the entrepreneur has a tidy business plan or a recognised label.[6] Without much money to spend, the return on investment (ROI) of every advertisement, of every campaign, is that much more important. In essence, it means learning how to manage the risk of misjudgements.[7] Because of a lack of resources, entrepreneurial marketing must necessarily rely on small sample sizes and qualitative data techniques. The key skill is speed; that is, rapidly matching the gigantic wants of customers against the limited capabilities and solutions that the firm can provide.[8]

Welsh and White remind us that 'a small business is not a little big business'.[9] Entrepreneurs are not corporations, but rather self-maximising profit-seeking autonomous individuals leading small teams. They need the broad thinking of a generalist and must be able to tolerate disorder. Worse still, they suffer from 'resource poverty', what is known as **liquidity constraints** that requires **zero-budget marketing**. This is both a problem and an opportunity. It means the entrepreneur must adopt an entirely different approach to marketing. Entrepreneurial marketing can save the day and secure the bottom line for start-up ventures. Another word for this is **guerrilla marketing**, a phrase that has taken on the meaning of a non-traditional, low-cost, highly effective marketing effort.[10] It all requires research and answering some fundamental questions. Buskirk and Lavik have put together an innovative way to assess entrepreneurial marketing opportunities (see Figure 10.1).

FIGURE 10.1: STOP AND GO SIGNS FOR ASSESSING MARKETING OPPORTUNITIES



Source: Bruce D. Buskirk and Molly Lavik, *Entrepreneurial Marketing: Real Stories and Survival Strategies*, Mason, OH: Thomson/South-Western, 2004: xxi

ASIA–PACIFIC GUERRILLA MARKETING

>>ENTREPRENEURSHIP IN PRACTICE

Hong Kong: Western Union needed to promote its service among Filipina maids of affluent Hong Kong residents, who often shop for their employers and are users of electronic funds transfer services to send money home. Western Union-branded replicas of Hong Kong dollars were stamped onto the conveyor belts of supermarket check-out counters. They moved swiftly, directly, automatically between corresponding Western Union-branded hands on either side of the rollers. The nearest Western Union branch saw a bump in transfers and researchers found a recall rate of 90 per cent.

Source: 'Belting It Out', *MediaWeek*, 18(44), 8 December 2008: 13

Hong Kong: To promote a new shopping centre, models took to the streets in Hong Kong's busy Central District, improvising a catwalk among the bustling rush-hour crowds. Unexpected activities included lying down for a quick nap or playing games.

Source: *Media: Asia's Media & Marketing Newspaper*, 7 February 2008: 8

China: A restaurant owner in Dalian City advertised his new establishment by putting up Chinglish signs that read, 'The boss is crazy. Before you come, you do not know; once you arrive, you cannot leave. Why? This is a bad place!' Another banner read, 'Before you eat you not know; once you eat you never forget. Why? Food is too bad!' The ads apparently have had a good effect on customers. They all wanted to find out how bad the restaurant is.

Source: Elissa, Elan, 'Ads Bash Boss, But Guests Impressed', *Nation's Restaurant News*, 39(42), 17 October 2005: 30+

Australia: Mini launched an outbreak of 'Normal' onto the Australian public to coincide with the launch of its new Clubman car. The campaign was based on the outbreak of the Virus Normulus. Mini's imaginary virus affected Australians suffering from boredom and normality. 'The Cure for Normal' campaign was delivered through direct mail, word of mouth, outdoor and above-the-line advertising, with public relations, sponsorship and a launch. Medical-themed launch kits were sent to dealerships along with stocks of health-giving tonic.

Source: 'Training Day', *Brandweek*, 49(43), 8 December 2008: 16

Japan: On most days, the six-mile diminutive Portoliner Monorail on Japan's island city of Kobe is packed full of people. For three weeks in 2008, Ikea took over an entire train and redecorated the train cars with couches, curtains and wallpaper. Many items bore actual sales tags complete with names and prices. Using the tiny train cars idea underscored the chain's positioning of being the brand of choice for decorating tiny living spaces.

Source: 'Herd on the Street: Tales of Guerrilla Marketing', *AdWeek*, 8 December 2008

Australia: Aussie strippers streaked onto the pitch at a Wallabies–All Blacks Tri Nations rugby game wearing nothing but prominently placed Vodafone logos. The cost for the mobile phone giant is a meagre £3500 – covering the offenders' fines. The publicity coup was priceless, even if there were dissenting voices from the sport talking about an error of judgement. Post-streakers, the arguably unsettled All Blacks missed a kick and went on to lose the game 16–14.

Source: 'Guerrilla Marketing du Jour – Naughty Vodafone', *Silicon.com*, 5 August 2002

Australia: Guerrilla event marketing for tobacco is well developed and documented in Australia. A leading fashion designer's after-show-party, bankrolled by a cigarette manufacturer, featured cigarette-bearing models. A 1950s themed room in a club was visited, with much fanfare, by young models who stacked a strategically placed retro refrigerator with cigarettes. A dance party featuring a wide range of 'feminine' products, including cigarettes, was promoted via the street press and followed up with questionnaires to partygoers about their smoking.

Source: S.M. Carter, 'Going Below the Line: Creating Transportable Brands for Australia's Dark Market', *Tobacco Control*, 1 December 2003, http://tobacco.health.usyd.edu.au

Here are the foundations and principles of guerrilla marketing:

- guerrilla marketing is specifically geared for the small business
- it should be based on human psychology instead of experience, judgement and guesswork
- instead of money, the primary investments of marketing should be time, energy and imagination
- the primary statistic to measure your business is the amount of profits, not sales
- the marketer should also concentrate on how many new relationships are made each month
- create a standard of excellence with an acute focus instead of trying to diversify by offering allied products and services
- instead of concentrating on getting new customers, aim for more referrals, more transactions with existing customers and larger transactions
- forget about the competition and concentrate more on cooperating with other businesses
- guerrilla marketers should always use a combination of marketing methods for a campaign
- use current technology as a tool to empower your marketing.[11]

>>ENTREPRENEURSHIP IN PRACTICE

THE GUERRILLA MARKETING PLAN

A business plan is essential for any entrepreneur planning to start an initiative; however, by the time you include your market research results, pro forma statements, and critical risks, your business plan will become a dense packet of information to be used when guiding your entire business – a document that few will read in its entirety. Given this fact, entrepreneurs should be able to quickly articulate the key aspects of their venture in a matter of a few minutes. One tool that can be used for this purpose is what is known as a guerrilla marketing plan.

A guerrilla marketing plan forces an entrepreneur to specify the seven most important marketing issues that face her company. Of course, there will most certainly be more than seven key areas to address; however, by going through the exercise of consolidating the marketing topics that require the most focus, an entrepreneur will be better prepared to get to the heart of her concept, both when presenting to potential investors and when managing the business.

The key is to address each area using no more than a sentence. Guerrilla marketing plans give people a quick understanding of exactly what is of the utmost concern to your business by eliminating much of the detail provided in your full business plan. Large companies make use of such plans by developing different ones for different products. For instance, Procter & Gamble develops a guerrilla marketing plan for each of its products.

Although some companies choose to attach several pages of documentation to their plans, the key is to get the seven sentences right. Following are guidelines for developing a guerrilla marketing plan:

>> You should begin your guerrilla marketing plan with a sentence that describes the purpose of your marketing. This sentence should be very specific and should address what impact your marketing initiative should have on a potential customer. Goals such as 'to be more successful than my competitors' or 'to be more profitable' are not useful. This sentence should quantify your overarching goal so that it is measurable. The point is to envision exactly what you want your customer to ideally do, and then to establish a goal for ensuring that customers will act in that way.

>> The next sentence is meant for you to address the competitive advantages of the enterprise; in other words, what are the characteristics of the business that make it uniquely positioned to offer value to the public? The objective with this sentence is to outline your business's strengths that are the most unique so that you can emphasise them in your marketing materials.

>>

- You will address your target audience in the third sentence. By specifying exactly who will be exposed to a marketing campaign, you will find the process of engineering an effective plan to be much more straightforward. Companies often have more than one target audience, so guerrilla marketing plans should be written to address all potential customers in order to avoid losing sales to competitors.
- For the fourth point, a list is most appropriate. This topic addresses the marketing weapons that you will use. The important idea of this section is to include only those tools that the company can understand, afford and use properly. Countless tools are now readily available to entrepreneurs, so filtering out those that do not meet these three criteria will help you avoid making poorly directed investments.
- You should discuss the company's market niche in the fifth sentence. Now that you have addressed the purpose, benefits and target market, understanding your marketing niche is the next logical step. The market niche should capture what customers most readily associate with your company. It could be speed, value, variety, or any number of other characteristics. You will not be able to please everyone, so defining what your company is and what it is not will help to narrow your focus when promoting it to potential customers.
- The sixth sentence is where you will establish the identity of your company. Entrepreneurs should ensure that the marketing image they broadcast to the world is supported by the identity of their companies, which means that the companies' operating procedures need to reinforce whatever identity they establish.
- The final sentence in your guerrilla marketing plan needs to explicitly state what percentage of projected gross sales you are willing to earmark as your marketing budget. The quality of your marketing materials will clearly reflect on your business, so this step requires a significant amount of research to ensure that the amount you have allotted will be sufficient for supporting all previous steps.

When developing your guerrilla marketing plan, all subsequent steps should be framed by the first sentence you write, which is meant to define the purpose of your plan. Entrepreneurs should theoretically be able to write a plan of this nature within five minutes, given its brevity. The more practise you get at articulating your business objectives, the easier you will find using tools – such as the guerrilla marketing plan – to communicate your business goals.

Source: Adapted from Jay Conrad Levinson and Jeannie Levinson, 'Here's the Plan', *Entrepreneur*, February 2008, www.entrepreneur.com/magazine/entrepreneur/2008/february/188842.html

It all comes down to relationships.[12] In relationship marketing, emphasis is placed on building longer-term relationships with customers rather than on individual transactions. It involves understanding the customers' needs as they go through their life cycles. It emphasises providing a range of products or services to existing customers as they need them. Relationship marketing is most appropriate for relatively high-value consumer products, when the costs of switching are high and when customer involvement is high.

Several well-known techniques and strategies can assist entrepreneurs with effectively analysing a potential market. By using them, entrepreneurs can gain in-depth knowledge about the specific market and can translate this knowledge into a well-formulated business plan. Effective marketing analysis also can help a new venture position itself and make changes that will result in increased sales.[13] The key to this process is marketing research.

MARKETING RESEARCH

Marketing research involves the gathering of information about a particular market, followed by analysis of that information.[14] Before undertaking a campaign, the entrepreneur must know and understand marketing research procedures for gathering, processing and interpreting market information.

>>ENTREPRENEURSHIP IN PRACTICE

GUERRILLA MARKETING TACTICS

The following guerrilla marketing tactics can help you to wage an inexpensive, yet highly effective, marketing campaign for your consulting firm or freelance business.

- >> Start a webzine related to your industry that will bring potential clients to your site. Advertise your services there.
- >> Send email newsletters to current, past, or potential customers on a regular basis.
- >> Send cards or e-cards to clients on special dates: their birthday, the day of your first meeting, a thank-you card after you give a sales pitch, etc.
- >> Regularly participate in online newsgroups and forums. Include your business name and contact information in a signature file at the bottom of every post you make. Don't use them strictly for advertising. Provide solutions for real problems and help build your reputation.
- >> Offer to give speeches to companies, schools or organisations about your field of expertise. You can hand out business cards or brochures at most events.
- >> Get referrals using your business cards. Trade sets of business cards with other businesses in your field, but not directly competing with yours, or give them to clients who have good things to say about you and a good contact list. Tell them to write 'referred by:' or something similar on the back of your cards and have them pass them out to potential clients. You can give them discounts or some other form of reward for bringing in a certain number of referrals.
- >> Make yourself newsworthy. If you do, you can get free exposure in your local and sometimes even national, media. Give a free speech. Do something environmentally conscious. Donate your services to a charity that could use your help. Just try doing something that no one else has done before.
- >> Offer to serve as a resource to your local media. Sometimes reporters need help when researching a story that could be in your field and sometimes they like to run interviews with professionals about hot news topics. Let them know you're available and willing to help them out.
- >> Give free samples, trials, consultations, etc. Everyone loves getting something for free. If you're a freelance business writer, write a company's first press release for free. If you're a legal consultant, give a free first consultation. Tailor your freebie to what your clients want and to what might convince them to buy.
- >> Do whatever your competition isn't doing. You have to keep your finger on the pulse of the market at all times. If they're charging for consultations, offer a free one. If their message is dry and boring, add a touch of humour. If they're advertising in big media, advertise in all of your area's small media outlets. If they're offering a discount, offer a bigger one. No matter what your competition is doing, they're missing out on clients somewhere. It's your job to find who those lost prospects are and scoop them up for yourself.

Source: Jennifer Mattern, 'Your Guide to Consulting/Freelance', http://consulting.about.com/od/marketingtactics/a/guerillatactics_p.htm

Defining the research purpose and objectives

The first step in marketing research is to define precisely the informational requirements of the decision to be made. Although this may seem too obvious to mention, the fact is that needs are too often identified without sufficient probing. If the problem is not defined clearly, the information gathered will be useless.

In addition, specific objectives should be established. For example, one study has suggested the following set of questions for establishing objectives for general marketing research:

- Where can potential customers go to purchase the good or service in question?
- Why do they choose to go there?
- What is the size of the market? How much of it can the business capture?

- How does the business compare with competitors?
- What impact does the business's promotion have on customers?
- What types of products or services are desired by potential customers?[15]

Gathering secondary data

Information that has been compiled by others is known as **secondary data**. Generally speaking, secondary data are less expensive to gather than are new, or primary, data. The entrepreneur should exhaust all the available sources of secondary data before going further into the research process. Marketing decisions often can be made entirely with secondary data from the Internet or from other entrepreneurs.

Secondary data may be internal or external. Internal secondary data consist of information that exists within the venture. The records of the business, for example, may contain useful information. External secondary data are available in numerous periodicals, and trade association and government publications.

Unfortunately, several problems accompany the use of secondary data. One is that such data may be outdated and, therefore, less useful. Another is that the units of measure in the secondary data may not fit the current problem. Finally, the question of validity is always present. Some sources of secondary data are less valid than others.

Gathering primary data

If secondary data are insufficient, a search for new information, or **primary data**, is the next step. Several techniques can be used to accumulate primary data. These are often classified as observational methods and questioning methods. Observational methods avoid contact with respondents, whereas questioning methods involve respondents in varying degrees. Observation is probably the oldest form of research in existence. Observational methods can be used very economically. Furthermore, they avoid a potential bias that can result from a respondent's awareness of their participation under questioning methods. A major disadvantage of observational methods, however, is that they are limited to descriptive studies.

Surveys and **experimentation** are two questioning methods that involve contact with respondents. Surveys include contact by mail, telephone and personal interviews. Mail surveys are often used when respondents are widely dispersed; however, these are characterised by low response rates. Telephone surveys and personal interview surveys involve verbal communication with respondents and provide higher response rates. Personal interview surveys, however, are more expensive than mail and telephone surveys. Moreover, individuals often are reluctant to grant personal interviews because they feel a sales pitch is forthcoming. (Table 10.2 describes the major survey research techniques.)

Experimentation is a form of research that concentrates on investigating cause-and-effect relationships. Normally the experimenter will actively manipulate one variable (the independent variable), attempt to hold all other variables constant and observe changes in the other (the dependent variable).

For the entrepreneurial marketer, experimentation may be necessary since many messages fall on deaf ears, fail to hit their targets and do not elicit the desired response. Experimentation may actually make it easier – and more cost effective – for companies to target the right customers. Marketers can model hundreds or even thousands of marketing messages accurately and efficiently – and they can adjust their messages accordingly.

Here are some examples:

- What effect will a price change have on sales? Here the price is the experimental variable and sales volume is the dependent variable. Measuring the relationship

TABLE 10.2: COMPARISON OF MAJOR SURVEY RESEARCH TECHNIQUES

CRITERIA	DIRECT/COLD MAILING	MAIL PANELS	TELEPHONE	PERSONAL IN-HOME	MALL INTERCEPT
Complexity and versatility	Not much	Not much	Substantial, but complex or lengthy scales difficult to use	Highly flexible	Most flexible
Quantity of data	Substantial	Substantial	Short, lasting typically between 15 and 30 minutes	Greatest quantity	Limited, 25 minutes or less
Sample control	Little	Substantial, but representativeness may be a question	Good, but non-listed households can be a problem	In theory, provides greatest control	Can be problematic; sample representativeness may be questionable
Quality of data	Better for sensitive or embarrassing questions; however, no interviewer is present to clarify what is being asked	Positive side, interview can clear up any ambiguities; negative side, may lead to socially accepted answers	In addition, there is the chance of cheating	In addition, unnatural testing environment can lead to bias	
Response rates	In general, low; as low as 10%	70–80%	60–80%	Greater than 80%	As high as 80%
Speed	Several weeks; completion time will increase with follow-up mailings	Several weeks with no follow-up mailings, longer with follow-up mailings	Large studies can be completed in three to four weeks	Faster than mail but typically slower than telephone surveys	Large studies can be completed in a few days
Cost	Inexpensive; as low as $2.50 per completed interview	Lowest	Not as low	Can be relatively expensive, but considerable variability	Less expensive than in-home, but higher than telephone; again, length and incidence rate will determine cost
Uses	Executive, industrial, medical and readership studies	All areas of marketing research, particularly useful in low-incidence categories	Particularly effective in studies that require national samples	Still prevalent in product testing and other studies that require visual cues or product prototypes	Pervasive-concept tests, name tests, package tests, copy test

Source: Peter R. Dickson, *Marketing Best Practices*, Fort Worth, TX: Harcourt College Publishers, 2000: 114. Reprinted with permission of South-Western, a division of Cengage Learning, http://permission.cengage.com/permissions

between these two variables would not be difficult if it were not for the many other variables involved.

- Direct marketers have long used simple techniques such as split mailings to compare how customers react to different prices or promotional offers.
- Another example would be to roll out a product in a test market. A new product is typically introduced in a select number of cities. These cities must be representative of the overall national (or international) population. They should also be relatively unpolluted by outside influences (for example, media from other cities).[16]

Developing an information-gathering instrument

The questionnaire is the basic instrument for guiding the researcher and the respondent through a survey. The questionnaire should be developed carefully before it is used. Several major considerations for designing a questionnaire are listed here:

- Make sure each question pertains to a specific objective in line with the purpose of the study.

- Place simple questions first and difficult-to-answer questions later in the questionnaire.
- Avoid leading and biased questions.
- Ask 'How could this question be misinterpreted?'; reword questions to reduce or eliminate the possibility they will be misunderstood.
- Give concise but complete directions in the questionnaire; succinctly explain the information desired and direct respondents around questions that may not relate to them.
- When possible, use scaled questions rather than simple yes/no questions to measure intensity of an attitude or frequency of an experience – for example, instead of asking 'Do we have friendly sales assistants?' (yes/no), ask 'How would you evaluate the friendliness of our sales assistants?' and have respondents choose a response on a five-point scale ranging from 'Very unfriendly' (1) to 'Very friendly' (5).[17]

Interpreting and reporting the information

After the necessary data have been collected, they should be developed into usable information. Large quantities of data are merely facts. To be useful, they must be organised and moulded into meaningful information. The methods of summarising and simplifying information for users include tables, charts and other graphic methods. Descriptive statistics, such as the mean, mode and median, are most helpful in this step of the research procedure.

Marketing research questions

The need for marketing research before and during a venture will depend on the type of venture. However, typical research questions might include the following, here divided by subject:

Sales

- Do you know all you need to know about your competitors' sales performance by type of product and territory?
- Do you know which accounts are profitable and how to recognise a potentially profitable one?
- Is your sales power deployed where it can do the most good, maximising your investment in selling costs?

Distribution

- If you are considering introducing a new product or line of products, do you know all you should about distributors' and dealers' attitudes towards it?
- Are your distributors' and dealers' salespeople saying the right things about your products or services?
- Has your distribution pattern changed along with the geographic shifts of your markets?

Markets

- Do you know all that would be useful about the differences in buying habits and tastes by territory and kind of product?
- Do you have as much information as you need on brand or manufacturer loyalty and repeat purchasing in your product category?
- Can you now plot, from period to period, your market share of sales by products?

Advertising

- Is your advertising reaching the right people?
- Do you know how effective your advertising is in comparison to that of your competitors?
- Is your budget allocated appropriately for greater profit – according to products, territories and market potentials?

Products

- Do you have a reliable quantitative method for testing the market acceptability of new products and product changes?
- Do you have a reliable method for testing the effect on sales of new or changed packaging?
- Do you know whether adding higher or lower quality levels would make new profitable markets for your products?

>>ENTREPRENEURSHIP IN PRACTICE

THE PERILS OF MARKETING THE OLYMPIC TORCH

Entrepreneurs know that the best way to get their products and services to market is to have a well-thought-out marketing plan in place; yet, even the best-laid plans sometimes go awry. The exposure gained by lavish marketing campaigns can draw light to aspects of a company that the management had not intended. An interesting example of this phenomenon can be observed in the marketing conducted by China leading up to the 2008 Olympics held in Beijing.

As is customary, the Olympic torch was to be symbolically carried around the globe to generate excitement for the impending games. China's Olympic committee made no exception when planning the marketing activities for the 2008 Olympics, despite recent turmoil that had taken place months before the event. The long, contentious history between Tibet and China had regained international attention when Tibetan protesters began to commit violent acts in protest at China's rule over their homeland. With news of this dispute being broadcast on a global scale, people around the world – most of whom had prior knowledge of the longstanding disagreement – began to debate China's right to hold the Olympics, bringing into question the issue of human rights. Many citizens began to protest their country's involvement in the 2008 Olympics, arguing that it was the moral responsibility of all participants to boycott the event to send a clear message to China.

This drama was unfolding as the Olympic torch relay was set in motion. The relay brought greater tension to the issue as opposed to a sense of peace and hope, as it was intended to do. Demonstrators met the torchbearers at every turn, and they extinguished the flame repeatedly. Protestors grew more aggressive as the torch made its way from Greece to London to Paris, where Parisians forced the torchbearers to be escorted by security forces and to abandon their scheduled routes. In addition, Chinese officials cancelled an Olympic reception to be held in Paris, reportedly because they were insulted by the pro-Tibetan sentiment in the city.

The most elaborate torch relay in Olympics history became a public relations nightmare for China. Chinese officials were forced to seek the help of international public relations firms to attempt to repair the country's image prior to the games. Clearly the campaign had not gone as the Chinese officials had intended. Not only had it not led to a positive reflection on the country and its re-emergence as a global superpower, but it had led to the most intense international protests since the student massacres in Tiananmen Square in 1989.

The lesson to be learned is that the euphemism that there is no such thing as bad press does not always apply. When marketing campaigns lead to negative publicity, companies can be left wondering whether they would have been better off saying nothing at all.

Source: Adapted from Clay Chandler, 'The Olympic Torch's World Tour: Is Beijing Playing with Fire?', *Fortune*, 8 April 2008, www.travelpod.com/travel-blog-entries/happysheep/shangri-la-la/1212737040/tpod.html

DEVELOPING THE MARKETING CONCEPT

Effective marketing is based on three key elements: marketing philosophy, **market segmentation** and **consumer behaviour**. A new venture must integrate all three elements when developing its **marketing concept** and its approach to the market. This approach helps set the stage for how the firm will seek to market its goods and services.

Marketing philosophy

Three distinct types of marketing philosophies exist among new ventures: production-driven, sales-driven and consumer-driven.

The **production-driven philosophy** is based on the belief that you should produce efficiently and worry about sales later. Production is the main emphasis; sales follow in the wake of production. New ventures that produce high-tech, state-of-the-art output sometimes use a production-driven philosophy – and likely will suffer from it. A **sales-driven philosophy** focuses on personal selling and advertising to persuade customers to buy the company's output. When an overabundance of supply occurs in the market, this philosophy often surfaces. New car dealers, for example, rely heavily on a sales-driven philosophy. A **consumer-driven philosophy** relies on research to discover consumer preferences, desires and needs before production actually begins. This philosophy stresses the need for marketing research in order to better understand where or who a market is and to develop a strategy targeted towards that group.

Three major factors influence the choice of a marketing philosophy:

- **Competitive pressure**: Many times the intensity of the competition will dictate a new venture's philosophy. For example, strong competition will force many entrepreneurs to develop a consumer orientation in order to gain an edge over competitors. If, on the

PERCEPTIONS OF A TARGET MARKET

>>ENTREPRENEURSHIP IN PRACTICE

The well-known anecdote of the two shoe-business owners who went to the country of Naboo to do market research for potential business expansion paints a vivid illustration of perceptions of target markets. When the two owners arrived, they found that most Nabooans did not wear shoes. In the presentation to the board of directors, the first owner said, 'Forget it, there is no market; no one there wears shoes,' whereas the second owner said, 'There is an enormous market opportunity there; no one is wearing shoes!'

The point of the story is that without an understanding of the full picture, you may inaccurately perceive either that there is an absolute market or that no market at all exists for your products and services. A market is defined by the presence of people who have a specific unsatisfied need or want and are willing and able to purchase a product or service to satisfy that need. Our friends in the shoe business clearly need to do more research before attempting to expand their business to Naboo.

Before deciding that there is or is not a market for their shoe business in Naboo, they must first explore the reasons no one there wears shoes. Do Nabooans have no need or desire to wear shoes? Maybe they feel that shoes are too encumbering or uncomfortable and are not necessary for their soft terrain. On the other hand, maybe they would like shoes, but have no money to buy them. Are shoes even available in Naboo? Perhaps there are no shoe manufacturers there and the only people who have shoes are those able to afford expensive imports or to travel abroad. In short, determining if there is a market requires thoroughly understanding the needs, wants and purchasing power of your potential customers.

Source: Sutia Kim Alter, *Managing the Double Bottom Line: A Business Planning Reference Guide for Social Enterprises*, Save the Children, 2000: 68, www.virtueventures.com/files/mdbl-preface.pdf other hand, little competition exists, the entrepreneur may remain with a production orientation in the belief that what is produced will be sold.

- **Entrepreneur's background**: The range of skills and abilities entrepreneurs possess varies greatly. While some have a sales and marketing background, others possess production and operations experience. The entrepreneur's strengths will influence the choice of a market philosophy.
- **Short-term focus**: Sometimes a sales-driven philosophy may be preferred due to a short-term focus on moving the merchandise and generating sales. Although this focus appears to increase sales (which is why many entrepreneurs pursue this philosophy), it also can develop into a hard-selling approach that soon ignores customer preferences and contributes to long-range dissatisfaction.

Any one of the three marketing philosophies can be successful for an entrepreneur's new venture. It is important to note, however, that over the long run the consumer-driven philosophy is the most successful, although many ventures do not adopt it. This approach focuses on the needs, preferences and satisfactions of the consumer and works to serve the end-user of the product or service.

Market segmentation

Market segmentation is the process of identifying a specific set of characteristics (subgroups) that differentiate one group of consumers from the rest. The total market is often made up of submarkets (called segments).[18]

Here are some examples:

- The poor do not have the cash to stockpile products. Yet there's money to be made in this market selling single-serve packages. In India, China, the Philippines and other countries, single-serve packs of shampoo, detergents, pickles, tea, aspirin, cookies, matches and ketchup are common.[19]
- There is an invisible market waiting at the bottom of the world economic pyramid – a market of 5 billion people who live on less than $2 a day. In fact, selling to the poor is a uniquely powerful way to achieve breakthroughs in products and management practices.[20]
- Nokia has made a mad dash for the low-end boom markets in cellphones. The Finnish company owes its 40 per cent share of the global handset market in large part to residents of places like Calcutta and Shanghai, many of whom live on just a few dollars a day.[21]
- Wine-related lifestyle segments in the Australian wine market have been classified as: ritual-oriented conspicuous wine enthusiasts, purposeful inconspicuous premium wine drinkers, fashion/image-oriented wine drinkers, basic wine drinkers and enjoyment-oriented social wine drinkers.[22]
- Ecotourists in outback Australia have been segmented into: 'harder' ecotourists, who reflect a high level of environmental commitment and affinities with wilderness-type experiences; 'softer' ecotourists, who are much less committed on either dimension; and 'structured' ecotourists, by comparison, who reveal a strong pattern of commitment but a level of desire for interpretation, escorted tours and services/facilities usually more associated with mass tourism.[23]

To identify specific market segments, entrepreneurs need to analyse several variables. As an example, two major variables that can be focused on are demographic and benefit variables. Demographic variables include age, marital status, sex, occupation, income, location and the like. These characteristics are used to determine a geographic and demographic profile of the consumers and their purchasing potential. The benefit variables help to identify unsatisfied

HOW MARKETERS CLASSIFY CITIES IN CHINA

>>ENTREPRENEURSHIP IN PRACTICE

Unilever's Lipton Milk Tea, a single-serving bag of instant tea and milk powder, quickly dominated the category across scores of Chinese regional capitals known as second-tier cities. It offers affordable, pre-packaged simplicity, and its foreign origin lets thrifty consumers feel worldly.

Two-year-old Lipton Milk Tea is a rare success story in China for marketers trying to move beyond the three first-tier cities – Beijing, Shanghai and Guangzhou – that are home to China's most well-heeled consumers.

'Unilever has done a great job with Lipton, but a lot of marketers haven't been looking enough at second- and third-tier cities. They've been an underserved market by multinationals, but it's difficult to get the right management talent to go into and even live in those markets and come up with the right strategies,' said Shaun Rein, managing director of China Market Research Group in Shanghai.

When marketers enter China, they typically evaluate the country's cities, giving each locale a tier designation – most advertisers use a four- or five-tier system, although one marketer actually has 10 classification levels. A city is relegated to a tier based on the size, sophistication, purchasing habits, attitudes and disposable income of its population.

Tier one is reserved for Beijing, Shanghai, Guangzhou and sometimes Shenzhen, just across the border from Hong Kong. Tier two has about 30 cities, mostly provincial capitals that have more than five million people.

Tier three encompasses about 150 county capitals, each of which has more than one million people. Tier four covers thousands of towns ranging in size from 100 000 to one million people, and tier five includes China's smallest towns and villages, the refuges of farmers and very few brands. Annual salaries from tier-two to tier-four cities average $2000 to $4000.

'Moving down the tiers', said Tom Doctoroff, JWT's CEO China, Shanghai, 'pennies are more pinched, so pricing becomes paramount and you have to adjust the brand portfolio' to include more value products and fewer premium items.

Even within this general framework, marketers segment China differently. Anta, one of China's leading sportswear brands, segments the country into 10 tiers based on the price of real estate for its retail outlets in each town. So Dalian, a posh seaside resort, ranks as a first-tier city, said Samuel Xu, Anta's Fujian-based marketing director. Most marketers would consider Dalian tier two or lower.

Tier definitions vary depending on a company's products and goals. 'It's always a function of their reach or coverage as well as their priorities, so everyone has a different understanding of the local tiers', said Matt Brosenne, international-business director at CSM Media Research, Beijing. 'It gets pretty messy, but it's cool because there are great rewards in lower-tier cities.'

Lenovo, for instance, is wrapping up a year-long road show that visited 1000 fourth- and fifth-tier cities. Those areas accounted for much of the company's double-digit growth in China during the past year despite ongoing price wars with local rivals.

Consumers in cities such as Hangzhou, Shenzhen and Dongguan often have greater spending power than Shanghainese or Beijingers because of their lower cost of living. While that trend lets luxury marketers like Louis Vuitton open profitable shops in a dozen second-tier cities, smaller cities remain an enormous challenge for mass-market brands. Local competitors are fierce, better at distribution and charge less.

Source: Normandy Madden, 'How Marketers Classify Cities in China: Population and Spending Power of Different Areas at Heart of Categorization', *Advertising Age*, 78(12), 19 March 2007

needs that exist within this market. Examples may include convenience, cost, style, trends and the like, depending on the nature of the particular new venture. Whatever the product or service, it is extremely valuable to ascertain the benefits a market segment is seeking in order to further differentiate a particular target group. **Psychographics** is a term that is gaining greater profile in the definition of market segments. Psychographics are statistical analysis of psychological characteristics of individuals which influence their buying behaviour. Table 10.3 shows **segmentation variables** for consumers and business markets.

TABLE 10.3: SEGMENTATION VARIABLES FOR THE CONSUMER AND BUSINESS MARKETS

SEGMENTATION VARIABLES: CONSUMER MARKETS	SEGMENTATION VARIABLES: BUSINESS MARKETS
Demographics: age group (e.g. teens, retirees, young adults), gender, education level, ethnicity, income, occupation, social class, marital status Geographics: location (e.g. national, regional, urban/suburban/rural, international), climate	Demographics: type (e.g. manufacturer, retailer, wholesaler), industry, size (e.g. sales volume, number of retail outlets), age (e.g. new, young growth, established growth, mature) Geographics: location (e.g. national, regional, urban/suburban/rural, international), climate Business arrangement: ownership (e.g. private versus public, independent versus chain), financial condition (e.g. credit rating, income growth, stock price, cash flow)
Current purchasing situation: brands used, purchase frequency, current suppliers Purchase ready: possess necessary equipment, property, knowledge and skill sets Local environment: cultural, political, legal	Current purchasing situation: brands used, purchase frequency, current suppliers Purchase ready: possess necessary equipment, property, knowledge and skill sets Local environment: cultural, political, legal Customers served by the business: identify the business's market Business's perceived image: identify how targeted businesses are perceived by their customers
Benefits sought: price, overall value, specific feature, ease-of-use, service Product usage: how used, situation when used Purchase conditions: time of day/month/year when purchased, credit terms, trade-in option Characteristics of individual buyer: purchase experience, how purchase is made, influencers on purchase decision, importance of purchase Psychographics: personality, attitudes and lifestyle combined with demographics	Benefits sought: price, overall value, specific features, services, profit margins, promotional assistance Product usage: how used (e.g. raw material, component product, major selling item at retail level), situation when used Purchase conditions: length of sales cycle, set product specifications, bid pricing, credit terms, trade-in option, product handling Characteristics of buying centre: purchase experience, number of members, make-up of key influencers, willingness to assume risk

Source: KnowThis.com, 'Tutorial: The Principles of Marketing', www.knowthis.com/tutorials/marketing/targeting_markets/3.htm

Consumer behaviour

Consumer behaviour is defined by the many types and patterns of **consumer characteristics**. However, entrepreneurs can focus their attention on only two considerations: personal characteristics and psychological characteristics. Table 10.4 provides an example by tying these characteristics to the five types of consumers: innovators, early adopters, early majority, late majority and laggards.

In Table 10.4, the differences in social class, income, occupation, education, housing, family influence and time orientation are illustrated. So, too, are the psychological characteristics labelled as needs, perceptions, self-concept, aspiration groups and reference groups. This breakdown can provide an entrepreneur with a visual picture of the type of consumer to target for the sales effort.

The next step is to link the characteristic make-up of potential consumers with buying trends in the marketplace. Table 10.5 shows the changing priorities that shaped buying decisions during the 1990s in the **family life cycle**. Each of these factors relates to consumer attitudes and behaviours based on education, the economy, the environment and/or societal changes. By tying together the data in Tables 10.4 and 10.5, the entrepreneur can begin to examine consumer behaviour more closely.

An analysis of the way consumers view the venture's product or service provides additional data. Entrepreneurs should be aware of five major consumer classifications:

- *Convenience goods* – whether staple goods (foods), impulse goods (checkout counter items), or emergency goods and services – are items that consumers will want, but will not be willing to spend time shopping for them.

TABLE 10.4: CONSUMER CHARACTERISTICS

	INNOVATORS (2–3%)	EARLY ADOPTERS (12–15%)	EARLY MAJORITY (33%)	LATE MAJORITY (34%)	LAGGARDS (12–15%)
PERSONAL CHARACTERISTICS					
1 Social class	Lower upper	Upper middle	Lower middle	Upper lower	Lower lower
2 Income	High income (inherited)	High income (earned from salary and investment)	Above-average income (earned)	Average income	Below-average income
3 Occupation	Highest professionals, merchants, financiers	Middle management and owners of medium-sized businesses	Owners of small businesses, non-managerial office and union managers	Skilled labour	Unskilled labour
4 Education	Private schooling	University	High school, trade school	Grammar school, some high school	Very little – some grammar school
5 Housing	Inherited property, fine mansions	Large homes – good suburbs or best apartments	Small houses, multiple-family dwellings	Low-income housing in urban-renewal projects	Slum apartments
6 Family influence	Not family oriented, children in private school or grown	Children's social advancement important, education important	Child centred and home centred	Children taken for granted	Children expected to raise themselves
7 Time orientation	Present oriented, but worried about impact of time	Future oriented	Present oriented	Present (security) oriented	Tradition oriented, live in the past
PSYCHOLOGICAL CHARACTERISTICS					
1 Nature of needs	Self-actualisation needs (realisation of potential)	Esteem needs (for status and recognition by others)	Belonging needs (with others and groups)	Safety needs (freedom from fear)	Survival needs (basic needs)
2 Perceptions	Cosmopolitan in outlook	Prestige, status conscious, aspire to upper class	Local aspirations and local social acceptance	Home and product centred	Live from day to day
3 Self-concept	Elite	Social strivers, peer group leaders, venturesome	Respectability from own reference groups and home	Security, home centred, aggressive, apathetic, no hope	Fatalistic, live from day to day
4 Aspiration groups	British upper class	Innovator class	In own social strata, dissociated from upper lower	Others in this classification and in early majority, dissociated from lower	Don't aspire
5 Reference groups	Sports, social and travel groups	Dominate industry and community organisations, golf, college and fraternity	Social groups of this strata – chambers of commerce, labour unions, family, church, PTA, auxiliaries	Family, labour unions	Ethnic group oriented

Source: *Roy A. Lindberg and Theodore Cohn, The Marketing Book for Growing Companies that Want to Excel,* New York: Van Nostrand Reinhold, 1986: 80–1. Reprinted with permission

TABLE 10.5: CHANGING PRIORITIES AND PURCHASES IN THE FAMILY LIFE CYCLE

STAGE	PRIORITIES	MAJOR PURCHASES
Fledgling – teens and early 20s	Self, socialising, education	Appearance products, clothing, cars, recreation, hobbies, travel
Courting – 20s	Self and other, pair bonding, career	Furniture and furnishings, entertainment and entertaining, savings
Nest building – 20s and early 30s	Babies and career	Home, garden, do-it-yourself items, baby-care products, insurance
Full nest – 30 to 50	Children and others, career, mid-life crisis	Children's food, clothing, education, transportation, orthodontics, career and life counselling
Empty nest – 50 to 75	Self and others, relaxation	Furniture and furnishings, entertainment, travel, hobbies, luxury cars, boats, investments
Sole survivor – 70 to 90	Self, health, loneliness	Healthcare services, diet, security and comfort products, TV and books, long-distance telephone services

Source: Peter R. Dickson, *Marketing Management*, Fort Worth, TX: The Dryden Press, 1994: 91. Reprinted with permission of South-Western, a division of Thomson Learning, www.thomsonrights.com

- *Shopping goods* are products consumers will take time to examine carefully and compare for quality and price.
- *Specialty goods* consist of products or services consumers make a special effort to find and purchase.
- *Unsought goods* are items consumers do not currently need or seek – common examples are life insurance, encyclopaedias and cemetery plots. These products require explanation or demonstration.
- *New products* are items that are unknown due to lack of advertising or are new products that take time to be understood – when micro-computers were first introduced, for example, they fell into this category.

Understanding these classifications is important both for selling to consumers and for choosing distribution channels.

DEVELOPING A MARKETING PLAN

A marketing plan is the process of determining a clear, comprehensive approach to the creation of customers. The following elements are critical for developing this plan:

- *current marketing research* – determining who the customers are, what they want and how they buy
- **sales research** *and analysis* – promoting and distributing products according to marketing research findings
- *marketing information system* – collecting, screening, analysing, storing, retrieving and disseminating marketing information on which to base plans, decisions and actions
- **sales forecasting** – coordinating personal judgement with reliable market information
- *evaluation* – identifying and assessing deviations from marketing plans.[24]

Current marketing research

The purpose of marketing research is to identify customers – target markets – and to fulfil their desires. For marketing research to be effective for the growing venture, the following areas warrant consideration:

- **The company's major strengths and weaknesses**: These factors offer insights into profitable opportunities and potential problems and provide the basis for effective decision making.
- **Market profile**: A market profile helps a company identify its current market and service needs: How profitable are existing company services? Which of these services offer the most potential? Which (if any) are inappropriate? Which will customers cease to need in the future?
- **Current and best customers**: Identifying the company's current clients allows management to determine where to allocate resources. Defining the best customers enables management to more directly segment this market niche.
- **Potential customers**: By identifying potential customers, either geographically or with an industry-wide analysis of its marketing area, a company increases its ability to target this group, thus turning potential customers into current customers.
- **Competition**: By identifying the competition a company can determine which firms are most willing to pursue the same basic market niche.
- **Outside factors**: This analysis focuses on changing trends in demographics, economics, technology, cultural attitudes and governmental policy. These factors may have substantial impact on customer needs and, consequently, expected services.
- **Legal changes**: Marketing research performs the important task of keeping management abreast of significant changes in governmental rates, standards and tax laws.[25]

GOING FROM UNDERDOG TO TOP DOG

>>ENTREPRENEURSHIP IN PRACTICE

>> An Australian food scientist sought to supplant the veritable British Marmite from the tables of Oz with his own locally produced product. It was an uphill battle to say the least. Who'd have thought that one dark, gooey, bitter, brewer's yeast extract recommended for its B-vitamin content would be so hard to supplant . . . especially by another dark, gooey, bitter brewer's yeast extract made world famous by the Olsen Twins' movie *Our Lips Are Sealed* as the one substance on earth guaranteed to make a Yank toss out his (or her) cookies. A 20-year battle for supremacy ensued with various attempts – some successful, others not – to win consumer approval. It's a tribute to belief in one's mission, the value of the product and downright pig headedness (in a good entrepreneurial way).

>> Sportswear brand Skins has raised a few eyebrows this year, with a series of humorous ads and a few digs at its well-established rivals. In a market famous for sponsoring and idolising sports stars, the compression tights and garments maker has kept its marketing budget low by doing quite the opposite and refusing to use famous people in its ads. And the brand's cheekiest stunt to date was stealing the famous Nike swoosh, turning it upside down and plastering it on the mouths of a series of sportsmen in its ads. Nike has chosen to ignore the slight rather than respond to it. One of the Skins TVCs, created by Arnold, derides 'baby-faced multi-millionaire sports stars that get paid too much . . . getting paid to advertise anything'.

>> If you believe its creators, Absolut Cut isn't your regular pre-mixed alcoholic drink. What is an absolute is the fact that unlike many of its competitors it hasn't relied on more traditional above-the-line campaigns to get its brand message out to a new market. In fact, its launch into Australia this year has been a softly, softly, targeted approach which has focused on what its agency Naked Communications has identified as the 'cultural creatives' that it believes will form the foundation for the growth and expansion of the brand. In Australia products such as Nudie Juice and Krispy Kreme doughnuts were largely launched using 'word of mouth' technique; that is, there was virtually no traditional advertising or promotion.

Sources: Adapted from Chuck Huckabay, 'Vegemite: An Entrepreneurial Underdog's Tale', http://1sthowtoworkathome.blogspot.com/2005/08/vegemite-entrepreneurial-underdogs.html; 'Ten Most Interesting Marketers', *B&T Weekly* (Australia), 5 August 2005; Grant Common, 'Rise of Word-of-Mouth Marketing Gives PR Fresh Impetus', *LexisNexis Australia News*, 2 August 2005; Edward O. Welles, 'Turf Wars', *Inc.*, February 2000: 90–8; Christopher Power, 'How to Get Closer to your Customers', *Business Week*, Enterprise Issue, October 1993: 42ff

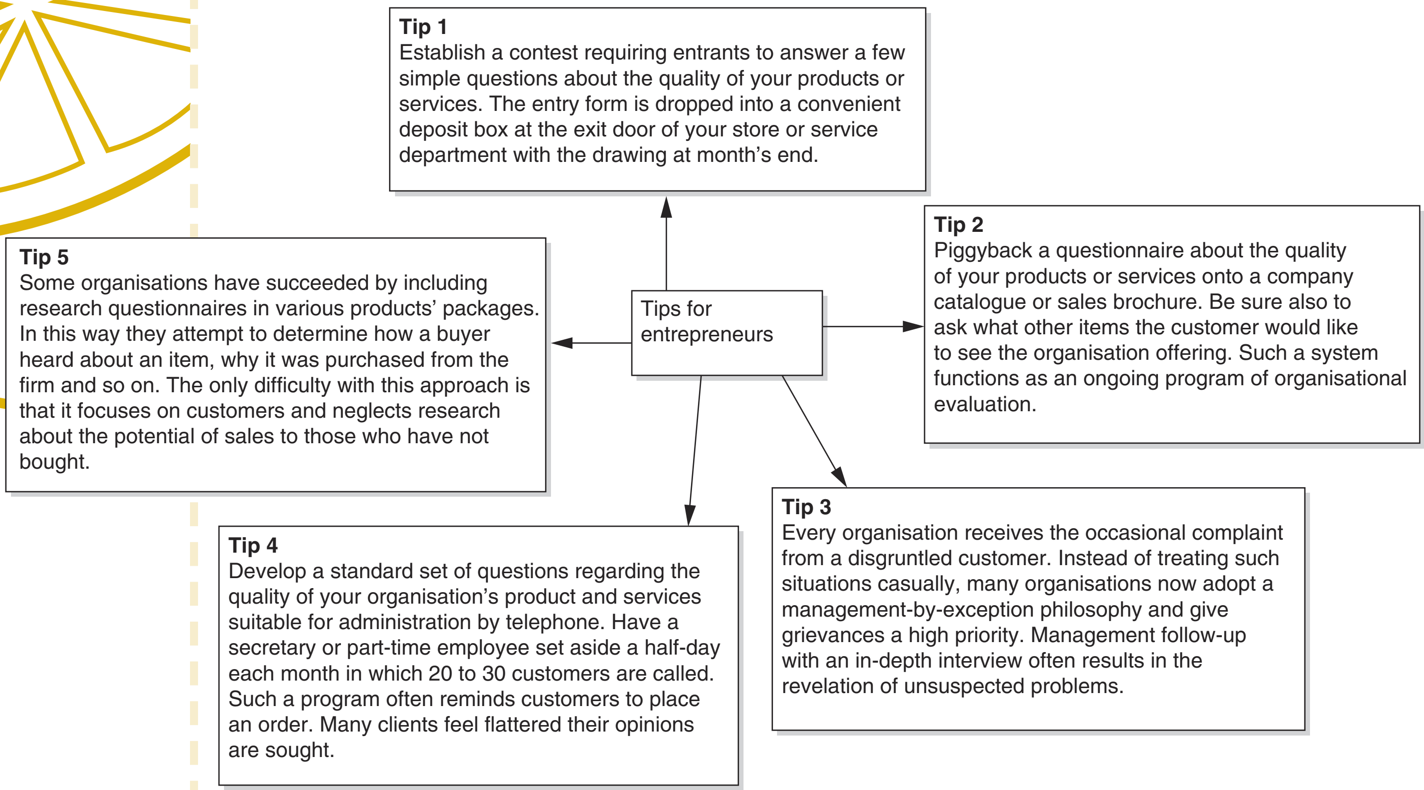
Marketing research need not be extremely expensive.[26] Presented in Figure 10.2 are some useful tips regarding low-cost research. These tips can be valuable to entrepreneurs needing research, but lacking the funds for sophisticated measures.

Current sales analysis

An entrepreneur needs to continually review the methods employed for sales and distribution in relation to the market research that has been conducted. Matching the correct customer profile with sales priorities is a major goal in sales research. The following is a list of potential questions to be answered by this research:

- Do salespeople call on their most qualified prospects on a proper priority and time-allocation basis?
- Does the sales force contact decision makers?
- Are territories aligned according to sales potential and salespeople's abilities?
- Are sales calls coordinated with other selling efforts, such as trade publication advertising, trade shows and direct mail?

FIGURE 10.2: USEFUL TIPS REGARDING LOW-COST RESEARCH



Source: Gerald B. McCready, *Marketing Tactics Master Guide for Small Business*, New Jersey: Prentice-Hall, a division of Simon & Schuster, Englewood Cliffs, 1982: 8. Reprinted by permission of the publisher, Prenctice Hall, a division of Simon & Schuster, Englewood Cliffs, New Jersey

- Do salespeople ask the right questions on sales calls? Do sales reports contain appropriate information? Does the sales force understand potential customers' needs?
- How does the growth or decline of a customer's or a prospect's business affect the company's own sales?

Marketing information system

A marketing information system compiles and organises data relating to cost, revenue and profit from the customer base. This information can be useful for monitoring the strategies, decisions and programs concerned with marketing. As with all information systems designs, the key factors that affect the value of such a system are: (1) data reliability, (2) data usefulness or intelligibility, (3) reporting system timeliness, (4) data relevance and (5) system cost.

Sales forecasting

Sales forecasting is the process of projecting future sales through historical sales figures and the application of statistical techniques. The process is limited in value due to its reliance on historical data, which many times fail to reflect current market conditions. As a segment of the comprehensive marketing–planning process, however, sales forecasting can be very valuable.

Product research

In **product research** the focus is on the competitor's product:

- What products do your competitors currently offer?
- What is the extent of their product range?
- Do they provide the consumer with a good range of choices?
- Do they have a product range that provides different levels of pricing and quality?
- Are fad items a feature of this industry?
- Are products seasonal?
- What is the life cycle of competitors' products?
- Do your products need to be quite different from the current offerings to be successful?

Evaluation

The final critical factor in the **marketing–planning** process is evaluation. Because a number of variables can affect the outcome of marketing planning, it is important to evaluate performance. Most importantly, reports should be generated from an analysis of customer retention or loss as well as established customer preferences and reactions. This analysis can be measured against performance in sales volume, gross sales dollars, or market share. It is only through this type of evaluation that flexibility and adjustment can be incorporated into marketing planning.

Final considerations for entrepreneurs

Marketing plans are part of a venture's overall strategic effort.[27] To be effective, these plans must be based on the venture's specific goals. Here is an example of a five-step program designed to help entrepreneurs follow a structured approach to developing a market plan:

- **Step 1**: Appraise strengths and weaknesses, emphasising factors that will contribute to the firm's competitive edge. Consider product design, reliability, durability, price/quality ratios, production capacities and limitations, resources and need for specialised expertise.
- **Step 2**: Develop marketing objectives along with the short- and intermediate-range sales goals necessary to meet those objectives. Next, develop specific sales plans for the current fiscal period. These goals should be clearly stated, measurable and within the company's capabilities. To be realistic, these goals should require only reasonable efforts and affordable expenditures.
- **Step 3**: Develop product/service strategies. The product strategy begins with identifying the end-users, wholesalers and retailers, as well as their needs and specifications. The product's design, features, performance, cost and price then should be matched to these needs.
- **Step 4**: Develop marketing strategies. Strategies are needed to achieve the company's intermediate- and long-range sales goals and long-term marketing objectives. These strategies should include advertising, sales promotion campaigns, trade shows, direct mail and telemarketing. Strategies also may be necessary for increasing the size of the sales force or marketing new products. Contingency plans will be needed in the event of technological changes, geographic market shifts, or inflation.

- **Step 5**: Determine a pricing structure. A firm's pricing structure dictates which customers will be attracted, as well as the type or quality of products/services that will be provided. Many firms believe the market dictates a competitive pricing structure. But this is not always the case – many companies with a high price structure are very successful. Regardless of the strategies, customers must believe that the product's price is appropriate. The price of a product or service, therefore, should not be set until marketing strategies have been developed.[28]

MARKETING STAGES FOR GROWING VENTURES

In truth, most emerging ventures will evolve through a series of **marketing stages**. In each stage the marketing functions will differ; thus each requires a specific type of marketing strategy.[29] Entrepreneurial is not one monolithic stage. Indeed, we can distinguish stages – entrepreneurial marketing (stage 1), opportunistic marketing (stage 2), responsive marketing (stage 3) and diversified marketing (stage 4).[30] Table 10.6 provides a breakdown of each stage in relation to marketing strategy, marketing organisation, marketing goals and critical success factors. Notice that the strategy in each stage relates closely to the marketing goals. For example, entrepreneurial marketing (stage 1) has a strategy of developing a market niche and a goal of attaining credibility in the marketplace. Stage 2, opportunistic marketing, seeks a strategy of **market penetration** for the purpose of attaining sales volume, thereby demonstrating the logical progression depicted in the table. Stage 3, responsive marketing, seeks to develop the product market and create customer satisfaction. Stage 4, diversified marketing, focuses on new-business development and seeks to manage the product life cycle.

It is important to realise that these stages are developed with a growing venture in mind. The idea of growth as a strategic planning factor, discussed in Chapter 13, is also presented here as a marketing factor.

MARKETING ON THE INTERNET

The Internet can assist a new venture's overall marketing strategy. First, the Internet allows the firm to increase its presence and brand equity in the marketplace. Company and brand sites provide the opportunity to communicate the overall mission of the company/brand, to provide information on attributes and/or ratings of the company/brand and to give information on the history of the company/brand. In addition, firms can easily communicate information on the marketing mix offered. Getting visibility and name recognition on the Internet requires a major marketing effort using leveraged approaches.

TABLE 10.6: THE EVOLUTION OF THE MARKETING FUNCTION

	STAGE 1: ENTREPRENEURIAL MARKETING	STAGE 2: OPPORTUNISTIC MARKETING	STAGE 3: RESPONSIVE MARKETING	STAGE 4: DIVERSIFIED MARKETING
Marketing strategy	Market niche	Market penetration	Product-market development	New-business development
Marketing organisation	Informal, flexible	Sales management	Product-market management	Corporate and divisional levels
Marketing goals	Credibility in the marketplace	Sales volume	Customer satisfaction	Product life cycle and portfolio management
Critical success factors	A little help from your friends	Production economies	Functional coordination	Entrepreneurship and innovation

Source: Tyzoon T. Tyebjee, Albert V. Bruno and Shelby H. McIntyre, 'Growing Ventures Can Anticipate Marketing Stages', exhibit 1, *Harvard Business Review*, January/February 1983: 64. Reprinted by permission.

Second, the Internet allows the company to cultivate new customers around the world and the entrepreneur should be prepared for global customers from day one. It works the other way too: Competition has no borders as long as goods and services can be delivered in a timely and reliable manner. Providing important information about both the attributes of the firm's product and those of competitive products can aid in the decision-making process. In addition, the website can demonstrate products in actual use. This kind of information builds interest in the brand.

The Internet also allows website visitors to match their needs with the offerings of the company. It is extremely important to remember that while traditional marketing techniques tend to be push-oriented (the company decides what the consumer will see and where), the Internet is pull-oriented (the consumer chooses what, when and how to look in greater detail). This technique requires website designers to think differently about what should or should not appear in the site offering.

Third, the Internet can improve customer service by allowing customers to serve themselves when and where they choose. As more consumers begin to use the Internet, companies can readily serve these individuals without incurring expensive distribution costs. The expansion of the number of customers served requires only that the organisation has enough servers available.

The fourth benefit to marketers relates to information transfer. Traditionally, companies have gathered information via **focus groups**, mail surveys, telephone surveys and personal interviews. However, these techniques can be very expensive to implement. In contrast, the Internet offers a mechanism for the company to collect similar information at a fraction of the cost.

Not only can information be gathered from consumers, but information also can be shared with them. For example, the Web can be used to provide expensive or specialised materials to consumers who request such information.

While this is not a course in **Internet marketing**, it is important to point out that the Web allows a start-up to go beyond market segmentation, characteristic of the mass media, into a relationship of increasing trust and product/service complexity. The Web allows entrepreneurs to target specific customers in different ways at different times. It allows low-cost ways to segment customers according to actual online behaviour and according to their relationship intensity.

Internet segmentation and customer behaviour

Customers have different experiences at different times. Take hunger, for instance. If someone is hungry on the way to work, they might grab a cuppa at the train station. Hunger is also culturally based: In India, thousands of *dubbawallas* deliver Tiffin box lunches home-packed by wives to their husbands at work. Or in China a grand *guanxi* dinner requires a Lazy Susan to share the dishes. The point is that the hungry consumer requires different combinations of inputs depending upon the occasion. Physical businesses are limited in the number of occasions they can cater to. But on the Web, people can construct their own occasions and return to a given website repeatedly constructing different interactions each time. This allows the clever Web-based entrepreneur to customise visitor experiences by performing **usage-based market segmentation**. This works for social entrepreneurs as well as business entrepreneurs. One way to segment customers this way is to categorise them as browsers, buyers and shoppers.

Some website visitors are just surfers, or browsers. Here the trick is to have trigger words that prompt a visitor to go more deeply into the site, add extra content and lead to a purchase decision. Others are buyers who arrive ready to make a purchase straight away. Here the site should put nothing in the way of purchase behaviour. Finally there are the shoppers. They arrive at the site knowing what it offers. They are motivated to buy, but don't know quite just what. The interesting thing is that a customer might arrive one day as a buyer, another as a browser and the third as a shopper.

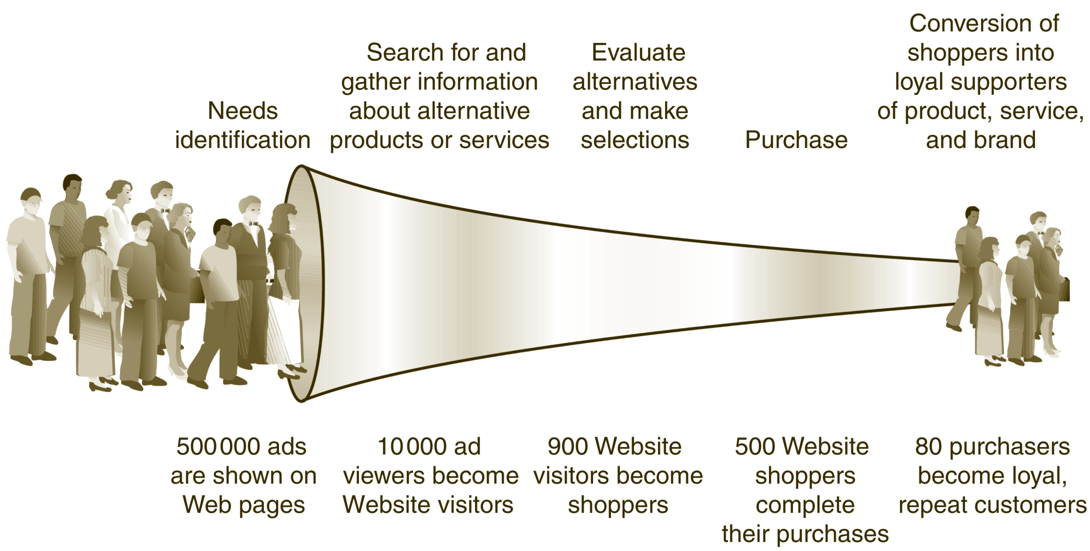
A McKinsey study looked at the online behaviour of 50 000 Internet shoppers and divided them into six different market segments. Each segment is defined by its online behaviour:

- *Simplifiers* like convenience. They are attracted by sites that make doing business easier, faster and more efficient.
- *Surfers* spend the most time online and use the Internet for a wide range of purposes. The trick is to turn their visits into revenue by maximising advertising opportunities and motivating them to make transactions.
- *Connectors* are relative novices. They use the Internet to connect with people, visit online chat rooms and send greeting cards to friends. Marketers focus on shaping their habits so that they become members of a more attractive segment, such as the Simplifiers.
- *Bargainers* are fiercely devoted to one aspect of the Internet: the quest for deals. For a site to attract repeat visits from Bargainers, it must appeal to them on both rational and emotional levels, satisfying their need for competitive pricing and the excitement of the quest.
- *Routiners* return to the same sites over and over again as a regular source of information, but are not necessarily online shoppers.
- *Sportsters,* like Routiners, use the Internet for information, but they focus largely on sports and entertainment.[31]

Relationship intensity

Another big difference with the traditional mass media is the ability of the Internet to create strong relationships with customers. We call this **relationship intensity**. Researchers have identified stages of loyalty as the relationship develops over time.

FIGURE 10.3: FUNNEL MODEL OF CUSTOMER ACQUISITION, CONVERSION AND RETENTION



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- **Awareness:** Consumers who recognise the name of the company or one of its products are in the awareness stage of consumer loyalty.
- **Exploration:** In this stage potential consumers learn more about the company or its products.
- **Familiarity:** Consumers who have completed several transactions and are aware of the company's policies regarding returns, credits and pricing flexibility are in this stage.
- **Commitment:** After experiencing a considerable number of highly satisfactory encounters with a company, some consumers develop a fierce loyalty or strong preference for the products or brands of that company.
- **Separation:** Over time, the conditions that made the relationship valuable might change. The consumer might be severely disappointed by changes in the level of service (either as provided by the company or as perceived by the consumer) or product quality.[32]

If we look at how customers interact with the business through these five stages, we see that each stage is called a **life-cycle segment.** As we see in Figure 10.3, for every 500 000 ads shown on the Web perhaps 80 viewers will become loyal, repeat customers. In this funnel model we see the steps that potential customers might take as they move toward becoming loyal customers.

>>ENTREPRENEURIAL EDGE

HOW A DONKEY, A GOAT AND SOME CHICKENS GENERATED $640 000 FOR OXFAM

With just $15 000 to achieve serious fundraising objectives at the busiest time of the year, something different was needed. This was the challenge faced by New Zealand Oxfam, the global charity that works to overcome the causes of poverty and injustice.

There was much anecdotal evidence that the market was generally trending towards ethical giving and Oxfam felt that goats, chickens, cows and the like were quirky enough to be popular gifts.

Oxfam developed the product range to ensure that donations could be made at every price point from $5 for a chicken right through to $4500 for a whole coffee plantation (a gift targeted at corporate donors). It then developed a website to make it much easier for donors to choose and send a gift online. The challenge was to let as many people as possible know about the opportunity – for as little money as possible.

The Internet proved to be a good way to communicate – especially with the core groups. The only problem was the clutter of the medium and the busy Christmas period. Oxfam needed something quite different to get the message through.

So rather than use the well-trodden and worthy 'do something for someone less fortunate' angle that many charities adopt, Oxfam decided to have some fun and focus on the rubbish most people give each other at Christmas time. That led to the release of an online song called 'Don't Buy Crap This Christmas'.

To maximise the budget, Oxfam needed to harness the viral power of the Internet and encourage those on its existing database to spread the message. It was vital that the advertising message was something they wanted to share.

This was achieved by creating a band called 'Oxfarm' – a talented bunch of animals that listed the tacky and unimaginative gifts people tend to default to at Christmas time, while offering themselves as fun and interesting alternatives.

The chorus contained Oxfam's core message and a simple, repetitive call to action – 'Don't buy crap this Christmas, buy me'. The video could then be emailed to existing supporters and included a friend-get-friend data-capture facility to encourage them to forward the viral email, so as to amplify the referral rate.

After watching the video, viewers could click through to the website to purchase any of the 'Oxfarm' band members (the animals) or other quirky, but life-saving, gifts.

Since its initial success the New Zealand viral video has been picked up by Oxfam worldwide, which has used the Kiwi-conceived marketing and communications strategies to generate thousands of dollars in other markets, including Spain, Ireland and Australia. Oxfam's Oxfarm characters harnessing the power of the Internet.

Source: 'Don't Buy Crap: How a Donkey, a Goat and Some Chickens Generated $640,000 for Oxfam', *NZ Marketing Magazine*, August 2008, www.marketingmag.co.nz/Awards/pdf/nfp.pdf

GREEN ENTREPRENEURIAL MARKETING The advent of the green economy coincides with the new global era of entrepreneurship. **Green marketing** is not just a trendy buzzword. It is a movement and it is also a controversy. One thing is for sure: Green marketing has become an important marketing strategy for entrepreneurial companies that aim to help improve the environment and position themselves as responsible organisations, all while attempting to drive sales. But entrepreneurial businesses need to carry out sustainable marketing that actually delivers on green objectives, not just green theming.[33] That is because much of green marketing today is nothing but deception by the business community. **Greenwashing** is defined as: 'Disinformation disseminated by an organisation so as to present an environmentally responsible public image'.[34] Nonetheless, a *Financial Times* report found that all major advertising agencies were predicting a wave of eco marketing. Brands simply will not be able to opt out. Companies which do not live by a green standard will be financially damaged because consumers will punish them.[35] Even media mogul Rupert Murdoch is bent on making his media empire sustainable. That means not only reducing the company's emissions, but also vowing to weave climate messaging into the content and programming of News Corp's many holdings.[36]

So entrepreneurial start-ups need to take a position on green marketing or they will be disadvantaged in the marketplace. After all, **carbon neutral** was the 2006 word of the year in the Oxford American English Dictionary.[37] That is now leading companies to *carbon footprint labelling* to indicate the product's **carbon footprint**. The new green labels would allow customers to compare and shop for items which required less energy to produce.[38] The buzzwords of the entrepreneurial near-term are GM-free, dolphin-friendly, biodegradable, energy efficient, additive-free, not tested on animals, fair-trade and free range.

LOHAS (Lifestyles of Health and Sustainability), an organisation that tracks green economic trends, has found that about 20 per cent of US adults are '**LOHAS consumers**', namely ones who consume goods and services focused on personal health, natural lifestyles, eco-tourism, alternative energy, green building and alternative transportation.[39] LOHAS awareness

>>ENTREPRENEURSHIP IN PRACTICE

GREENWASHING IN AUSTRALIA AND NEW ZEALAND

- >> The NSW Minerals Council advertised in 2006: 'Mining employs more environmentalists than the entire environment movement. The industry continues to work with dedication and commitment to ensure that the industry is at the forefront of innovative ways to minimise the environmental impacts of mining'.
- >> NSW Minerals Council advertised in 2007: 'Life: Brought to you by mining' and 'A cleaner future: Brought to you by mining'. The environmental group Rising Tide launched its parodies: 'Destruction: Brought to you by mining' and 'Propaganda: Brought to you by the mining lobby'.
- >> Saab's 'Grrrrrreen' advertising campaign states that 'every Saab is green'. One car model, which runs on a part ethanol mix, is 'fueled by nature: enjoy more power with a cleaner conscience'.
- >> New Zealand furniture entrepreneur and designer David Trubridge was 'called to the carpet' about a collection of seating and lights claiming it could be 'deconstructed for ease of recycling at the end of its lifespan'. One critic questioned the eco-validity of using timber shipped from Australia, hydro-electric sources for manufacturing and sending waste to separate recycling facilities, and oil-based plastic in lights.

Source: Sourcewatch, 'Greenwashing/Australia', www.sourcewatch.org; Alice Neville, 'Greenwashing Clash Puts Furniture Designer on Spot', *New Zealand Herald*, 30 June 2008 is growing around the world, especially in Taiwan, Singapore, South Korea, New Zealand and Australia. Table 10.7 presents the market sectors of the LOHAS market.

The problem is that such surveys show that consumers would *prefer* to choose a green product *all others things being equal*. But those 'other things' just don't add up. Take the case in 2002 of Ford's revolutionary two-seat electrical car, the Ford Think. The Think required a recharge to its batteries every 50 miles! This demanded too radical a change of consumer behaviour.[40] Think of the poor Chinese car buyer. For the millions of first-time car buyers, cost of ownership is ahead of environmental concerns (not to mention that most Chinese consumers think it is the government's responsibility to do something about the environment!).[41]

The situation is actually quite grave as far as ecological consumerism is concerned. The World Business Council for Sustainable Development says that current global consumption patterns are unsustainable and that efficiency gains and technological advances alone will not be sufficient to bring global consumption to a sustainable level. Changes will also be required to consumer lifestyles, including the ways in which consumers choose and use products and services.[42] Survey after survey shows consumers are, on the whole, concerned about their impacts on the environment and willing to act, but they do not always follow through. The

TABLE 10.7: LOHAS MARKET SECTORS AND ESTIMATED US ANNUAL MARKET SIZE (UPDATED 2005)

PERSONAL HEALTH ($118.03 BILLION)	**NATURAL LIFESTYLES ($10.6 BILLION)**
Natural, organic products	Indoor and outdoor furnishings
Nutritional products	Organic cleaning supplies
Integrative healthcare	Compact fluorescent lights
Dietary supplements	Social change philanthropy
Mind Body Spirit products	Apparel
GREEN BUILDING ($50 BILLION)	**ALTERNATIVE TRANSPORTATION ($6.12 BILLION)**
Home certification	Hybrid vehicles
Energy Star appliances	Biodiesel fuel
Sustainable flooring	Car-sharing programs
Renewable energy systems	
Wood alternatives	
ECO TOURISM ($24.17 BILLION)	**ALTERNATIVE ENERGY ($380 MILLION)**
Eco-tourism travel	Renewable energy credits
Eco-adventure travel	Green pricing

Source: Natural Marketing Institute, LOHAS Online, www.lohas.com/about.html

TABLE 10.8: PLACES TO STUDY ENTREPRENEURIAL GREEN MARKETING

www.buylesscrap.org	BUY (LESS) provides a means for people to donate directly to charity and reduce consumption.
www.dotherightthing.com	'Unfiltered' information about the impacts of companies on people.
http://ecopreneurist.com	Provides news and advice on sustainable and social entrepreneurship.
www.globalcool.org	Global Cool Foundation inspires people to save a planet through taking individual action in reducing their carbon footprint.
www.grist.org	Provides an irreverent, humorous source of all things green.
www.sustainablemarketing.com	Provides information on green and organic marketing.
www.theclimategroup.org	Climate Group is tracking the net effect of a list of household name companies introducing a green innovation.
www.thegoodmix.com	The goodMix marketing agency serves the eco-economy.

reasons for that are numerous: some green choices aren't cost effective, it's inconvenient to give up certain things and there is a general lack of understanding or confusion around areas like product labelling.

Consumers have just not reached the '**tipping point**', the point at which the momentum for change to the new product becomes unstoppable. The truth is that many people think that global warming has *yet* not reached the point where consumers are willing to compromise on convenience, price and performance.[43] While 70 per cent of Americans think the evidence is 'solid' that the earth is warming, they remain more concerned about deficits and crime. 'Scaring people is not the way to get them to act . . . they respond better to appeals to their native optimism.'[44]

The level of ecological concern varies widely around the world since geography and culture greatly influence attitudes towards the environment. So what follows about the American public may not necessarily be true for Australians or Chinese. The Ecological Roadmap is a market segmentation survey conducted by American Environics that looks at environmentalist identity, especially the chasm between two core values:

- **Ecological fatalism**: People who believe that some amount of pollution is unavoidable in industrial societies and accept it as a part of life. They feel that there is little they can do to change this fact.
- **Ecological concern**: People who believe that today's environmental problems are a result of industrial and personal disregard for the environment. They feel that the trend towards environmental destruction is unacceptable and reject the notion that job protection or economic advancement should be allowed at the expense of environmental protection.[45]

The findings are revealing for the future of entrepreneurial activities within the movement toward a green economy.[46] (See experiential exercise, 'The 10 environmental world views' at the end of this chapter.)

PRICING STRATEGIES

One final marketing issue that needs to be addressed is that of **pricing strategies**. Many entrepreneurs, even after marketing research is conducted, are unsure of how to price their product or service. Many factors affect this decision – the degree of competitive pressure, the availability of sufficient supply, seasonal or cyclical changes in demand, distribution costs, the product's life cycle stage, changes in production costs, prevailing economic conditions, customer services provided by the seller, the amount of promotion done, and the market's buying power. Obviously, the ultimate price decision will balance many of these factors and, usually, will not satisfy all conditions. However, awareness of the various factors is important.

Other considerations, sometimes overlooked, are psychological in nature:

- In some situations, the quality of a product in some situations is interpreted by customers according to the level of the item's price.
- Some customer groups shy away from purchasing a product where no printed price schedule is available.
- An emphasis on the monthly cost of purchasing an expensive item often results in greater sales than an emphasis on total selling price.
- Most buyers expect to pay even-numbered prices for prestigious items and odd-numbered prices for commonly available goods.
- The greater the number of meaningful customer benefits the seller can convey about a given product, generally the less will be the price resistance.[47]

Pricing procedures differ depending on the nature of the venture – retail, manufacturing, or service. Pricing for the product life cycle is presented in Table 10.9; however, this might be applied to any type of business. The table demonstrates the basic steps of developing a pricing system and indicates how that system should relate to the desired pricing goals. Customer demand and sales volume will vary with the development of a product. Thus pricing for products needs to be adjusted at each stage of their life cycle.

With this general outline in mind, potential entrepreneurs can formulate the most appropriate pricing strategy. Table 10.10 provides a thorough analysis of pricing strategies, outlining when each strategy is generally used, what the procedures are and the advantages and disadvantages associated with each. This checklist can provide entrepreneurs with reference points for establishing and evaluating pricing strategies for their ventures.

Key lessons of entrepreneurial marketing

According to Lodish et al., entrepreneurs must focus on positioning and target segmentation:

- Price your products to produce maximum profit stream over the product's life.
- Creating 'buzz' is the key and is more credible than paid advertising.
- Distribution ('bundling') is a perceived plus. Concept testing with possible partners is the key.
- Choose your reference accounts wisely.
- Use unique promotional campaigns. Test them broadly for their impact on your positioning.
- Advertising experiments can add much value and productivity.
- Marketing may affect capital raising more than sales in the new venture's early years.
- Entrepreneurs are more concerned with getting a magic, short-term marketing tactic that will work.[48]

TABLE 10.9: PRICING FOR THE PRODUCT LIFE CYCLE

PRODUCT LIFE CYCLE STAGE	PRICING STRATEGY	REASONS/EFFECTS
Introductory stage		
Unique product	**Skimming** – deliberately setting a high price to maximise short-term profits	Initial price set high to establish a quality image, to provide capital to offset development costs and to allow for future price reductions to handle competition
Non-unique product	**Penetration** – setting prices at such a low level that products are sold at a loss	Allows quick gains in market share by setting a price below competitors' prices
Growth stage	**Consumer pricing** – combining penetration and competitive pricing to gain market share; depends on consumer's perceived value of product	Depends on the number of potential competitors, size of total market and distribution of that market
Maturity stage	**Demand-oriented pricing** – a flexible strategy that bases pricing decisions on the demand level for the product	Sales growth declines; customers are very price-sensitive
Decline stage	**Loss leader pricing** – pricing the product below cost in an attempt to attract customers to other products	Product possesses little or no attraction to customers; the idea is to have low prices bring customers to newer product lines

Source: Adapted from Colleen Green, 'Strategic pricing', *Small Business Reports*, August 1989: 27–33

TABLE 10.10: PRICING STRATEGY CHECKLIST

STRATEGY OBJECTIVE	WHEN GENERALLY USED	PROCEDURE	ADVANTAGES	DISADVANTAGES
Skim the cream off the market for high short-term profit (without regard for long term)	No comparable competitive products Drastically improved product or new product innovation Large number of buyers Little danger of competitor entry due to high price, patent control, high R&D costs, high promotion costs and/or raw material control Uncertain costs Short life cycle Inelastic demand	Determine preliminary customer reaction Charge premium price for product distinctiveness in short run, without considering long-run position Some buyers will pay more because of higher present value to them Then gradually reduce price to tap successive market levels (i.e. skimming the cream of a market that is relatively insensitive to price) Finally, tap more sensitive segments	Cushions against cost overruns Requires smaller investment Provides funds quickly to cover new-product promotion and initial development costs Limits demand until production is ready Suggests higher value in buyer's mind Emphasises value rather than cost as a guide to pricing Allows initial feeling out of demand before full-scale production	Assumes that a market exists at high price Results in ill will in early buyers when price is reduced Attracts competition Likely to underestimate ability of competitors to copy product Discourages some buyers from trying the product (connotes high profits) May cause long-run inefficiencies
Slide down demand curve to become established as efficient manufacturer at optimum volume before competitors become entrenched, without sacrificing long-term objective (e.g. obtain satisfactory share of market)	By established companies launching innovations Durable goods Slight barriers to entry by competition Medium life span	Tap successive levels of demand at highest prices possible Then slide down demand curve faster and farther than forced to in view of potential competition Rate of price change is slow enough to add significant volume at each successive price level, but fast enough to prevent large competitor from becoming established on a low-cost volume basis	Emphasises value rather than cost as a guide to pricing Provides rapid return on investment Provides slight cushion against cost overruns	Requires broad knowledge of competitive product developments Requires much documented experience Results in ill will in early buyers when price is reduced Discourages some buyers from buying at initial high price
Compete at the market price to encourage others to produce and promote the product to stimulate primary demand	Several comparable products Growing market Medium to long product life span Known costs	Start with final price and work back to cost Use customer surveys and studies of competitors' prices to approximate final price Deduct selling margins Adjust product, production and selling methods to sell at this price and still make necessary profit margins	Requires less analysis and research Existing market requires fewer promotion efforts Causes no ill will in early buyers since price will not be lowered soon	Limited flexibility Limited cushion for error Slower recovery of investment Must rely on other differentiating tools
Market penetration to stimulate market growth and capture and hold a satisfactory market share at a profit through low prices Become strongly entrenched to generate profits over long term	Long product life span Mass market Easy market entry Demand is highly sensitive to price Unit costs of production and distribution decrease rapidly as quantity of output increases Newer product No 'elite' market willing to pay premium for newest and best	Charge low prices to create a mass market, resulting in cost advantages derived from larger volume Look at lower end of demand curve to get price low enough to attract a large customer base Also review past and competitor prices	Discourages actual and potential competitor inroads because of apparent low profit margins Emphasises value more than cost in pricing Allows maximum exposure and penetration in minimum time May maximise long-term profits if competition is minimised	Assumes volume is always responsive to price reductions, which isn't always true Relies somewhat on glamour and psychological pricing, which doesn't always work May create more business than production capacity available Requires significant investment Small errors often result in large losses
Pre-emptive pricing to keep competitors out of market or eliminate existing ones	Used more often in consumer markets Manufacturers may use this approach on one or two products, with other prices meeting or higher than those of competitors	Price at low levels so that market is unattractive to possible competitors Set prices as close as possible to total unit cost As increased volume allows lower cost, pass advantage to buyers via lower prices If cost declines rapidly with increases in volume, can start price below cost (can use price approaching variable costs)	Discourages potential competitors because of apparent low profit margins Limits competitive activity and expensive requirements to meet them	Must offer other policies that permit lower price (limited credit, delivery, or promotions) Small errors can result in large losses Long-term payback period

Source: Roy A. Lindberg and Theodore Cohn, *The Marketing Book for Growing Companies That Want to Excel*, New York: Van Nostrand Reinhold, 1986: 116–17. Reprinted with permission

SUMMARY

Entrepreneurial marketing is different from marketing in established firms. Sales are more important than brand recognition because that is what investors look at. Entrepreneurial marketing has to rely on smaller sample sizes and more data. The entrepreneur must adopt an entirely different approach to marketing. One such way is called 'guerrilla marketing'.

Marketing research involves the gathering of information about a particular market, followed by analysis of that information. The marketing research process has five steps: define the purpose and objectives of the research, gather secondary data, gather primary data, develop an information-gathering instrument (if necessary) and interpret and report the information.

Entrepreneurs do not carry out marketing research for four major reasons: cost, complexity of the undertaking, belief that only major strategic decisions need to be supported through marketing research, and belief that the data will be irrelevant to company operations. Usually they misunderstand the value of marketing research or fear its cost.

Developing a marketing concept has three important areas. One area is the formulation of a marketing philosophy. Some entrepreneurs are production-driven, others are sales-driven and still others are consumer-driven. The entrepreneur's values and the market conditions will help determine this philosophy. A second area is market segmentation, which is the process of identifying a specific set of characteristics that differentiate one group of consumers from the rest. Demographic, benefit and psychographic variables are often used in this process. A third area is an understanding of consumer behaviour. Since many types and patterns of consumer behaviour exist, entrepreneurs need to focus on the personal and psychological characteristics of their customers. In this way they can determine a tailor-made, consumer-oriented strategy. This customer analysis focuses on such important factors as general buying trends in the marketplace, specific buying trends of targeted consumers and the types of goods and services being sold.

Most emerging ventures go through the four marketing stages of entrepreneurial marketing, opportunistic marketing, responsive marketing and diversified marketing. Each stage requires a different strategy and the entrepreneur must adjust accordingly.

Marketing planning is the process of determining a clear, comprehensive approach to the creation of customers. When developing this plan, the following elements are critical: marketing research, sales research, a marketing information system, sales forecasting, marketing plans and evaluation.

The Internet is fast becoming the greatest marketing tool for entrepreneurs. It offers numerous benefits for the overall marketing strategy of a company, including brand recognition, information transfer and customer services.

Entrepreneurs must come to grips with the concept of green marketing since the advent of the green economy coincides with the new global era of entrepreneurship. Entrepreneurial companies that do not live by a green standard will be financially damaged.

Pricing strategies are a reflection of marketing research and must consider such factors as marketing competitiveness, consumer demand, life cycle of the goods or services being sold, costs and prevailing economic conditions.

KEY TERMS & CONCEPTS

carbon neutral
carbon footprint
consumer behaviour
consumer characteristics
consumer-driven philosophy
consumer pricing
demand-oriented pricing
ecological concern
ecological fatalism
entrepreneurial marketing
entrepreneurial marketing plan
experimentation
family life cycle
focus groups
green marketing
greenwashing
guerrilla marketing
Internet marketing
life-cycle segmentation
liquidity constraints
LOHAS consumers
loss leader pricing
market
market penetration
market segmentation
marketing concept
marketing planning
marketing research
marketing stages
penetration
pricing strategies
primary data
product research
production-driven philosophy
psychographics
relationship intensity
sales-driven philosophy
sales forecasting
sales research
secondary data
segmentation variables
skimming
surveys
tipping point
usage-based market segmentation
zero-budget marketing

REVIEW & DISCUSSION QUESTIONS

1 What are the differences between entrepreneurial marketing and 'ordinary' marketing?
2 Why do we say that a small business is not a little big business?
3 In your own words, what is a market? How can marketing research help an entrepreneur identify a market?
4 What are the five steps in the marketing research process? Briefly describe each.
5 Which is of greater value to the entrepreneur: primary or secondary data? Why?
6 Identify and describe three of the primary obstacles to undertaking marketing research.
7 How would an entrepreneur's new-venture strategy differ under each of the following marketing philosophies: production-driven, sales-driven and consumer-driven? Be complete in your answer.
8 In your own words, what is market segmentation? Give examples.
9 What role do demographic and benefit variables play in the segmentation process?
10 Identify and discuss three of the most important personal characteristics that help the entrepreneur identify and describe customers. Also, explain how the product life cycle will affect the purchasing behaviour of these consumers.
11 How does the way that consumers view a venture's product or service affect strategy? For example, why would it make a difference to the entrepreneur's strategy if the consumers viewed the company as selling a convenience good as opposed to a shopping good?
12 Identify and describe four of the major forces shaping buying decisions in the new century.
13 Most emerging ventures evolve through a series of marketing stages. What are these stages? Identify and describe each.
14 For developing a marketing plan, what are the five steps that are particularly helpful? Identify and describe each.
15 Describe several different methods of Internet marketing. Give examples.
16 Describe the major green consumer market segmentation variables. Identify three companies whom you suspect of greenwashing.
17 What are some of the major environmental factors that affect pricing strategies? What are some of the major psychological factors that affect pricing? Identify and discuss three of each.

EXPERIENTIAL EXERCISE:
THE 10 ENVIRONMENTAL WORLD VIEWS

In the box below are the 10 environmental world views identified by Environics' *Ecological Roadmap*. 1. See if you can estimate the percentage of the US population that corresponds to the world view (answers are at end of the chapter). 2. Estimate the same percentage for your own country or community. 3. Identify where you personally fit on the spectrum.

SEGMENT	WORLD VIEW IN BRIEF
(1) Compassionated caretakers	Healthy families need a healthy environment.
(2) Proud traditionalists	Religion and morality dictate actions in a world where humans are superior to nature.
(3) Murky middles	Indifferent to most everything, including the environment.
(4) Greenest Americans	Everything is connected, and our daily actions have an impact on the environment.
(5) Anti-authoritarian materialists	Little can be done to protect the environment, so why not get a piece of the pie?
(6) Driven independents	Protecting the earth is fine as long as it doesn't get in the way of success.
(7) Cruel worlders	Resentments and isolation leave no room for environmental concerns.
(8) Borderline fatalists	Getting material and status needs met on a daily basis trumps worries about the planet.
(9) Ungreens	Environmental degradation and pollution are inevitable in maintaining prosperity.
(10) Post-modern idealists	Green lifestyles are part of a new way of being.

Source: Adapted from *The Ecological Roadmap*, cited in Joel Makower with Cara Pike, *Strategies for the Green Economy: Opportunities and Challenges in the New World of Business*, US Green Building Council, 2008

EXPERIENTIAL EXERCISE: IDENTIFYING THE CUSTOMER

One of the most important activities of entrepreneurs is identifying their customers. A list of the five basic types of consumers (A) to (E) and a list of descriptions of these types (a) to (o) follow. Identify the order in which people adopt new goods by ranking the first list from 1 (first adopters) to 5 (last adopters). Then match the descriptions with the types of consumer by placing a 1 next to those that describe initial adopters, on down to a 5 next to those that describe final adopters. (Three descriptions are listed for each of the five types of consumer.) Answers are provided at the end of the chapter.

A Early adopters
B Early majority
C Laggards
D Innovators
E Late majority

a High-income people who have inherited their wealth
b Future oriented
c Below-average-income wage earners
d Present (security) oriented
e High-income people who have incomes from salary and investment
f Highest professionals, including merchants and financiers
g Present oriented
h Average-income wage earners
i Middle managers and owners of medium-sized businesses
j Above-average-income wage earners
k Present oriented, but worried about the impact of time
l Unskilled labour
m Skilled labour
n Owners of small businesses; non-managerial office and union managers
o Tradition-oriented people who often live in the past.

CASE 10.1: DEALING WITH THE COMPETITION

Six months ago Yung-Chien Lou opened a small office supply store in Taipei. Yung-Chien sells a wide range of general office merchandise, including photocopying and typing paper, writing tablets, envelopes, writing instruments and computer diskettes, as well as a limited range of office desks, chairs and lamps.

Several office supply stores in the local area are, in Yung-Chien's opinion, competitors. In an effort to better understand the competition, Yung-Chien has visited four of these stores and pretended to be a customer so she could get information regarding their prices, product offerings and service. Each has a different strategy. For example, one of them sells strictly on price. It is the customer's responsibility to pick up the merchandise and carry it away. Another relies heavily on service, including a 90-day credit plan for those purchasing equipment in excess of $500. This company's prices are the highest of the four stores Yung-Chien visited. The other two stores use a combination of price and service strategies.

Yung-Chien believes that in order to get her new venture off the ground she must develop a marketing strategy that helps her effectively compete with these other firms. Since her store is extremely small, Yung-Chien believes that a certain amount of marketing research could be of value. On the other hand, her budget is extremely limited and she is not sure how to collect the information. Yung-Chien believes that what she needs to do is develop a market niche that will be loyal to her. In this way, no matter how extensive the competition, she always will have a group of customers who buy from her. Yung-Chien also believes that the focus of this research has to be in two general directions. First, she has to find out what customers look for from an office supply store. How important is price? Service? Quality? Second, she has to determine the general strategy of each of her major competitors so she can develop a plan of action for preventing them from taking away her customers. Right now, however, her biggest question is: How do I go about getting the information I need?

Questions

1 Will the information Yung-Chien is seeking be of value to her in competing in this market? Why or why not?

2 How would you recommend Yung-Chien put together her marketing research plan? What should be involved? Be as complete as possible in your answer.

3 How expensive will it be for Yung-Chien to follow your recommendations for her marketing research plan? Describe any other marketing research efforts she could undertake in the near future that would be of minimal cost.

CASE 10.2: FOR COOKS ONLY

When Phil Hartrack was a young man, he already knew what he wanted to be: a salesperson. His mother was delighted. 'Salespeople make great money', she explained to him, 'and with your appetite, you're going to need all of the money you can make. You've got the biggest appetite in the family.'

After graduating from college, Phil took a job with a consumer-goods firm. For the next 10 years, he was one of its leading salespeople every year. At the end of this time, however, Phil admitted to himself that although he enjoyed selling, what he really wanted to do was sell books. 'I want to own my own bookstore', he told his wife. 'I know it sounds silly because I have had no experience in bookstore selling, but I've always loved books and I'm a terrific salesperson.' After researching the market, Phil and his wife had to face a very important fact – the competition in this business is extremely aggressive. Most small bookstores do not last more than three years and the majors such as Angus & Robertson and Borders dominate the industry.

Phil refused to admit defeat. 'There has to be a market niche somewhere in this field that the majors are not addressing. I'm going to find that niche and go after it', he told his banker. Six months ago, Phil concluded that he had found this niche. 'Cookbooks are the wave of the future', he explained to his wife. 'The average person today buys twice as many cookbooks as 10 years ago. It is the fastest-growing segment of the book market. Moreover, with your cooking skills and my appetite, we're a natural for this market. We love food and we have sales skills.'

Taking all of their savings, Phil and his wife opened their bookstore in a popular suburban mall. It is called For Cooks Only and sells only cookbooks. By the end of the first month, the Hartracks realised they had made the right choice. Their wide selection of cookbooks and their familiarity with many of the books helped them build a loyal clientele. They even provide a 'Recommended Recipe' service, showcasing easy recipes that use foods in season. This service has resulted in many people coming by to look at a recipe – and then returning within a couple of weeks to buy the book.

Although Phil is quite happy over the business's success, he realises that his limited market niche could dry up in a short period of time. He feels that the best way to prevent this from happening is by conducting marketing research, seeing if he can add any additional books or services to the line and developing the strongest possible clientele loyalty. The first place to begin, in his opinion, is by examining the current purchasing habits of customers and then using this as a foundation for deciding where to go from here.

Questions

1 From the customer's viewpoint, what type of good is a cookbook? Defend your answer.

2 Why is Phil's store doing so well? Include in your answer his philosophy of marketing.

3 In his marketing research efforts, what type of information would you suggest Phil collect?

4 How can he go about doing this? Be complete in your answer.

CASE 10.3: A NEW SPIN ON MUSIC

Following his graduation from an excellent university with a degree in entrepreneurship, Brian Wright was eager to launch a business. Brian always enjoyed working with new technologies as well as watching movies, playing video games and listening to music. Because of the proliferation of online movie and video game rental services he believed that a service proving the online rental of CDs made perfect sense.

Brian was confident that the success of other online rental services proved that there was a market for the online rental of entertainment media; therefore, renting CDs online would be an easy concept for customers to grasp. Although MP3s and MP3 players were growing in popularity, Brian knew that he and his friends preferred to listen to an album in its entirety; after all, Brian believed that 'any true fan of an artist would want the entire album'.

When calculating potential revenue, Brian concluded that the average retail price of a CD was approximately $14. If he charged $2 per CD per rental – which would offer an 85 per cent savings to the customer based on the full retail price of a CD – he could recoup his costs within seven rentals. In addition, Brian believed that he could negotiate contracts with music labels to purchase CDs in bulk at a discount, which would in turn reduce the time it would take for him to reach break-even. He knew enough about music encryption technologies to know that restrictions could be built into the CDs to deter people from copying songs from them. He decided that taking such precautions would alleviate any concerns that the music labels might have regarding piracy.

As Brian began discussing his idea with his friends, their enthusiasm convinced him that he needed to act quickly before someone else seized the opportunity. At $2 per rental and an estimated two rentals per customer per month, he would only need a little of 20 000 customers to reach $1 000 000 in annual revenue. After looking at his financial forecasts, Brian decided that it was time to bring his online CD rental service to the market.

Questions

1. Has Brian completed the proper marketing research for this potential opportunity? Why or why not? Explain.
2. Based on the case, are there key mistakes that you would caution Brian about? Explain.
3. What specific steps would you recommend to Brian for him to better assess this opportunity?

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Boost your Marketing ROI with Experimental Design

Publication date: 1 October 2001
Author(s): Eric Almquist, Gordon Wyner
Product number: R0109K

This marketing case covers consumer marketing, Internet marketing, marketing implementation, marketing planning, marketing strategy, statistical analysis, statistical methods and test markets.

Steinway & Sons: Buying a Legend

Publication date: 8 October 1999
Author(s): John T. Gourville, Joseph B. Lassiter III
Product number: 500028

It is 1995 and Steinway & Sons has just been purchased by two young entrepreneurs. For 140 years, Steinway has held the reputation for making the finest quality grand pianos in the world. However, the past 25 years have proven to be a challenge. First, the company has changed hands several times and product quality has become a concern. Second, the worldwide market for pianos has been in a steady decline, and competition for high-end grand pianos has increased. Finally, in 1992 Steinway took the questionable step of introducing a mid-priced line of grand pianos under the brand name 'Boston'. Designed by Steinway, but manufactured by a Japanese piano maker, the Boston line represented a major shift in strategy for the company. Within this context, what do two young entrepreneurs (with little or no experience in the piano industry) hope to accomplish in buying Steinway? In particular, what value do they bring to the company and what decisions should they make?

Entrepreneurial Marketing: Learning from High-Potential Ventures

Publication date: 3 October 2002
Revision date: 20 October 2005
Author(s): Joseph B. Lassiter III
Product number: 9-803-036

This case describes entrepreneurial marketing as both a mind-set and a process, draws on some 30 business field cases and some 300 student projects that provide insight into what managers do in high-potential settings.

Sa Sa Cosmetics

Publication date: 8 May 2003
Author(s): David E. Bell, Iris T. Li
Product number: 9-502-085

Sa Sa Cosmetics has had spectacular success as a low-price retailer of branded cosmetics. But recently, growth has slackened. What are the causes? This case describes recent strategic initiatives and provides market research data to aid the students in diagnosis.

Rediscovering Market Segmentation

Publication date: 1 February 2006
Author(s): Daniel Yankelovich, David Meer
Product number: R0602G

In 1964, Daniel Yankelovich introduced in the pages of *Harvard Business Review* the concept of non-demographic segmentation, by which he meant the classification of consumers according to criteria other than age, residence, income and such. Buying patterns had become far better guides to consumers' future purchases. But more than 40 years later, non-demographic segmentation has become just as unenlightening as demographic segmentation had been. Now, Yankelovich returns to these pages, with consultant David Meer, to argue the case for a broad view of non-demographic segmentation.

Toyota Motor Corp: Launching Prius

Publication date: 13 January 2006
Author(s): Masako Egawa, Forest Reinhardt, Dennis Yao
Product number: 9-706-458

In 1995, Hiroshi Okuda, president of Toyota Motor Corp, considered whether to push for a more aggressive launch of the Toyota Prius – an automobile that incorporated Toyota's new and technically advanced hybrid power train. This launch decision allows discussion of the importance of the Prius in Toyota's overall product strategy and explores issues ranging from market structure to competitive advantage and competitive dynamics.

Answers to 'The 10 Environmental World Views'

(1) Compassionated caretakers	24
(2) Proud traditionalists	20
(3) Murky middles	17
(4) Greenest Americans	9
(5) Anti-authoritarian materialists	7
(6) Driven independents	7
(7) Cruel worlders	6
(8) Borderline fatalists	5
(9) Ungreens	3
(10) Postmodern idealists	3

Answers to 'Identifying the Customer'

A	2	c	5	j	3
B	3	d	4	k	1
C	5	e	2	l	5
D	1	f	1	m	4
E	4	g	3	n	3
a	1	h	4	o	5
b	2	i	2		

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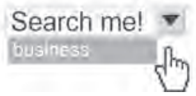

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skimming
surveys

11 MEASURING PERFORMANCE FOR ENTREPRENEURIAL VENTURES

Small company managers are too inclined to delegate to outside accountants every decision about their companies' financial statements. Indeed, it is most unfair to suppose that accountants can produce – without management's advice and counsel – the perfect statement for a company. Instead, I contend, top managers of growing small companies must work with their independent accountants in preparing company financial statements to ensure that the right message is being conveyed . . .

James McNeill Stancill, 'Managing Financial Statements: Image and Effect'[1]

Companies must be prepared to respond to the growing demands for transparency and accountability, particularly with respect to their economic, social, and environmental impact. This requires, first and foremost, that those who run the businesses be aware of the challenges and opportunities they face in the age of globalisation. Here, business schools can play a crucial role by ensuring that tomorrow's business leaders understand what responsible business means and how it can have positive effects for both the company's bottom line and the society in which it operates . . . Business success does not rely on financial success as an isolated ideal. Consideration should also be given to environmental and social issues.

UN Secretary General Ban Ki-moon[2]

chapter objectives

- **01** To distinguish between the two kinds of performance measurement and their importance/relevance to entrepreneurs
- **02** To explain the principal financial statements needed for any entrepreneurial venture – the balance sheet, income statement and cash-flow statement
- **03** To outline the process of preparing an operating budget
- **04** To discuss the nature of cash flow and to explain how to draw up such a document
- **05** To explain how capital budgeting can be used in the decision-making process
- **06** To illustrate how to use break-even analysis
- **07** To describe ratio analysis and illustrate the use of some of the important measures and their meanings
- **08** To understand the important of Triple Bottom Line accounting.
- **09** To appreciate the diversity of environmental accounting.

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Today's entrepreneur operates in a competitive environment characterised by strong competitors and decreasing resources. Safe-guarding of resources therefore becomes a top priority. In order to compete effectively, the entrepreneur must accumulate and allocate resources efficiently. Three kinds of resources are available: financial, material (including environmental) and human. In this chapter we focus on the financial material and environmental resources.

The entrepreneur's constant preoccupation is with measuring of economic performance such as sales, revenue, operating budgets, cash flow and the like. Measuring (or 'accounting for') these is in the realm of financial accounting, our first topic. Traditionally, companies have reported only on these issues to their shareholders.

Increasingly stakeholders and the public are expecting entrepreneurs to show that they are not merely delivering economic value, but also following socially and environmentally responsible paths. That means we will also be covering a different kind of performance measures in this chapter. This is where the entrepreneur must come to grips with expanding traditional reporting to take into account environmental and social performance in addition to financial performance. The term we will use is Triple Bottom Line reporting. As the argument intensifies that the Earth's **carrying capacity** is becoming more at risk, governments, such as in Australia, are coming closer to accepting the need for formal metrics for ecological and social loss or risk for companies. We first examine financial performance measures, and then discuss tax burdens and ration analysis. Finally, we cover important areas of sustainability performance measures.

MEASURING FINANCIAL PERFORMANCE

Financial information pulls together all the information presented in the other segments of the business: marketing, distribution, manufacturing and management. It quantifies all the assumptions and historical information concerning business operations.[3]

It should be remembered that entrepreneurs must make assumptions when numbers are derived and correlate these assumptions with information presented in other parts of the business operations. The set of assumptions on which projects are based should be clearly and precisely presented; without these assumptions, numbers will have little meaning. It is only after carefully considering such assumptions that the entrepreneur can assess the validity of financial projects. Because the rest of the financial plan is an outgrowth of these assumptions, they are the most integral part of any financial statement. (See Table 11.1 for a financial glossary for entrepreneurs.)

In order for entrepreneurs to develop the key components of a financial segment they should follow a clear process described in the next section.

TABLE 11.1: A FINANCIAL GLOSSARY FOR THE ENTREPRENEUR

Accrual system of accounting: A method of recording and allocating income and costs for the period in which each is involved, regardless of the date of payment or collection. For example, if you were paid $100 in April for goods you sold in March, the $100 would be income for March under an accrual system. (Accrual is the opposite of the cash system of accounting.)

Assets: Anything of value that is owned by you or your business.

Balance sheet: An itemised statement listing the total assets, liabilities and net worth of your business at a given moment. Also called a *statement of condition*.

Capital: (1) The amount invested in a business by the proprietor(s) or shareholders. (2) The money available for investment or money invested.

Cash flow: The schedule of your cash receipts and disbursements.

Cash system of accounting: A method of accounting whereby revenue and expenses are recorded when received and paid, respectively, without regard for the period to which they apply.

Collateral: Property you own that you pledge to the lender as security on a loan until the loan is repaid. Collateral can be a car, home, shares, bonds or equipment.

>>

Cost of goods sold: The value of products sold to customers in a period. This is determined by subtracting the value of the ending inventory from the sum of the beginning inventory and purchases made during the period. Gross sales less cost of goods sold give you gross profit.

Current assets: Cash and assets that can be easily converted to cash, such as accounts receivable and inventory; current assets should exceed current liabilities.

Current liabilities: Debts you must pay within a year (also called *short-term liabilities*).

Depreciation: Lost usefulness; expired utility; the diminution of service yield from a fixed asset or fixed asset group that cannot or will not be restored by repairs or by replacement of parts.

Equity: An interest in property or in a business, subject to prior creditors. An owner's equity in their business is the difference between the value of the company's assets and the debt owed by the company. For example, if you borrow $30 000 to purchase assets for which you pay a total of $50 000, your equity is $20 000.

Expense: An expired cost; any item or class of cost of (or loss from) carrying on an activity; a present or past expenditure defraying a present operating cost or representing an irrecoverable cost or loss; an item of capital expenditures written down or off; a term often used with some qualifying expression denoting function, organisation, or time, such as a selling expense, factory expense, or monthly expense.

Financial statement: A report summarising the financial condition of a business. It normally includes a balance sheet and an income statement.

Gross profit: Sales less the cost of goods sold. For example, if you sell $100 000 worth of merchandise for which you paid $80 000, your gross profit would be $20 000. To get net profit, however, you would have to deduct other expenses incurred during the period in which the sales were made, such as rent, insurance and sales staff salaries.

Income statement: Also called *profit and loss (P&L) statement*. A statement summarising the income of a business during a specific period.

Interest: The cost of borrowing money. It is paid to the lender and is usually expressed as an annual percentage of the loan. That is, if you borrow $100 at 12 per cent, you pay 1 per cent (.01 x $100) interest per month. Interest is an expense of doing business.

Liability: Amount owing to your creditors. Liabilities can be in the form of a bank loan, accounts payable and so on. They represent a claim against your assets.

Loss: When a business's total expenses for the period are greater than the income.

Net profit: Total income for the period less total expenses for the period. (See *Gross profit*.)

Net worth: The same as *equity*.

Personal financial statement: A report summarising your personal financial condition. Normally it includes a listing of your assets, liabilities, large monthly expenses and sources of income.

Pro forma balance sheet: A financial statement that projects the results of future business operations, such as a pro forma balance sheet, an income statement or a cash-flow statement. The term 'pro forma' is applied to practices that seek to satisfy the minimum requirements or to conform to convention. The pro forma accounting is a statement of the company's financial activities excluding 'unusual and non-recurring transactions'.

Profit: (See *Net profit* and *Gross profit*.) 'Profit' usually refers to net profit.

Profit and loss statement: Same as income statement.

Time value of money: The idea that money available today is worth more than the same amount in the future due to its potential interest-earning capacity. Any amount of money is worth more the sooner it is received.

Variable cost: Costs that vary with the level of production or sales, such as direct labour, material and sales commissions.

Working capital: The excess of current assets over current liabilities.

UNDERSTANDING THE KEY FINANCIAL STATEMENTS

Financial statements are powerful tools that entrepreneurs can use to manage their ventures.[4] The basic financial statements an entrepreneur needs to be familiar with are the balance sheet, the income statement and the cash-flow statement. The following sections examine each of these in depth and provide a foundation for understanding the books of record that all ventures need.

The balance sheet

A **balance sheet** is a financial statement that reports a business's financial position at a specific time. Many accountants like to think of it as a picture taken at the close of business on a particular day, such as 31 December. The closing date is usually the one that marks the end of the business year for the organisation.

The balance sheet is divided into two parts: the financial resources owned by the firm and the claims against these resources. Traditionally, these claims against the resources come from two groups: creditors who have a claim to the firm's assets and who can sue the company if these obligations are not paid, and owners who have rights to anything left over after the creditors' claims have been paid.

The financial resources that the firm owns are called **assets**. The claims that creditors have against the company are called **liabilities**. The residual interest of the firm's owners is known as **owners' equity**. When all three are placed on the balance sheet, the assets are typically listed on the left, and the liabilities and owners' equity are listed on the right.

An asset is something of value the business owns. To determine the value of an asset, the owner/manager must do the following: (1) identify the resource, (2) provide a monetary measurement of that resource's value and (3) establish the degree of ownership in the resource.

Most assets can be identified easily. They are tangible, such as cash, land and equipment. However, intangible assets also exist. These are assets that cannot be seen; examples include intellectual property such as copyrights and patents (see Chapter 7).

Liabilities are the debts of the business. These may be incurred either through normal operations or through the process of obtaining funds to finance operations. A common liability is a **short-term account payable** in which the business orders some merchandise, receives it, but has not yet paid for it. This often occurs, for example, when a company receives merchandise during the third week of the month and does not pay for it until it pays all of its bills on the first day of the next month. If the balance sheet was constructed as of the end of the month, the account still would be payable at that time.

Liabilities are divided into two categories: short term and long term. **Short-term liabilities** (also called **current liabilities**) are those that must be paid during the coming 12 months. **Long-term liabilities** are those that are not due and payable within the next 12 months, such as a mortgage on a building or a five-year bank loan.

Owners' equity is what remains after the firm's liabilities are subtracted from its assets – it is the claim the owners have against the firm's assets. If the business loses money, its owners' equity will decline. This concept will become clearer when we explain why a balance sheet always balances.[5]

Understanding the balance sheet

To fully explain the balance sheet and the other concepts in this chapter, we take the example of Mámor Chocolates Ltd, the author's own Australia-based limited liability company and manufacturer of fine Pasifika chocolates, bars and truffles. Mámor is a mixed product-services company; it produces chocolate products and carries out services such as events and education. It started operations in 2001 and is moving from start-up to growth phase in the Pacific-blended gourmet chocolates market.

Table 11.2 presents Mámor's balance sheet as of 31 December 2010. Note that Table 11.2 has three sections: assets, liabilities and owners' equity. Within each of these classifications are various types of accounts. The following sections examine each type of account presented in the table.

Current assets

Current assets consist of Mámor's cash and other assets that are reasonably expected to be turned into cash, sold, or used up during a normal operating cycle. The most common types of current assets are those shown in Table 11.2.

Cash refers to coins, currency and cheques on hand. It also includes money that the business has in its cheque and savings accounts.

TABLE 11.2: MÁMOR CHOCOLATES LTD BALANCE SHEET FOR THE YEAR ENDED 31 DECEMBER 2010

ASSETS		
CURRENT ASSETS		
Cash		$200 000
Accounts receivable	$375 000	
Less: allowance for uncollectible accounts	$25 000	350 000
Inventory		150 000
Prepaid expenses		35 000
Total current assets		$735 000
FIXED ASSETS		
Land		$330 000
Building	$315 000	
Less: Accumulated depreciation of building	80 000	(net) $235 000
Equipment	410 000	
Less: Accumulated depreciation of equipment	60 000	(net) $350 000
Total fixed assets including land		$915 000
Total assets		$1 650 000
LIABILITIES		
CURRENT LIABILITIES		
Accounts payable	$150 000	
Notes payable	25 000	
Taxes payable	75 000	
Loan payable	50 000	
Total current liabilities		$300 000
Bank loan		200 000
Total liabilities		$500 000
OWNERS' EQUITY		
CONTRIBUTED CAPITAL		
Common shares, $10 par, 40 000 shares		$400 000
Preferred shares, $100 par, 500 shares	-----------	
Authorised, none sold		
RETAINED EARNINGS		750 000
Total owners' equity		1 150 000
Total liabilities and owners' equity		$1 650 000

Accounts receivable are claims that Mámor has against its customers for unpaid balances from the sale of merchandise or the performance of services. Many firms sell on credit and expect their customers to pay by the end of the month. Or, in many of these cases, they send customers a bill at the end of the month and ask for payment within 10 days.

The **allowance for uncollectible accounts** refers to accounts receivable judged to be uncollectible. How does a business know when receivables are not collectible? This question can be difficult to answer and a definitive answer is not known. However, one method for making the estimates is to use an accounts receivable ageing schedule. But here assume that the business asks all of its customers to pay within the first 10 days of the month following the purchase.

An examination of Mámor's ageing accounts receivable shows that the following amounts are due to the firm:

NUMBER OF DAYS OUTSTANDING	AMOUNT OF RECEIVABLES
1–11	$325 000
11–20	25 000
21–30	20 000
31–60	5000
61–90	7500
91+	17 500

In this case, the firm might believe that anything more than 60 days old will not be paid and will likely be written off as uncollectible. Note that in Table 11.2 the allowance for uncollectible accounts is $25 000, the amount that has been outstanding more than 60 days. When the amount increases from one period to the next, the amount of this increase is typically classified as an expense. When the company abandons any hope of collection of an account from a specific customer it will reduce both the accounts receivable balance and the balance in the allowance for uncollectible accounts.

Inventory is merchandise held by the company for resale to customers. For Mámor, this includes chocolate in blocks as well as flavourings and other ingredients. Current inventory in our example is $150 000, but this is not the entire inventory the firm had on hand all year. Naturally the company started the year with some inventory, purchased more, and sold some to customers. This balance sheet figure is what was left at the end of the fiscal year.

Prepaid expenses are expenses the firm already has paid but that have not yet been used. For example, insurance paid on the company car for the next six months is a prepaid-expense entry because it will be six months before the entire premium has been used. As a result, the accountant would reduce this prepaid amount by one-sixth each month. Sometimes supplies, services and rent are also prepaid, in which case the same approach is followed.

Fixed assets

Fixed assets consist of land, building, equipment and other assets expected to remain with the firm for an extended period. They are not totally used up in the production of the firm's goods and services within a single period. Some of the most common types are shown in Table 11.2.

Land is property used in the operation of the firm. This is not land that has been purchased for expansion or speculation; that would be listed as an **investment** rather than a fixed asset. Land is listed on the balance sheet at cost, and its value usually is changed only periodically. For example, every five years, the value of the land might be recalculated so that its value on the balance sheet and its resale value are approximately the same.

Building consists of the structures that house the business' manufacturing and retails operations. If the firm had more than one building, the total cost of all the structures would be listed.

Accumulated **depreciation** of building refers to the amount of the building that has been written off the books due to wear and tear. For example, referring to Table 11.2, the original cost of the building was $315 000, but accumulated depreciation is $80 000, leaving a net value of $235 000. The amount of depreciation charged each year is determined by the company accountant after checking with tax office rules. A standard depreciation is 5 per cent per year for new buildings, although an accelerated method sometimes is used. In any event, the amount written off is a tax-deductible expense. Depreciation therefore reduces the amount of taxable income to the firm and helps lower the tax liability. In this way, the business gets the opportunity to recover part of its investment.

Equipment is the machinery that Mámor uses to produce finished chocolate goods. It is placed on the books at the original cost and then depreciated and listed as the accumulated depreciation of equipment. In our example, it is $60 000. The logic behind equipment depreciation and its effect on the firm's income taxes is the same as that for accumulated depreciation on the building.

Current liabilities

Current liabilities are obligations that will become due and payable during the next year or within the operating cycle. The most common current liabilities are listed in Table 11.2.

Accounts payable are liabilities incurred when goods or supplies are purchased on credit. For example, Mámor purchases much of its chocolate from a Swiss supplier. If Mámor buys on net 30-day terms, during those 30 days the bill for the goods will constitute an account payable.

A **note payable** is a promissory note given as tangible recognition of a supplier's claim or a note given in connection with an acquisition of funds. In Mámor's case this was a loan by the Swiss supplier for the roasting and milling machines that transform cocoa beans into chocolate. The Swiss company required that a note be given when Mámor bought merchandise and was unable to pay for it immediately.

Taxes payable are liabilities owed to the government such as GST, the goods and services tax. (In other countries, this might be sales or value-added taxes.) Mámor must collect the taxes and remit them to the tax agency.

A **loan payable** listed in current liabilities is the current instalment on a long-term debt that must be paid this year. The remainder is carried as a long-term debt. Note that, in Table 11.2, $50 000 of this debt will be paid in 2011 by Mámor.

Long-term liabilities

As we have said, long-term liabilities consist of obligations that will not become due or payable for at least one year or not within the current operating cycle. The most common are bank loans.

A **bank loan** is a long-term liability arising from a loan from a lending institution. Although it is unclear from the balance sheet in Table 11.2 how large the bank loan originally was, it is apparently being paid down at the rate of $50 000 annually. Thus, it will take four more years to pay off the loan.

Owning shares in a limited company

Mámor's founders have shares in the company as do some other individuals who have purchased shares. Various kinds of shares can be sold by a company, the most typical being common shares and preferred shares. Only common shares have been sold by Mámor.

Common shares are the most basic form of corporate ownership. The owners of a limited company – whether private or public – are referred to as shareholders. An individual can become a part owner of the business by purchasing shares in that business. This ownership gives the individual the right to vote for individuals to serve on the board of directors. Usually, for every common share held, the individual is entitled to one vote. As shown in Table 11.2, the company has issued 40 000 shares of $10 par value common shares, raising $400 000. Although the term *par value* may have little meaning to most shareholders, it has legal implications. It determines the stated minimum value of capital that will be retained in the company. Shares must originally be sold for at least this value or the owner of the shares can face liability to make up the difference. For legal reasons the total par value of the shares is maintained in the accounting records. However, it has no effect on the market value of the shares after issuance.

Preferred shares differ from common shares in that their holders have preference to the assets of the firm in case of dissolution. This means that after the creditors are paid, preferred shareholders have the next claim on whatever assets are left. The common shareholders' claims come last. Table 11.2 shows that 500 preferred shares were issued, each worth a par value of $100, but none has yet been sold. Therefore, it is not shown as a number on the balance sheet.

Retained earnings

Retained earnings are the accumulated net income kept by the business over the life of the business to date. In Table 11.2, the retained earnings are shown as $750 000. Every year this amount increases by the profit the firm makes and keeps within the company. If Mámor declares **dividends** to its shareholders, they, of course, are paid from the total net earnings. Retained earnings are what remain after that.

Why the balance sheet always balances

By definition, the balance sheet always balances.[6] If something happens that increases or decreases one side of the balance sheet, it is offset by something on the other side. Hence, the balance sheet remains in balance. Before examining some illustrations, let us restate the balance-sheet equation:

$$\text{Assets} = \text{Liabilities} + \text{Owners' equity}$$

With this in mind, let us look at some examples of typical business transactions and their effect on the balance sheet.

A credit transaction

Mámor calls one of its suppliers and asks for delivery of $11 000 of materials such as chocolate calettes used in manufacturing. The materials arrive the next day, and Mámor takes possession of them. But the bill is to be paid within 30 days. How is the balance sheet affected? Inventory goes up by $11 000 and accounts payable rise by $11 000. The increase in current assets is offset by an increase in current liabilities.

Continuing this illustration, what happens when the bill is paid? Mámor issues a cheque for $11 000, and cash declines by this amount. At the same time, accounts payable decrease by $11 000. Again, these are offsetting transactions, and the balance sheet remains in balance.

A bank loan

Table 11.2 shows that Mámor Chocolates Ltd had an outstanding bank loan of $200 000 in 2010. Assume that the company increases this loan by $110 000 in 2010. How is the balance sheet affected? Cash goes up by $110 000, and the bank loan increases by the same amount. Again, balance is achieved. However, what if the firm uses this $110 000 to buy new machinery? In this case, cash decreases by $110 000 and equipment increases by a like amount. Thus the total amount of assets remains unchanged so no offset is needed on the other side. Again, a balance exists. Finally, what if Mámor decides to pay off its bank loan? In this case, the first situation is reversed; cash and bank loan (long-term liabilities) decrease in equal amounts.

A sale of shares

Suppose that Mámor issues and sells another 40 000 shares of $10 par common stock. How does this action affect the balance sheet? (This answer is rather simple.) Common shares increase by $400 000 and so does cash. Once more, a balance exists.

With these examples in mind, it should be obvious why the balance sheet always balances. Every entry has an equal and offsetting entry to maintain this equation:

$$\text{Assets} = \text{Liabilities} + \text{Owners' Equity}$$

In accounting language, the terms *debit* and *credit* denote increases and decreases in assets, liabilities and owners' equity. Unfortunately, this is not a one-to-one correspondence between the words. The following chart relates debits and credits to increases and decreases.

CATEGORY	A TRANSACTION INCREASING THE AMOUNT	A TRANSACTION DECREASING THE AMOUNT
Asset	Debit	Credit
Liability	Credit	Debit
Owners' equity	Credit	Debit

Applying this idea to the preceding examples results in the following:

	DEBIT	CREDIT
CREDIT TRANSACTION		
Inventory	$11 000	
Accounts payable		$11 000
BANK LOAN		
Cash	110 000	
Bank loan		110 000
SHARES SALE		
Cash	400 000	
Common shares		400 000
TOTAL	$511 000	$511 000

The income statement

The **income statement** is a financial statement that shows the change that has occurred in a firm's position as a result of its operations over a specific period. This is in contrast to the balance sheet, which reflects the company's position at a particular point in time.

The income statement, sometimes referred to as a 'profit and loss statement' or 'P&L', reports on the success (or failure) of the business during the period. In essence, it shows whether sales revenues were greater than or less than expenses.

Most income statements cover a one-year interval, but it is not uncommon to find monthly, quarterly, or semi-annual income statements. All of the revenues and expenses accumulated during this time are determined and the net income for the period is identified. Many firms prepare quarterly income statements, but construct a balance sheet only once a year. (But see the entrepreneurship in practice box entitled 'Enron's fraudulent accounting practices'.) This is because they are far more interested in their profits and losses than in examining their asset, liability and owners' equity positions. However, it should be noted that the income statement drawn up at the end of the year will coincide with the firm's fiscal year, just as the balance sheet does. As a result, at the end of the business year, the organisation will have both a balance sheet and an income statement. In this way, they can be considered together and the interrelationship between them can be studied. A number of different types of income and expenses are reported on the income statement. However, for purposes of simplicity, the income statement can be reduced to three primary categories: (1) revenues, (2) expenses and (3) net income.

ENRON'S FRAUDULENT ACCOUNTING PRACTICES

>>ENTREPRENEURIAL EDGE

Why was no one suspicious of a company that grew from $10 billion in value to $65 billion in 16 years? To accomplish this, President and Chief Operating Officer Jeffrey Skilling began advocating a novel idea: the company did not really need any assets.

Under Skilling, Enron adopted the so-called 'mark to market' accounting, in which anticipated future profits from any deal were tabulated as if they were real today. Thus, Enron could record predicted gains from what over time might actually turn out to be losses. But when the company's success was measured by agreeable financial statements emerging from a black box, a term Skilling himself admitted, actual balance sheets proved inconvenient. Indeed, Enron's unscrupulous actions were often gambles to keep the deception going and so push up the share price, which was posted daily in the company elevator. An advancing number meant a continued infusion of investor capital on which debt-ridden Enron in large part subsisted. Its fall would collapse the house of cards. When Wall Street complained that Enron was the only company that could not release a balance sheet along with its earnings statements, Skilling allegedly replied: 'Well, thank you very much, we appreciate that . . . asshole'. That became an inside joke among many Enron employees.

Source: Peter C. Fusaro and Ross M. Miller, *What Went Wrong at Enron?*, John Wiley and Sons, 2002: 110; Bethany McLean and Peter Elkind, *The Smartest Guys in the Room: The Amazing Rise and Scandalous Fall of Enron*, London: Penguin, 2003: 342

Revenues are the gross sales the business made during the particular period under review. Revenue often consists of the money actually received from sales, but this need not be the case. For example, sales made on account still are recognised as revenue, as when Mámor Chocolate Ltd sells $500 of chocolate corporate gifts to a customer today, delivers them tomorrow and will receive payment two weeks from now. From the moment the goods are delivered the company can claim an increase in revenue.

Expenses are the costs associated with producing goods or services. For example, in the preceding paragraph, the expenses associated with the sale would include the costs of acquiring, selling and delivering the merchandise. Sometimes these are expenses that will be paid later. For example, the people who make the chocolate may be paid every two weeks, so the actual outflow of expense money in the form of salaries will not occur at the same time as the work is performed. Nevertheless, it is treated as an expense.

Net income is the excess of revenue over expenses during the particular period under discussion. If revenues exceed expenses, the result is a net profit. If the reverse is true, the firm suffers a net loss. At the end of the accounting period, all of the revenues and expenses associated with all of the sales of goods and services are added together, then the expenses are subtracted from the revenues. In this way, the firm knows whether it made an overall profit or suffered an overall loss.[7]

Understanding the income statement

Let's now turn to Mámor's income statement. To explain the income statement fully, it is necessary to examine one and determine what each account is. Table 11.3 illustrates five major sections: (1) sales revenue, (2) cost of goods sold, (3) operating expenses, (4) financial expenses and (5) estimated income taxes.

TABLE 11.3: MÁMOR CHOCOLATES LTD INCOME STATEMENT FOR THE YEAR ENDED 31 DECEMBER 2010

	ASSETS	
SALES REVENUE	$1 750 000	
less: Sales returns and allowances	50 000	
Net sales		$1 700 000
COST OF GOODS SOLD		
Inventory, January 2010	$150 000	
Purchases	1 050 000	
Goods available for sale	$1 200 000	
Less: inventory, December 2010	$200 000	
Cost of goods sold		1 000 000
Gross margin		$700 000
OPERATING EXPENSES		
Selling expenses	$150 000	
Administrative expenses	100 000	
Total operating expenses		250 000
Operating income		$450 000
FINANCIAL EXPENSES		$20 000
Income before income taxes		$430 000
Estimated income taxes		172 000
Net profit		$258 000

Revenue

Every time Mámor sells a chocolate or hosts an event, it obtains revenue. This often is referred to as *gross revenue* or *sales revenue*. However, it is usually an overstated figure, because the company finds that some of its goods are returned or some customers take advantage of prompt-payment discounts.

In Table 11.3, Mámor's sales revenue is $1 750 000. However, the firm also has returns and allowances of $50 000. These returns are common for companies that operate on a 'satisfaction or your money back' policy. (Mámor keeps tabs on these returns and allowances to see if the total is high in relation to the total sales revenue. If so, the firm will know that something is wrong with what it is selling and it can take action to correct the situation.) Deducting the sales returns and allowances from the sales revenue, the company finds its net sales. This amount must be great enough to offset the accompanying expenses in order to ensure a profit.

Cost of goods sold

As the name implies, the cost of goods sold section reports the cost of all the inputs (sugar, cream, chocolate, flavourings, etc.) of the merchandise that Mámor has sold during the accounting period. Simply put, the cost of goods for a given period equals the beginning inventory plus any purchases the firm makes minus the inventory on hand at the end of the period. Note that in Table 11.3 the beginning inventory was $150 000 and purchases totalled $1 050 000. This gave Mámor goods available for sale of $1 200 000. The ending inventory for the period was $200 000, so the cost of goods sold was $1 000 000. This is what it cost the company to acquire the inventory it sold. When this cost of goods sold is subtracted from net sales the result is the **gross margin**. The gross margin is the amount available to meet expenses and to provide some net income for the firm's owners.

Operating expenses

The major expenses, exclusive of costs of goods sold, are classified as **operating expenses**. These represent the resources expended, except for inventory purchases, to generate the revenue for the period. Expenses often are divided into two broad sub-classifications: selling expenses and administrative expenses.

Selling expenses result from Mámor's activities in displaying, selling, delivering and installing its products or performing a service. Expenses for displaying a product include rent for storage space, depreciation on fixtures and furniture, property insurance and utility and tax expenses. Sales expenses, salaries, commissions and advertising also fall into this category. Costs associated with getting the product from the store to the customer also are considered selling expenses. Finally, if the firm installs the product for the customer, all costs – including the parts used in the job – are considered in this total. Taken as a whole, those are the selling expenses.

Administrative expenses is a catch-all term for operating expenses not directly related to selling or borrowing. In broad terms these expenses include the costs associated with running the firm. They include salaries of Mámor's managers, expenses associated with operating the office, general expenses that cannot be related directly to buying or selling activities and expenses that arise from delinquent or uncollectible accounts.

When these selling and administrative expenses are added together the result is total operating expenses. Subtracting them from the gross margin gives the firm its operating income. Note that, in Table 11.3, selling expenses are $150 000, administrative expenses are $100 000 and total operating expenses are $250 000. When subtracted from the gross margin of $700 000, the operating income is $450 000.

Financial expense

The **financial expense** is the interest expense on long-term loans, also known as **debt servicing**. As seen in Table 11.3, this expense is $20 000. Additionally, many companies include their interest expense on short-term obligations as part of their financial expense.

Estimated income taxes

Companies often pay estimated taxes in advance, then, at some predetermined time (for example, 31 December), the books are closed, actual taxes are determined and any additional payments are made (or refunds claimed). When these taxes are subtracted from the income before income taxes, the result is the net profit. In our example, Mámor Chocolates made $258 000.

The cash-flow statement

The **cash-flow statement** (also known as *statement of cash flows*) shows the effects of Mámor's operating, investing and financing activities on its cash balance. The principal purpose of the statement of cash flows is to provide relevant information about the company's cash receipts

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and cash payments during a particular accounting period. It is useful for answering such questions as:

- How much cash did the firm generate from operations?
- How did the firm finance fixed-capital expenditures?
- How much new debt did the firm add?
- Was the cash from operations sufficient to finance fixed-asset purchases?

The statement of cash flows is a supplement to the balance sheet and income statements. One of the limitations of the income and balance sheet statements is that they are based on accrual accounting. In the **accrual system of accounting**, revenues and expenses are recorded when an obligation is incurred – not when cash changes hands. For example, if Mámor makes a sale on credit, under accrual accounting the sale is recognised, but cash has not been received. Similarly, a tax expense may be shown in the income statement, but it may not be paid until later. The statement of cash flows reconciles the accrual-based figures in the income and balance sheet statements to the actual cash balance reported in the balance sheet.

The statement of cash flows is broken down into operating, investing and financing activities. Table 11.4 provides an outline of a statement of cash flows. **Operating cash flows** refer to cash generated from or used in the course of the ordinary business operations of the firm. The net operating cash flows will be positive for most firms, because their operating inflows (primarily from revenue collections) will exceed operating cash outflows (for example, payment for raw materials and wages).

Investing activities refer to cash-flow effects from long-term investing activities, such as the purchase or sale of plant and equipment. The net cash flow from investing activities can be either positive or negative. A firm such as Mámor that is still in the growth phase would be building up fixed assets (installing new equipment or building new plants) and therefore would show negative cash flows from investing activities. On the other hand, a firm that is shrinking in size by divesting unprofitable divisions may realise cash inflows from the sale of assets and therefore would show a positive cash flow from investing activities.

Financing activities refer to cash-flow effects of the financing decisions of the firm, including the sale of new securities (such as shares and bonds), repurchase of securities and payment of dividends. Note that payment of interest to lenders is not included under financing activities. Accounting convention in determining the statement of cash flows assumes that interest payments are part of operating cash flows. Once the cash flows from the three different sources – operating, investing and financing – are identified, the beginning and ending cash balances are reconciled.

Up until now we have been examining Mámor's cash-flow statement. While this is most frequently used by those analysing the firm (for example, a bank or venture investor), the cash budget procedure is actually more useful to start-up entrepreneurs and growing firms and will be covered in the next section.

TABLE 11.4: FORMAT OF STATEMENT OF CASH FLOWS

Cash flows from operating activities	$50 000
Cash flows from investing activities	($10 000)
Cash flows from financing activities	$5000
Net increase (decrease) in cash	$45 000
Cash at beginning of period	$400 000
Cash at end of period	$445 000

WATCHING YOUR ACCOUNTS RECEIVABLE

>>ENTREPRENEURSHIP IN PRACTICE

One of the primary issues that plagues start-up companies is poor cash flow and one of the largest contributors to this problem is uncollected accounts receivables. When the economy is in decline, the first tactic that most businesses will employ is to stretch out the payments on their accounts payables as long as they can, which presents an issue for their vendors. Most entrepreneurs offer credit to their customers to encourage business, but when those customers choose not to pay off that credit in a timely manner, businesses servicing them can face a cash deficit, making payments to their own vendors problematic. In some cases entrepreneurs are left with no choice but to take on credit cards that charge excessive interest rates just to keep their business afloat.

Avoiding this situation takes significant forethought on the part of the management team. A good rule of thumb is to always secure funding before your company needs it. You will usually find cash when in dire straights, but the cost of that capital can be significant. Securing an operating line of credit and keeping tabs on your accounts receivable will help prevent expensive mistakes when the going gets tough.

Here are five tips for making sure that you are paid what is coming to you:

- **Develop a process**. Customers will stretch out their payments to you if they think they can get away with it; do not let them. Being consistent when dealing with your customers will let them know that you take collecting your receivables seriously. Establish a payment due date and enforce it. If you let your customers slide, you will be sending them the message that they can pay when they want to, which might work fine when your company is flush with cash, but will be a significant burden if your business hits a lull.
- **Make some noise**. Once you have provided a product or service, you are entitled to get paid. You should not feel guilty about contacting your customers about a delinquent payment. After all, you have upheld your end of the deal. Your customers are going to pay the vendors who are the most committed to getting paid. If you choose to sit idle, you may never get your money.
- **Get paid up front**. When in doubt, there is no better way to ensure payment than by mandating that your customers pay up front; this is especially useful when working with new clients. You can always charge a percentage so that you and your customers are sharing the burden of responsibility. In the event that you choose to issue credit to a customer, make sure to perform a credit check first.
- **Find an advocate**. The person paying your company is most likely not the entrepreneur. Find out who is responsible for issuing payments in each of your respective customers' businesses so that you get to know her. The order in which payments are submitted will usually be at the discretion of this individual, so you stand a greater chance of being at the top of that list if she knows you.
- **Know when to walk away**. Despite what traditional thinking suggests, customers are not always right and they are not always profitable. The time spent collecting fees from a customer and the cost of carrying the credit for that customer might outweigh the margins that customer's business is generating. If that turns out to be the case, do not be afraid to discontinue the relationship. Often the costs far outweigh what appears on your financial statements, given that time spent on troublesome customers could be spent acquiring new business. To prevent such issues from burdening your company, conduct annual audits of your customers and consider eliminating those that cost you money.

Cash-flow management is a process that never ends for an entrepreneur. Liquidity is an important metric when considering the health of your business; if you are allowing your customers to postpone their payments, you risk them putting your company's life in jeopardy.

Source: Adapted from C.J. Prince, 'Time Bomb', *Entrepreneur*, January 2008, www.entrepreneur.com/magazine/entrepreneur/2008/january/187658.html. Accessed 16 March 2008

PREPARING FINANCIAL BUDGETS

One of the most powerful tools the entrepreneur can use in planning financial operations is a **budget**.[8] The **operating budget** is a *statement* estimating income and expenses over a specified future period of time. Another common type of budget is the **cash-flow budget**, which is a statement of the estimated cash receipts and expenditures over a specified period of time. It is typical for a firm to prepare both types of budgets by first computing an operating budget and then constructing a cash budget based on the operating budget. A third common type of budget is the **capital budget**, which is used to plan expenditures on assets whose returns are expected to last beyond one year. This section examines all three of these budgets: operating, cash flow and capital. Then the preparation of pro forma financial statements from these budgets is discussed.

The operating budget

The operating budget is made up of a variety of forecasts, including sales forecasts, expense forecasts, production forecasts and operating forecasts.

Sales forecasts

Typically, the first step in creating an operating budget is the preparation of the **sales forecast**.[9] An entrepreneur can prepare the sales forecast in several ways. One way is to implement a statistical forecasting technique such as simple **linear regression**. Simple linear regression is a method of estimating the expected value of one variable *y* given the values of some other variable or variables *x*. 'Linear' refers to the assumption that a linear relationship (straight line) exists between *y* and *x*:

$$Y = a + bx$$

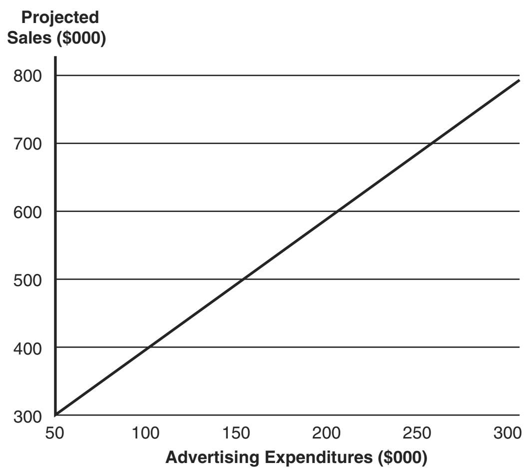
Y is a dependent variable (it is dependent on the values of *a*, *b* and *x*), *x* is an independent variable (it is not dependent on any of the other variables), *a* is a constant (in regression analysis, *Y* is dependent on the variable *x*, all other things held constant) and *b* is the slope of the line (the change in *Y* divided by the change in *x*). For estimating sales, for instance, *Y* is the variable used to represent the expected sales and *x* is the variable used to represent some factor on which sales might be dependent (such as advertising expenditures or foot traffic past the store).

When using regression analysis, the entrepreneur draws conclusions about the relationship between, for example, product sales and advertising expenditures. Here is an example of how Hanna Frederick, Mámor's managing director, used regression analysis.

> Hanna began with two initial assumptions: (1) If no money is spent on advertising, total sales will be $200 000 and (2) for every dollar spent on advertising, sales will be increased by two times that amount. Relating these two observations yields the following simple linear regression formula:
>
> $$S = \$200\,000 + 2A$$
>
> where:
>
> $$S = \text{Sales (projected)}$$
>
> $$A = \text{Advertising expenditures}$$

[Note: It is often easier to substitute more meaningful letters into an equation. In this case, the letter *S* was substituted for the letter *Y* simply because the word 'sales' starts with that letter. The same is true for the letter *A*, which was substituted for the letter *x*.] In order to determine the expected sales level, Hanna must insert different advertising expenditures and complete the simple linear regression formula for each different expenditure. The following data and Figure 11.1 demonstrate the results.

FIGURE 11.1: REGRESSION ANALYSIS



Simple Linear Regression ($000)

A	2A	S = $200 + 2A
$ 50	$100	$300
100	200	400
105	300	500
200	400	600
205	500	700
300	600	800

Another commonly used technique for the preparation of a sales forecast is the estimation that current sales will increase by a certain percentage over the prior period's sales. This percentage is based on a trend line analysis that usually covers the five preceding sales periods and assumes that the seasonal variations will continue to run in the same pattern. Obviously, because it needs five preceding sales periods, trend line analysis is used for established ventures, but it could also draw upon industry data as a benchmark for the new venture's growth.

Here is an example of how Mamor used trend line analysis to forecast sales:

> After considerable analysis of the company's and the industry's sales history, Hanna decided to use trend line analysis and estimated that sales would increase 5 per cent during the next year, with the seasonal variations following roughly the same pattern. Since she has a personal computer with an electronic spreadsheet program, such as Microsoft Excel, Hanna chose to use the input of last year's sales figures in the spreadsheet and to instruct the computer to increase each month by 5 per cent. The results are shown in Table 11.5.

Expense (purchase) forecasts

After a firm has forecast its sales for the budget period, expenses must be estimated. The first type of expense that should be estimated is the **cost of goods sold**, which follows sales on the income statement. For retail firms this is a matter of projecting purchases and the corresponding

TABLE 11.5: MÁMOR'S SALES FORECASTS FOR 2010 ($000)

	JANUARY	FEBRUARY	MARCH	APRIL	MAY	JUNE
Sales	$300	$350	$400	$375	$500	$450
x 1.05	315	368	420	394	525	473
	JULY	**AUGUST**	**SEPTEMBER**	**OCTOBER**	**NOVEMBER**	**DECEMBER**
Sales	$475	$480	$440	$490	$510	$550
x 1.05	499	504	462	515	536	578

beginning and desired ending inventories. Many firms prefer to have a certain percentage of the next month's sales on hand in inventory.

Here is how Hanna determines her company's expected purchases and inventory requirements:

> For determining the purchase requirements, Hanna believes her gross profit will represent 15 per cent of her sales dollar. This is based on analysis of the past five years' income statement. Consequently, cost of goods sold will represent 85 per cent of the sales for the current month. In addition, Hanna wants to have approximately one week's inventory on hand. Thus the ending inventory is estimated to be 25 per cent of next month's sales. The results are shown in Table 11.6.

Operating expenses

The last step in preparing the operating budget is to estimate the operating expenses for the period. Three of the key concepts in developing an expense budget are fixed, variable and mixed costs. A **fixed cost** is one that does not change in response to changes in activity for a given period of time. Rent, depreciation and certain salaries are examples. A **variable cost** is one that changes in the same direction as, and in direct proportion to, changes in operating activity. Shipping supplies and sales commissions are examples. **Mixed costs** are a blend of fixed and variable costs.

TABLE 11.6: MÁMOR'S PURCHASE REQUIREMENTS BUDGET FOR 2010 ($000)

	JAN.	FEB.	MAR.	APR.	MAY	JUNE	JULY	AUG.	SEPT.	OCT.	NOV.	DEC.
Sales revenue	$315	$368	$420	$394	$525	$473	$499	$504	$462	$515	$536	$578
Cost of goods sold calculation												
Beginning inventory	$67	$78	$89	$84	$112	$101	$106	$107	$98	$109	$114	$123
Purchases	$263	$305	$331	$341	$410	$383	$400	$395	$380	$416	$437	$413
Cost of goods available	$326	$379	$415	$420	$515	$478	$500	$495	$472	$519	$544	$528
Ending inventory	$78	$89	$84	$112	$101	$106	$107	$98	$109	$114	$123	66
Cost of goods sold	$268	$313	$357	$335	$446	$402	$424	$428	$393	$438	$456	$491
Gross profit	$63	$74	$84	$79	$105	$95	$100	$101	$92	$103	$108	$116

Assumptions:

- Beginning inventory = Prior month's ending inventory or current month's sales × ((.85) × (.25))
- Purchases = Cost of goods available − Beginning inventory
- Cost of goods available = Cost of goods sold + Ending inventory
- Ending inventory = Next month's sales × (0.85)(0.25) (since inventory is carried at cost)
- Cost of goods sold = Current period sales × (0.85)
- Gross profit = Sales − Cost of goods sold

An example is utilities, since part of this expense would be responsive to changes in activity and the rest would be a fixed expense, remaining relatively stable over the budget period. Mixed costs can present a problem for management in that it is sometimes difficult to determine how much of the expense is variable and how much is fixed.

After the expenses have been budgeted, the sales, cost of goods and expense budget are combined to form the operating budget. Table 11.7 outlines Mámor's anticipated expenses for the budget year and the completed operating budget for the period. Each month represents the pro forma, or projected, income and expenses for that period.

TABLE 11.7: MÁMOR'S OPERATING EXPENSE BUDGET FOR 2010 (000'S)

In order to identify the behaviour of the different expense accounts, Mámor decided to analyse the past five years' income statements. Following are the results of her analysis:

- *Rent is a constant expense and is expected to remain the same over the next year.*
- *Payroll expense for sales personnel changes in proportion to sales, since the more sales the store has, the more people it must hire to meet increased consumer demands.*
- *Utilities are expected to remain relatively constant over the budget period. This is because the food coolers will be running at the same level even though the sales levels may vary.*
- *Taxes are based primarily on sales and payroll and are therefore considered a variable expense.*
- *Supplies will vary in proportion to sales. This is because most of the supplies (cash register tape, vegetable trays, meat trays and plastic meat and vegetable bags) will be used to support sales.*
- *Repairs are relatively stable and are a fixed expense. Hanna has maintenance contracts on the equipment in the store and the cost is not scheduled to rise during the budget period.*

	JAN.	FEB.	MAR.	APR.	MAY	JUNE	JULY	AUG.	SEPT.	OCT.	NOV.	DEC.
Operating expenses												
Rent	$2	$2	$2	$2	$2	$2	$2	$2	$2	$2	$2	$2
Payroll	32	37	42	39	53	47	50	50	46	51	54	58
Utilities	5	5	5	5	5	5	5	5	5	5	5	5
Taxes	3	4	4	4	5	5	5	5	5	5	5	6
Supplies	16	18	21	20	26	24	25	25	23	26	27	29
Repairs	2	2	2	2	2	2	2	2	2	2	2	2
Total expenses	$60	$68	$76	$72	$93	$85	$89	$89	$83	$91	$95	$102

The cash-flow budget

After the operating budget has been prepared the entrepreneur can proceed to the next phase of the budget process, the **cash-flow budget**. This budget, which is often prepared with the assistance of an accountant, provides an overview of the cash inflows and outflows during the period. By pinpointing cash problems in advance, management can make the necessary financing arrangements.[10]

The first step in the preparation of the cash-flow budget is the identification and timing of cash inflows. For the typical business, cash inflows will come from three sources: (1) cash sales, (2) cash payments received on account and (3) loan proceeds. Not all of a firm's sales revenues are cash. In an effort to increase sales, most businesses will allow some customers to purchase goods on account. Consequently, part of the funds will arrive in later periods and will be identified as cash payments received on account. Loan proceeds represent another form of cash inflow that is not directly tied to the sales revenues. A firm may receive loan proceeds for several reasons – for example, the planned expansion of the firm (new building and equipment) or meeting cash-flow problems stemming from an inability to pay current bills.

Some businesses have a desired minimum balance of cash indicated on the cash-flow budget, highlighting the point at which it will be necessary to seek additional financing. Table 11.8 provides an example of how Mámor prepared its cash-flow budget.

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TABLE 11.8: MÁMOR'S CASH-FLOW BUDGET

Mámor's Hanna Frederick has successfully completed her operating budget and is now ready to prepare her cash-flow worksheet. After analysing the sales figures and the cash receipts, Hanna has determined that 80 per cent of monthly sales are in cash. Of the remaining 20 per cent, 15 per cent is collected in the next month and the final 5 per cent is collected in the month following (see the sales forecast worksheet in Table 11.5). Hanna's purchases are typically paid during the week following the purchase. Therefore, approximately one-fourth of the purchases are paid for in the following month. Rent expense is paid a month in advance. However, since it is not expected to go up during the budget period, the monthly cash outlay for rent remains the same. All the other expenses are paid in the month of consumption (see the operating expense budget in Table 11.7). Finally, the cash-flow worksheet is constructed by taking the beginning cash balance, adding the cash receipts for that month and deducting the cash disbursements for the same month.

MÁMOR'S CASH RECEIPTS WORKSHEET FOR 2010 ($000)

	JAN.	FEB.	MAR.	APR.	MAY	JUNE	JULY	AUG.	SEPT.	OCT.	NOV.	DEC.
Sales	$315	$368	$420	$394	$525	$473	$499	$504	$462	$515	$536	$578
Current month	$252	$294	$336	$315	$420	$378	$399	$403	$370	$412	$428	$462
Prior month	82	47	55	63	59	79	71	75	76	69	77	80
Two months back	26	28	16	18	21	19	26	24	24	25	24	26
Cash receipts	$360	$369	$407	$396	$500	$476	$496	$502	$470	$506	$529	$568

MÁMOR'S CASH DISBURSEMENTS WORKSHEET FOR 2010 ($000)

	JAN.	FEB.	MAR.	APR.	MAY	JUNE	JULY	AUG.	SEPT.	OCT.	NOV.	DEC.
Purchases	$263	$305	$331	$341	$410	$383	$400	$395	$380	$416	$437	$413
Current month	$197	$228	$248	$256	$307	$287	$300	$296	$285	$312	$328	$309
Prior month	98	66	76	83	85	102	96	100	99	95	104	109
Purchase payments	$295	$294	$324	$339	$392	$396	$396	$396	$384	$407	$432	$419
Operating expenses	$60	$68	$76	$72	$93	$85	$89	$89	$83	$91	$95	$102
Cash payments	$355	$362	$400	$412	$485	$481	$485	$485	$467	$498	$527	$521

MÁMOR'S CASH-FLOW WORKSHEET FOR 2010 ($000)

	JAN.	FEB.	MAR.	APR.	MAY	JUNE	JULY	AUG.	SEPT.	OCT.	NOV.	DEC.
Beginning cash	$122	$127	$134	$141	$127	$141	$143	$154	$170	$173	$181	$184
Add: Receipts	360	369	407	396	500	476	496	502	470	506	529	568
Cash available	$482	$496	$541	$537	$627	$617	$639	$656	$640	$679	$710	$752
Less: Payments	355	362	400	411	485	481	485	485	467	498	527	521
Ending cash	$127	$134	$141	$126	$142	$136	$154	$171	$173	$181	$183	$231

>>ENTREPRENEURSHIP IN PRACTICE

SMALL BUSINESS OWNERS NEED TO BRUSH UP ON THEIR MATHS

Almost one in two people running small businesses struggle to understand a balance sheet, according to a survey of 1000 businesses in the UK. Owner managers were excellent when it came to questions on marketing, management and leadership, but they fell down when tackling finance issues. Seven out of 10 did not know the meaning of depreciation. Almost half failed to make a basic calculation to show the borrowings of a business in a simple balance sheet. The results indicate that many owner–managers might not have any real idea what their accounts are telling them, particularly on matters of profitability, according to this survey prepared for the Federation of Small Businesses.

Source: 'Quiz Leaves Many Managers Wanting to Phone a Friend', *Daily Telegraph*, 21 April 2003: 29

CHARACTERISTICS OF CREDIBLE FINANCIALS

>>ENTREPRENEURSHIP IN PRACTICE

Although every section of a business plan has its purpose, the financial section bears the most scrutiny. A business's financial statements are deserving of this attention for two reasons: (1) the management team has significant discretion in how the financials are constructed and (2) potential investors reviewing a business plan will be interested in the financial viability of the company's strategy. Following are characteristics that convincing financial statements have in common:

- **Holistic.** An income statement tells only part of your business's financial story; the balance sheet and cash-flow statement are necessary to fill in the remaining details. Investors and lenders are interested in every detail of your company's financial health, so never exclude relevant information, such as the amount of and the timeline for the cash you will need.
- **Precise.** Although investors will carefully analyse your financial statements, helping them to pinpoint the important details will ensure that they do not lose patience searching through your plan. To aid the readers of your plan, focus your sales and cost of goods sold numbers on major product lines. In addition, pay attention to how you label your line items to ensure that your readers will understand what you are trying to communicate. For instance, 'costs' are what you pay for what you are selling, while 'expenses', like payroll and rent, are overhead charges you would have without sales.
- **Realistic.** When you tailor your figures to achieve a predetermined revenue goal, you will have trouble justifying your numbers when questioned. Instead, build your financials by starting with your costs and sales in your local market to anchor your figures in reality. In addition, your projections beyond the first year should be annual or quarterly.
- **Simple.** Significant volatility in your industry should be noted, such as your business being impacted by seasonality; however, bogging down your plan with lengthy explanations regarding the probability of your projections will only serve to confuse the reader. Including clarifying statements, such as 'most likely', and supporting addendums, such as your break-even analysis, will be sufficient.
- **Accurate.** Investors know that your plan will change repeatedly as you build your business; however, overlooking simple expenses, such as interest payments, can cast doubt on your attention to detail. Once you have your financial statements completed, verifying the finer points, such as the accuracy of the interest and tax rates, will show that you are able to take your business from plan to implementation.

Sources: Adapted from Tim Berry, 'The Facts about Financial Projections', May 2007. Accessed 21 June 2008 from *Entrepreneur* magazine website, www.entrepreneur.com/startingabusiness/businessplans/businessplancoachtimberry/article178210.html; Jim Casparie, 'Realistic Projections that Attract Investors', April 2006. Accessed 21 June 2008 from *Entrepreneur* magazine website, www.entrepreneur.com/money/financing/raisingmoneycoachjimcasparie/article159516.html

Pro forma statements

The final step in the budget process is the preparation of **pro forma statements**, which are projections of a firm's future financial statements. Pro forma comes from Latin meaning 'according to form'. In the normal accounting cycle, the income statement is prepared first and then the balance sheet. Similarly, in the preparation of pro forma statements, the pro forma income statement is followed by the pro forma balance sheet.

In the process of preparing the operating budget, the firm will have already prepared the pro forma income statements for each month in the budget period. Each month presents the anticipated income and expense for that particular period, which is what the monthly pro forma income statements do. In order to prepare an annual pro forma income statement, the firm combines all months of the year.

The process for preparing a pro forma balance sheet is more complex. The last balance sheet prepared before the budget period began, the operating budget and the cash-flow budget are all needed in preparing a pro forma balance sheet. Starting with the beginning balance sheet balances, the projected changes as depicted on the budgets are added to create the projected balance sheet totals.

After preparing the pro forma balance sheet, the entrepreneur should verify the accuracy of their work with the application of the traditional accounting equation:

$$\text{Assets} = \text{Liabilities} + \text{Shareholders' Equity}$$

If the equation is not in balance, the work should be rechecked. Table 11.9 provides a brief account of the process of preparing pro forma financial statements for Mámor Chocolates Ltd.

TABLE 11.9: MÁMOR CHOCOLATES: PRO FORMA STATEMENTS

At this point in the budget process, Mámor's Hanna Frederick has the information necessary to prepare pro forma financial statements. The first set she has decided to prepare are the pro forma income statements. To do this, Hanna simply copies the information from the operating budget (see the comparative income statements below and compare with the operating budget). The next set of pro forma statements is the pro forma balance sheets. In order to compile these, she uses the following information along with the operating budget and the cash-flow worksheet she has prepared:

- *cash – the ending cash balance for each month from the cash-flow worksheet*
- *accounts receivable – 20 per cent of the current month's sales plus 5 per cent of the preceding month's sales*
- *inventory – the current month's ending inventory on the pro forma income statements*
- *prepaid rent – the $2000 is expected to remain constant throughout the budget period and is always paid one month in advance*
- *building and equipment – no new acquisitions are expected in this area, so the amount will remain constant*
- *accumulated depreciation – in the interest of simplicity, we assume this will stay the same; all buildings and equipment are fully depreciated*
- *accounts payable – 25 per cent of current purchases*
- *capital – prior month's capital balance plus current month's net income. (No dividend payments are anticipated.)*

MÁMOR'S COMPARATIVE PRO FORMA INCOME STATEMENTS FOR 2010 ($000)

	JAN.	FEB.	MAR.	APR.	MAY	JUNE	JULY	AUG.	SEPT.	OCT.	NOV.	DEC.
Sales	$315	$388	$420	$394	$525	$473	$499	$504	$462	$515	$536	$578
Cost of goods sold	$252	$294	$336	$315	$420	$378	$399	$403	$370	$412	$428	$462
Gross profit	$63	$74	$84	$79	$105	$95	$100	$101	$92	$103	$108	$116
Total operating expenses	$60	$68	$76	$72	$93	$85	$89	$89	$83	$91	$95	$102
Net profit	$3	$6	$8	$7	$12	$10	$11	$12	$9	$12	$12	$14

MÁMOR CHOCOLATES COMPARATIVE PRO FORMA BALANCE STATEMENTS FOR 2010 ($000)

	JAN.	FEB.	MAR.	APR.	MAY	JUNE	JULY	AUG.	SEPT.	OCT.	NOV.	DEC.
Assets												
Cash	$127	$134	$141	$126	$142	$136	$154	$171	$173	$181	$183	$231
Accounts receivable	91	89	102	100	125	121	123	126	117	126	133	142
Inventory	74	84	79	105	95	100	101	92	103	107	116	66
Prepaid rent	2	2	2	2	2	2	2	2	2	2	2	2
Building and equipment	350	350	350	350	350	350	350	350	350	350	350	350
Less: Accumulated depreciation	–350	–350	–350	–350	–350	–350	–350	–350	–350	–350	–350	–350
Total assets	$294	$309	$324	$333	$364	$359	$380	$391	$395	$416	$434	$441
Liabilities												
Accounts payable	$66	$76	$83	$85	$102	$96	$100	$99	$95	$104	$109	$103
Capital	228	234	242	249	261	270	280	292	300	312	326	339
Total liabilities and equity	$294	$310	$325	$334	$363	$366	$380	$391	$395	$416	$435	$442

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CAPITAL BUDGETING

Entrepreneurs are usually required to make several investment decisions (that is, decisions to acquire assets with a life longer than one year) in the process of managing their firms. These are commonly referred to as capital investments or capital expenditures. A technique the entrepreneur can use to help plan for capital expenditures is **capital budgeting**.[11]

The first step in capital budgeting is to identify the cash flows related to a proposed investment and their timing. The inflows – or returns as they are commonly called – are equal to net operating income before deduction of payments to the financing sources but after the deduction of applicable taxes and with depreciation added back, as represented by the following formula:

$$\text{Expected returns} = X\,(1 - T) + \text{Depreciation}$$

X is equal to the net operating income and *T* is defined as the appropriate tax rate. An illustration follows.

> Hanna Frederick is faced with a dilemma. She has two mutually exclusive projects, both of which require an outlay of $1000. The problem is that she can afford only one of the projects. After discussing the problem with her accountant, Hanna discovered that the first step she needs to take is to determine the expected return on each project. In order to gather this information, she has studied the probable effect on the store's operations and has developed the data shown in Table 11.10.

Table 11.10 provides a good illustration of the expected returns for Hanna's two projects. At this point, however, the cash inflows of each year are shown without consideration of the **time value of money** (the idea that money available today is worth more than the same amount in the future due to its potential interest earning capacity). The cash outflow is used to refer to the initial cash outlay that must be made in the beginning (the purchase price). When gathering data

TABLE 11.10: MÁMOR'S EXPECTED RETURN WORKSHEET

			PROPOSAL A		
YEAR	X	(1 – T), WHERE (T = .40)	X(1 – T)	DEPRECIATION	X(1 – T) + DEPRECIATION
1	$500	$0.60	$ 300	$200	$500
2	333	0.60	200	200	400
3	167	0.60	100	200	300
4	–300	0.60	–180	200	20
5	–317	0.60	–190	200	10
			PROPOSAL B (1 – T)		
YEAR	X	(1 – T), WHERE (T = .40)	X(1 – T)	DEPRECIATION	X(1 – T) + DEPRECIATION
1	–$167	$0.60	–$100	$200	$100
2	0	0.60	100	200	200
3	167	0.60	100	200	300
4	333	0.60	200	200	400
5	500	0.60	300	200	500

Assumptions:

X = Anticipated change in net income
T = Applicable tax rate (.40)
Depreciation = Depreciation (computed on a straight-line basis) = Cost/Life = 1000/5

to estimate the cash flows over the life of a project, it is imperative to obtain reliable estimates of the savings and expenses associated with the project.

The principal objective of capital budgeting is to maximise the value of the firm. It is designed to answer two basic questions:

1. Which of several mutually exclusive projects should be selected? (Mutually exclusive projects are alternative methods of doing the same job. If one method is chosen, the other methods will not be required.)
2. How many projects, in total, should be selected?[12]

The three most common methods used in capital budgeting that can take into account the time value of money are the **payback method**, the **net present value (NPV) method** and the **internal rate of return (IRR) method**. Each has certain advantages and disadvantages. In this section, the same proposal will be examined under each method to more clearly illustrate each technique.

Payback

One of the easiest capital-budgeting techniques to understand is the payback method or, as it is sometimes called, the payback period. In this method the length of time required to 'pay back' the original investment is the determining criterion. The entrepreneur will select a maximum timeframe for the payback period. Any project that requires a longer period will be rejected and projects that fall within the timeframe will be accepted. Here is an example of the payback method used by Mámor:

> Hanna has a decision to make. She would like to purchase a new cash register for her store but is unsure which of two proposals to accept. Each machine costs $1000. An analysis of the projected returns reveals the following information:

YEAR	PROPOSAL A	PROPOSAL B
1	$500	$100
2	$400	$200
3	$300	$300
4	$20	$400
5	$10	$500

> After careful consideration, Hanna decides to use the payback method with a cut-off period of three years. In this case she discovers that Proposal A would pay back her investment in two and one-third years; $900 of the original investment will be paid back in the first two years and the last $100 in the third year. Proposal B, on the other hand, will require four years for its payback. Using the decision criterion of the shorter payback period, Hanna chooses Proposal A and rejects Proposal B.

One of the problems with the payback method is that it ignores cash flows beyond the payback period. Thus, it is possible that the project chosen will be less profitable over its total life than the alternative. Nevertheless, many companies, particularly entrepreneurial firms, continue to use this method for several reasons: (1) it is very simple to use in comparison to other methods; (2) projects with a faster payback period normally have more favourable short-term effects on earnings; and (3) if a firm is short on cash, it may prefer to use the payback method because it provides a faster return of funds.

Net present value

The net present value (NPV) method is a technique that helps to overcome some of the shortcomings of the payback method by recognising the future cash flows beyond the payback period. The concept works on the premise that a dollar today is worth more than a dollar in the future. How much more depends on the applicable cost of capital for the firm. The cost of capital is the rate used to adjust future cash flows to determine their value in present period terms. This procedure is referred to as discounting the future cash flows. The discounted cash value is determined by the present value of the cash flow.

To use this approach, the entrepreneur must find the present value of the expected net cash flows of the investment, discounted at the appropriate cost of capital and subtract from it the initial cost outlay of the project. The result is the net present value of the proposed project. Many financial accounting and finance textbooks have tables (called present value tables) that list the appropriate discount factors to multiply by the future cash flow to determine the present value. In addition, financial calculators are available that will compute the present value given the cost of capital, future cash flow and the year of the cash flow. Finally, given the appropriate data, electronic spreadsheet programs can be programmed to determine the present value. After the net present value has been calculated for all of the proposals, the entrepreneur can select the project with the highest net present value. Here is an example of the net present value method used by Mámor Chocolates:

> Not really satisfied with the results she has obtained from the payback method, Hanna has decided to use the NPV method to see what result

THE INDIAN ENTREPRENEUR AND THE CUNNING NPV

>>ENTREPRENEURIAL EDGE

An Indian business entrepreneur ran a small warehouse and a van for hire delivering raw material to a factory 20 kilometres away. His vehicle was reasonably new but to save money he had hired an old driver with defective vision who was working for half the salary of a regular driver. The driver could do only four trips a day covering 80 kilometres.

When he calculated his profits, the entrepreneur realised this income was not adequate for his survival and for his son's college education. He could not even maintain his vehicle properly and it was frequently breaking down. To make ends meet he thought he had to sell the delivery business, fire the driver, sell off his vehicle, pay his son's college entrance fees and maintain his family by selling his wife's jewels and silver.

What price should he ask for the business? He decided he would take the earnings for the next few years, subtract the cost of running the vehicle and calculate the net present value (NPV) by discounting each year's earnings at around 10 per cent. Or was there another solution?

Ever the entrepreneur, he came up with a cunning plan. After some thought he decided to fire his ageing driver and generously gave him a month's leave. He got the van tuned and repaired for better petrol consumption. Then he hired a competent driver at the full going rate and sent him on eight trips a day doing 160 kilometres of deliveries. After a fortnight he realised his earnings had gone up by two to three times because of more trips and fewer breakdowns. The service, the product and the vehicle were all the same, but were operated differently.

He worked out NPV on the basis of the new earnings but with the same discount rate as before. The value was now three times higher. If he had sold it on his earlier calculations, some clever buyer would have got a bargain and benefited from the entrepreneur's first faulty calculation. Now with an efficient going concern he could sell the delivery service and the vehicle at the higher price based on the new NPV. He was able to pay for his son's education and also pay off some of his past debts.

Source: Adapted from 'How to Polish & Sell Family Silver', *Financial Express* (Mumbai), 29 August 2002 it would produce. After conferring with her accountant, Hanna learned that the cost of capital for her firm is 11 per cent. She then prepares the information contained in Table 11.11.

TABLE 11.11: MÁMOR'S NET PRESENT VALUE

PROPOSAL A			
YEAR	CASH FLOW	DISCOUNT FACTOR	PRESENT VALUE
1	$500	0.9091	$454.55
2	400	0.8264	330.56
3	300	0.7513	225.39
4	20	0.6830	13.66
5	10	0.6209	6.21
			$1030.37
Less: Initial outlay			–1000.00
Net present value			$30.37

PROPOSAL B			
YEAR	CASH FLOW	DISCOUNT FACTOR	PRESENT VALUE
1	$100	0.9091	$90.91
2	200	0.8264	165.28
3	300	0.7513	225.39
4	400	0.6830	273.20
5	500	0.6209	310.45
			$1065.23
Less: Initial outlay			–1000.00
Net present value			$65.23

Since Proposal B has the higher net present value, Hanna selected Proposal B and rejected Proposal A.

Internal rate of return

The internal rate of return (IRR) method is similar to the net present value method in that the future cash flows are discounted. However, they are discounted at a rate that makes the net present value of the project equal to zero. This rate is referred to as the internal rate of return of the project. The project with the highest internal rate of return is then selected.

One of the major drawbacks to the use of the IRR method is the difficulty that can be encountered when using the technique. Using the NPV method it is quite simple to look up the appropriate discount factors in the present value tables. When using the IRR concept, however, the entrepreneur must begin with a net present value of zero and work backward through the tables. This means that the entrepreneur must estimate the approximate rate and eventually try to track the actual internal rate of return for the project. Although this may not seem too difficult for projects with even cash flows (that is, cash flows that are fairly equal over the business periods), projects with uneven cash flows (fluctuating periods of cash inflow and cash outflow) can be a nightmare. Unfortunately, reality dictates that most projects will probably have uneven cash flows. Fortunately, electronic calculators and spreadsheet programs are available that can determine the actual internal rate of return given the cash flows, initial cash outlays and appropriate cash-flow periods. Here is an example of the internal rate of return method used by Mámor Chocolates:

> Having obtained different results from the payback period and the net present value method, Hanna is confused about which alternative to select. To alleviate this confusion, she has decided to use the internal rate of return to evaluate the two proposals and has decided that the project with the higher internal rate of return will be selected. Accordingly, she has prepared the following tables with the help of her calculator:

PROPOSAL A (11.73% IRR)

YEAR	CASH FLOW	DISCOUNT FACTOR	PRESENT VALUE
1	$500	0.8942	$447.11
2	400	0.7996	319.84
3	300	0.7151	214.53
4	20	0.6394	12.80
5	10	0.5718	5.73
			$1000.00
Less: Initial outlay			–1000.00
Net present value			$0.00

PROPOSAL B (12.01% IRR)

YEAR	CASH FLOW	DISCOUNT FACTOR	PRESENT VALUE
1	$100	0.8928	$89.27
2	200	0.7971	159.42
3	300	0.7117	213.51
4	400	0.6354	254.15
5	500	0.5673	283.65
			$1000.00
Less: Initial outlay			–1000.00
Net present value			$0.00

> Proposal B is selected because it has the higher internal rate of return. This conclusion supports the statement that the project with the higher net present value will also have the higher internal rate of return.

The Mámor Chocolates examples illustrate the use of all three capital-budgeting methods. Even though Proposal A showed great value by the first method (payback), under the other two methods (net present value and internal rate of return) Proposal B surfaced as the better proposal. It is important for entrepreneurs to understand all three methods and to use the one that best fits their needs. If payback had been Hanna's only consideration, then Proposal A would have been selected. When future cash flows beyond payback are to be considered, the net present value and the internal rate of return are the methods to determine the best proposal.

The budgeting concepts discussed so far are extremely powerful planning tools. But how can entrepreneurs monitor their progress during the budget period? How can they use the information accumulated during the course of the business to help plan for future periods? Can this information be used for pricing decisions? The answer to the third question is 'yes', and the rest are answered in the following sections.

>>ENTREPRENEURSHIP IN PRACTICE

WHEN CURRENCY LOSES ITS GLOBAL VALUE

A nation's currency is the bedrock on which its wealth is built. Without it, citizens would be left to barter for products and services. Currency is not inherently valuable. Its worth stems from the faith of the nation's citizens in their government's ability to back its currency. As global commerce has become more prevalent, entrepreneurs have been forced to understand the pitfalls and the possibilities of national borders giving way to open trade. One of the repercussions has been the increased volatility of national currency caused by international forces. The fluctuation in the value of the US dollar is an example of this phenomenon.

The dollar has historically been the world's reserve currency, driving the global economy. Because American consumers have been unable to quench their insatiable hunger for foreign goods, more foreigners are in possession of dollars – which in and of itself is not bad; however, when their faith in the US economy falters they are inclined to offload dollars in order to hedge against the risk of inflation, which, of course, is self-fulfilling. Due to the sub-prime lending debacle in the US, in conjunction with the country carrying record levels of debt, this scenario has begun to play out. For instance, the Chinese government recently announced that it would be moving its reserves into stronger currencies, which most likely translates to abandoning the dollar for the euro. As other countries follow its lead the dollar will continue to lose value.

What are entrepreneurs to do when the value of their national currency falls? Ironically, some entrepreneurs can benefit from the situation, at least initially. When a country's currency loses value, revenue generated through tourism tends to increase due to foreigners travelling to the country in order to take advantage of the improved conversion rates. Most business owners are quick to ignore the implications of such a shift as their business prospects improve; however, when foreign companies move from buying products to buying the manufacturers, the national landscape can morph in unpredictable ways. Foreign ownership in the US has been on the rise during the last couple of decades, and – as the dollar continues its decline – there is no end in sight.

Start-up ventures often have little recourse when their country's currency begins to lose value. While large corporations hedge their bets by converting their capital to foreign currency or by making direct foreign investments, small businesses are left to make the best of a bad situation. Diversifying a company's customer base to include international consumers is one way to help mitigate the risk, but in the end the factors at play are outside of the control of even the largest companies.

Source: Adapted from Geoff Colvin, 'What's Sinking the Dollar?', *Fortune*, 13 November 2007, http://money.cnn.com/magazines/fortune/fortune_archive/2007/11/26/101232904/index.htm?postversion_2007111309. Accessed 9 April 2008

See also Entrepreneurial Case Analysis, '10Pin Confronts the Asian Financial Meltdown', pages 461–7.

BREAK-EVEN ANALYSIS

In today's competitive marketplace, entrepreneurs need relevant, timely and accurate information that will enable them to price their products and services competitively and yet be able to earn a fair profit. **Break-even analysis** supplies this information.

Break-even point computation

Break-even analysis is a technique commonly used to assess expected product profitability. It helps determine how many units must be sold in order to break even at a particular selling price.

Contribution margin approach

A common approach to break-even analysis is the **contribution margin approach**. The contribution margin is the difference between the selling price and the variable cost per unit. It is the amount per unit that is contributed to cover all other costs.[13] With this information, the entrepreneur can decide whether to add or drop a product line, how to price a product or service and how to structure sales commissions or bonuses. It starts by grouping together a business's fixed and variable costs.

> Mámor's Hanna Frederick wants to know for every dollar of sales, after the costs that were directly related to the sales were subtracted, how much remained to contribute towards paying for the direct costs and for profit. Here's an example of an income statement formatted to calculate the contribution margin:

TABLE 11.12: MÁMOR'S CONTRIBUTION MARGIN INCOME STATEMENT FOR 2010 ($000)

Sales	$463
Less: Variable costs	
Cost of goods sold	$231
Sales commissions	$59
Delivery charges	$14
Total variable costs	$304
Contribution margin (34%)	$159
Less: Fixed costs	
Advertising	$2
Depreciation	$13
Insurance	$5
Payroll taxes	$8
Rent	$10
Utilities	$18
Wages	$40
Total fixed costs	$96
Net operating income	$63

Since the break-even point occurs where income equals expenses, the contribution margin approach formula is:

$$0 = (SP - VC)S - FC \text{ or } FC = (SP - VC)S$$

where:

SP = Unit selling price
VC = Variable costs per unit
S = Sales in units
FC = Fixed cost

Hanna's contribution margin for the year was 34 per cent. This means that, for every dollar of sales, after the costs that were directly related to the sales were subtracted, 34 cents remained to contribute towards paying for the direct costs and for profit.

This model also can be used for profit planning by including the desired profit as part of the fixed cost.

Handling questionable costs

Although the contribution margin approach is adequate for situations in which costs can be broken down into fixed and variable components, some firms have expenses that are difficult to assign. For example, are repairs and maintenance expenses fixed or variable expenses? Can firms facing this type of problem use break-even analysis for profit planning? The answer is 'yes', thanks to a new technique designed specifically for entrepreneurial firms. This technique calculates break-even points under alternative assumptions of fixed or variable costs to see if a product's profitability is sensitive to cost behaviour.

The decision rules for this concept are:

- If expected sales exceed the higher break-even point, then the product should be profitable, regardless of the other break-even point.
- If expected sales do not exceed the lower break-even point, then the product should be unprofitable.

Only if expected sales are between the two break-even points is further investigation of the questionable costs' behaviour needed.[14]

The concept works by substituting the cost in question (*QC*) first as a fixed cost and then as a variable cost. The break-even formulas presented earlier would have to be modified to determine the break-even levels under the two assumptions. Under the fixed-cost assumption, the entrepreneur would use the following equation:

$$0 = (\mathrm{SP} - \mathrm{VC})\mathrm{S} - \mathrm{FC} - \mathrm{QC}$$

To calculate the break-even point assuming *QC* is variable, the following equation would be used:

$$0 = [\mathrm{SP} - \mathrm{VC} - (\mathrm{QC}/\mathrm{U})]\mathrm{S} - \mathrm{FC}$$

U is the number of units for which the questionable cost normally would be appropriate. What the entrepreneur is determining is the appropriate unit cost that should be used if the cost is a variable cost. Here is an example of how an entrepreneur could use the technique:

> Mámor's Hanna Frederick manufactures chocolate moulds for other companies. She has decided to use break-even analysis as a profit-planning tool for her company. She believes using this technique will enable her firm to compete more effectively in the marketplace. From an analysis of the operating costs, Hanna has determined that the variable cost per unit is \$9, while fixed costs are estimated to be \$1200 per month. The anticipated selling price per unit is \$15. She also has discovered she is unable to classify one cost as either variable or fixed. It is a \$200 repair and maintenance expense allocation. This \$200 is appropriate for an activity level of 400 units; therefore, if the cost were variable, it would be \$0.50 per unit (\$200/400). Finally, sales are projected to be 400 units during the next budget period.
>
> The first step in this process is to determine the break-even point assuming the cost in question is fixed. Consequently, Hanna would use the following equation:
>
> $$\begin{aligned} 0 &= (\mathrm{SC} - \mathrm{VC})\mathrm{S} - \mathrm{FC} - \mathrm{QC} \\ &= (15 - 9)\mathrm{S} - 1200 - 200 \\ &= 6\mathrm{S} - 1400 \\ 1400 &= 6\mathrm{S} \\ 234 &= \mathrm{S} \end{aligned}$$
>
> Figure 11.2 provides a graphic illustration of the results. Notice that the final quantity was rounded up to the next unit, because a business normally will not sell part of a unit.

The next step in the process is to calculate the break-even point assuming the cost in question is a variable cost. Hanna would use the following equation to ascertain the second break-even point:

$$\begin{aligned} 0 &= [SC - VC - (QC/U)]S - FC \\ &= [15 - 9 - (200/400)]S - 1200 \\ &= (6 - .50)S - 1200 \\ 1200 &= 5.50S \\ 219 &= S \end{aligned}$$

Figure 11.3 presents a graphic illustration of the results.

FIGURE 11.2: MÁMOR CHOCOLATES FIXED-COST ASSUMPTION

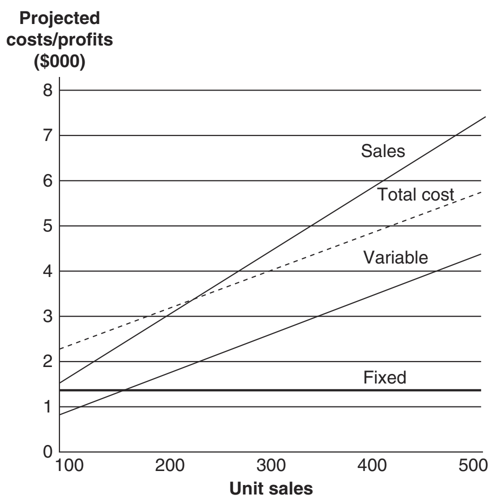
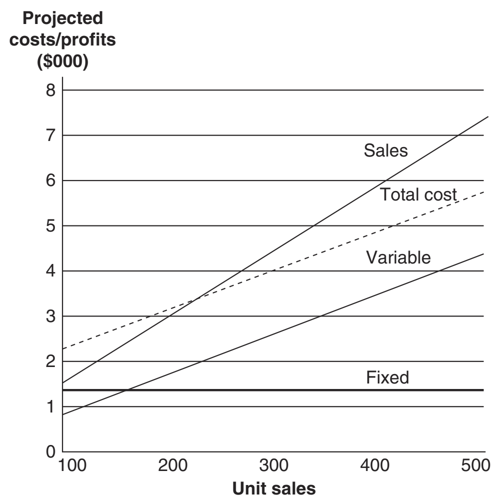


FIGURE 11.3: MÁMOR CHOCOLATES VARIABLE-COST ASSUMPTION



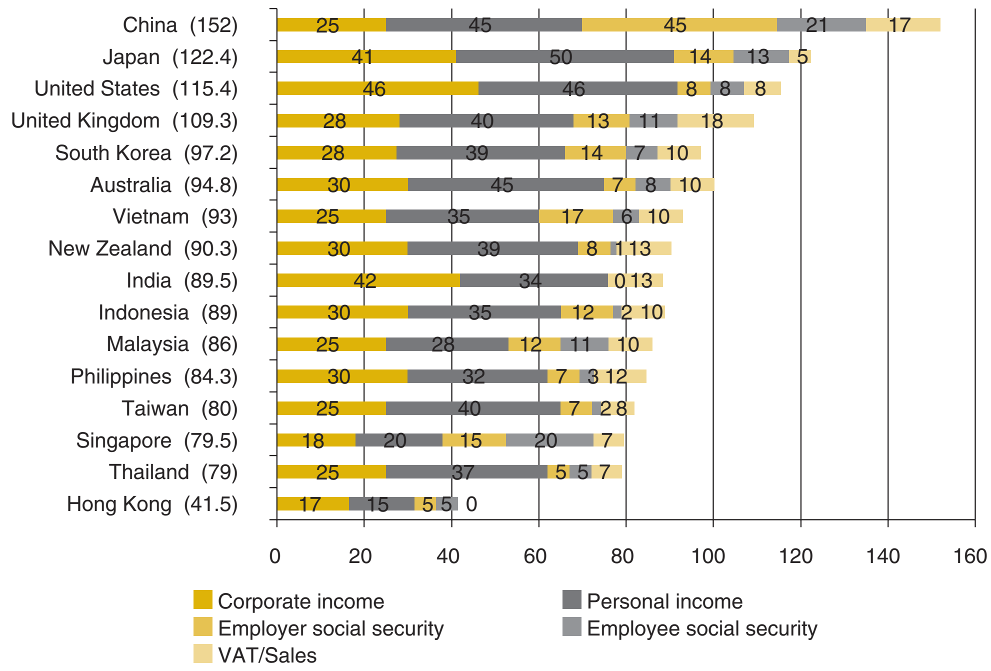
Now that the two possible break-even points have been established, Hanna must compare them to her projected sales. The variable-cost sales of 400 units are greater than the larger break-even point of 234 units. Therefore, the product is assumed to be profitable regardless of the cost behaviour of the repair and maintenance expense. It does not matter whether the cost is variable or fixed; the firm will still be profitable.

COMPARATIVE ASIA–PACIFIC TAX REGIMES Many Asian countries are reducing the tax load that entrepreneurs face. But the biggest nations in our region are lagging behind.[15]

According to the Forbes' 'Tax Misery Index', China has the harshest tax regime in the Asia–Pacific region while Hong Kong offers the friendliest. The survey showed that China levies a 25 per cent tax on corporate income, 45 per cent on personal income, 49 per cent for employers' social security, 23 per cent for employees' social security and a 17 per cent tax on goods and services. China's tax misery rate was exceeded only by France, Netherlands, Belgium and Sweden.

Forbes calculates the misery score by taking the sum of the corporate, personal, social security and sales tax rates.

FIGURE 11.4: TAX MISERY INDEX IN ASIA



By contrast, Hong Kong's corporate tax stands at 16.5 per cent, personal income tax at 15 per cent and employer and employee social security levy at 5 per cent each, it said. It was bettered only by Qatar and the United Arab Emirates.

Japan is Asia's second-least friendly tax environment after China, while Thailand followed Hong Kong as the region's second-most friendly.

After Hong Kong and Thailand, Singapore, Taiwan and the Philippines were the next friendliest tax regimes in Asia.

FINANCIAL RATIO ANALYSIS

Financial statements report both on a firm's position at a point in time and on its operations over some past period. However, the real value of financial statements lies in the fact that they can be used to help predict the firm's earnings and dividends. From an investor's standpoint, predicting the future is what financial statement analysis is all about; from an entrepreneur's standpoint, financial statement analysis is useful as a way to assess financial wealth, assess trends in profitability and liquidity and, most importantly, as a starting point for planning actions that will influence the course of events.

An analysis of the firm's ratios is generally the key step in a financial analysis. The ratios are designed to show relationships among financial statement accounts. For example, Firm A might have a debt of $6 250 000 and interest charges of $520 000, while Firm B might have a debt of $62 800 000 and interest charges of $5 840 000. Which company is stronger? The true burden of these debts and the companies' ability to repay them can be ascertained: (1) by comparing each firm's debt to its assets and (2) by comparing the interest each must pay to the income it has available for interest payment. Such comparisons are made by ratio analysis.[16]

Table 11.13 lists **financial ratios**. It has been prepared as an entrepreneur's guide to understanding the various ratios. Note that this outline presents the ratio's importance to

TABLE 11.13: FINANCIAL RATIOS

RATIO	FORMULA	WHAT IT MEASURES	WHAT IT TELLS YOU
	RATIOS FOR OWNERS		
Return on investment ROI	$\frac{\text{Net income}}{\text{Average owner's equity}}$	Return on owner's capital	How well is this company doing as an investment?
Return on assets ROA	$\frac{\text{Net income}}{\text{Average total assets}}$	How well assets have been employed by management	How well has management employed company assets? Does it pay to borrow?
	RATIOS FOR MANAGERS		
Net profit margin	$\frac{\text{Net income}}{\text{Sales}}$	Operating efficiency; the ability to create sufficient profits from operating activities	Are profits high enough, given the level of sales?
Asset turnover	$\frac{\text{Sales}}{\text{Average total assets}}$	Relative efficiency in using total resources to produce output	How well are assets being used to generate sales revenue?
Return on assets	$\frac{\text{Net income}}{\text{Sales}} \times \frac{\text{Sales}}{\text{Total assets}}$	Earning power on all assets; ROA ratio broken into its logical parts; turnover and margin	How well has management employed company assets?
Average collection period	$\frac{\text{Average accounts receivable}}{\text{Annual credit sales}} \times 365$	Liquidity of receivables in terms of average number of days receivables are outstanding	Are receivables coming in too slowly?
Inventory turnover	$\frac{\text{Cost of goods sold expense}}{\text{Average inventory}}$	Liquidity of inventory; the number of times it turns over per year	Is too much cash tied up in inventories?
	RATIOS TO ASSESS SHORT-TERM LIQUIDITY		
Average age of payables	$\frac{\text{Average accounts payable}}{\text{Net purchases}} \times 365$	Approximate length of time a firm takes to pay its bills for trade purchases	How quickly does a prospective customer pay its bills?
Working capital	Current assets − Current liabilities	Short-term debt-paying ability	Does this customer have sufficient cash or other liquid assets to cover its short-term obligations?
Current ratio	$\frac{\text{Current assets}}{\text{Current liabilities}}$	Short-term debt-paying ability without regard to the liquidity of current assets	Does this customer have sufficient cash or other liquid assets to cover its short-term obligations?
Quick ratio	$\frac{\text{Cash + Marketable securities + Accounts receivable}}{\text{Current liabilities}}$	Short-term debt-paying ability without having to rely on inventory sales	Does this customer have sufficient cash or other liquid assets to cover its short-term obligations?
Long-term creditors			
Debt-to-equity ratio	$\frac{\text{Total debt}}{\text{Total equity}}$	Amount of assets creditors provide for each dollar of assets the owners provide	Is the company's debt load excessive?
Times interest earned	$\frac{\text{Net income + Interest + Taxes}}{\text{Interest expense}}$	Ability to pay fixed charges for interest from operating profits	Are earnings and cash flows sufficient to cover interest payments and some principal repayments?
Cash flow to liabilities	$\frac{\text{Operating cash flow}}{\text{Total liabilities}}$	Total debt coverage General debt-paying ability	Are earnings and cash flows sufficient to cover interest payments and some principal repayments?

owners, managers and creditors. More important than the simple calculation of formulas are the categories that explain what each ratio measures and what each ratio tells an entrepreneur.

Ratio analysis can be applied from two directions. **Vertical analysis** is the application of ratio analysis to one set of financial statements. Here an analysis 'up and down' the statements is done to find signs of strengths and weaknesses. **Horizontal analysis** looks at financial statements and ratios over time. In horizontal analysis, the trends are critical: Are the numbers increasing or decreasing? Are particular components of the company's financial position getting better or worse?[17]

PERFORMANCE TOOLS FOR SUSTAINABLE ENTREPRENEURS

In addition to the financial performance measures just described, entrepreneurs now can find a variety of planning, strategy and performance tools to use in launching and evaluating new sustainable ventures.

Life Cycle Assessment (LCA)

Life-cycle costing is a method of cost account that looks at a product's entire value chain from a cost perspective. Other types of costing generally look only at the production process, whereas life-cycle costing tracks and evaluates costing from the research and development phase of a product's life, through to the decline and eventual conclusion of a product's life.[18] The entrepreneur inputs data and other project information at the 'front end' of the model, such as applicable utility tariff information, project costs, energy savings and operations and maintenance cost information as appropriate. The engine of the model then calculates a cash flow stream based on the data and information inputs, and produces economic evaluation information, such as the internal rate of return, net present value of the cash flows, simple and actual paybacks and more importantly, debt coverage ratios. There is a variety of LCA spreadsheets downloadable from the Internet.

Design for the environment (DFE)

Designing products with sustainability in mind means being able to measure the potential impacts so that these 'wastes' can be 'designed out' at the beginning of the product's life cycle. This could involve choosing biodegradable materials over non-biodegradable materials, using renewable energy sources in the manufacturing process and making sure the product is recyclable at the end of its useful life. Design approaches that attempt to reduce the overall environmental impact of a product, process or service has a number of business benefits: (1) the bottom line – cuts raw material and waste disposal costs; (2) innovation – encourages good design and drives innovation; (3) customer expectations – meets user needs/wants by exceeding current expectations for price, performance and quality; (4) enhanced reputation – demonstrating good environmental performance can enhance the company's standing with shareholders, investors and other stakeholders; (5) improvements in workplace health and safety – through reduced waste and emissions; (6) increased staff morale – there is a growing awareness among staff that businesses play an important role in working towards sustainable development, which can provide a strong personal incentive to pursue DFE; and (7) environmental performance of products – reduces the environmental impact of products throughout their life cycle (see also Experiential Exercise 'Clean Green Factory', pages 96–7).

Factor X

Factor X relates to eco-efficiency (doing more with less) as originally defined by the World Business Council for Sustainable Development. Factor 4 is doubling the output while halving the impact, or quadrupling the output for the same impact, or producing the same amount for 25 per cent of the impact. Factor 10 ranges from 10 times the output for the same impact to the same impact for 10 per cent of the output. This is associated with the concept introduced in the 1998 book, *Factor 4,* written by L. Hunter Lovins and Amory Lovins of the Rocky Mountain Institute, and Ernst von Weizsäcker, founder of the Wuppertal Institute for Climate, Environment & Energy.[19] *Factor 4* explained how relatively easy it was for businesses to achieve Factor 4 results (four times the efficiency of materials and energy use) with existing technologies. It has many examples of real-world projects that save money and reduce pollution simultaneously.

EMS, ISO 14 000, Clean Production

The concept of an Environmental Management System (EMS) is connected to the implementation of ISO 14 000 standards. EMS serves as a tool to improve environmental performance and provides a systematic way of managing a firm's environmental affairs. An EMS follows a Plan-Do-Check-Act Cycle, or PDCA. The model is continuous because an EMS is a process of continual improvement in which an organisation is constantly reviewing and revising the system. ISO stands for the International Standards Organization, located in Geneva, Switzerland. ISO 14000 refers to a family of voluntary standards and guidance documents to help organisations address environmental issues. Included in the family are standards for EMS, environmental and EMS auditing, environmental labelling, performance evaluation and life-cycle assessment. The concept of Clean Production, originally developed under the Kyoto Protocol, was to help industrialised countries meet their obligations for the reduction of greenhouse gases. It involved mechanisms to assist developing countries, which had no history of producing large quantities of greenhouse gases, to avoid copying the mistakes of the past and was described as one contribution to long-term sustainable development of the recipient country. Clean Production is one of the essential components of a favourable LCA.

Environmental impact assessment (EIA)

An environmental impact assessment (EIA) is an assessment of the possible impact – positive or negative – that a proposed project may have on the natural environment. The purpose of the assessment is to ensure that decision makers consider the ensuing environmental impacts to decide whether to proceed with the project. There are a variety of tools under EIA: (1) the impact inventory assesses areas and indicators (economic, environmental and social); (2) the model inventory assesses whether a policy proposal can be assessed and quantified using existing models; and (3) the good practice inventory displays the stages of impact assessment, from description of the problem to stakeholder consultation.

Material flow analysis (MFA)

Material flow analysis (MFA) (also known as substance flow analysis; SFA) is a method of analysing the flows of a material in a well-defined system. MFA is an important tool of industrial ecology, and is used to produce better understanding of the flow of materials through an industry and connected ecosystems, to calculate indicators and to develop strategies for improving the material flow systems. Material Flow Analysis is the basis for a material flow management.

MET Matrix

A MET (Materials, Energy and Toxicity) Matrix is an analysis tool used to evaluate various environmental impacts of a product over its life cycle. The tool takes the form of a 3x3 matrix with descriptive text in each of its cells. One dimension of the matrix is composed of a qualitative input–output model that examines environmental concerns related to the product's materials use, energy use and toxicity. The other dimension looks at the life cycle of the product through its production, use and disposal phase. The text in each cell corresponds to the intersection of two particular aspects. This means that by looking at certain cells you can examine aspects such as energy use during the production phase, or levels of toxicity that may be a concern during the disposal phase.[20]

TRIPLE BOTTOM LINE PERFORMACE MEASURES Climate change has suddenly exploded onto the agenda of financial disclosure statements – at least in the US. Companies are now talking about climate change both positively (touting their own progress on emissions reductions) and negatively (disclosing the ways in which climate change can hurt the bottom line).

Sustainable development performance looks at three areas: people (social), planet (environment) and profits (economic). The phrase 'Triple Bottom Line' was coined by John Elkington in 1994.[21] It was later expanded and articulated in his 1998 book *Cannibals with Forks: The Triple Bottom Line of 21st Century Business*.[22] In its broadest sense, the Triple Bottom Line captures the spectrum of values that organisations must embrace – economic, environmental and social. In practical terms, the Triple Bottom Line performance measure means expanding the traditional company reporting framework to take into account not just financial outcomes but also environmental and social performance.

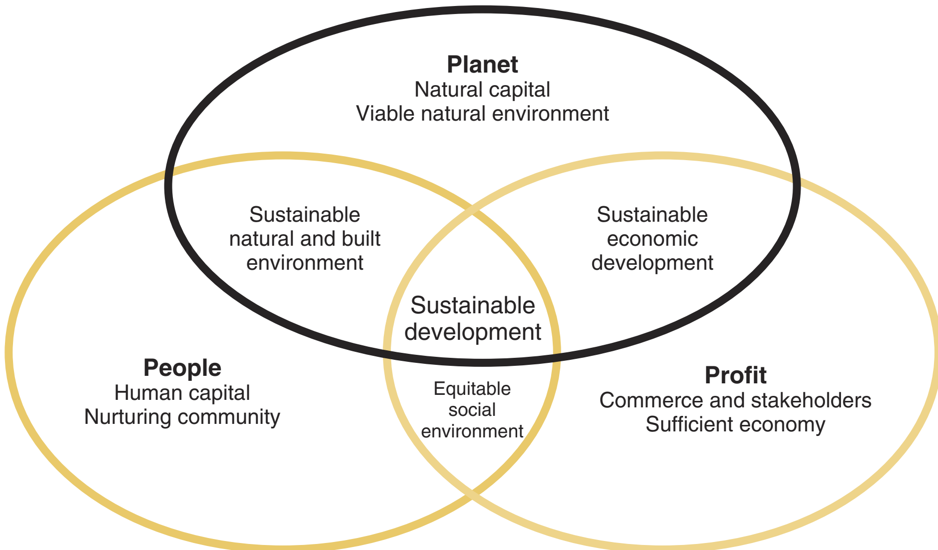
Let's have a look at the meat industry. By the standards of traditional financial accounting, a meat producer really has no need to 'account for' environmental impact. The company merely passes these costs onto the planet, the government and the individual consumer. Market prices for beef do not reflect the full environmental costs of production. Producing a single kilo of beef typically takes around 10 kilos of grain and requires an incredible 100 000 litres of water.[23]

There are various trade-offs that have to be calculated into the bottom line. A single bag of rice that you can buy for $2.50 at the store requires 21 000 litres of clean water, but it generates 50 per cent more jobs than the average calculated for the entire economy. Private services such as lawyers have little environmental impact, but they don't contribute to exports. Mining actually has a more positive environment and financial impact than expected, but the social indicators are well below average.[24]

The **Triple Bottom Line** (or 'TBL', '3BL', or 'People, Planet, Profit') goes beyond financial accounting to measure the performance of a variety of values and criteria for organisational ecological and social success. One of the most important differences with financial accounting is that TBL looks at a company's **stakeholders**, not just its **shareholders**. A stakeholder is broadly defined as someone who is influenced, either directly or indirectly, by the actions of the firm. (Some advocate that it should be any living being, including animals.) The Triple Bottom Line concept is made up of three intersecting circles: People, Planet and Profit.[25] Compare this to the 'Five Capitals Model' of sustainable development (see Figure 8.1).

- 'People' means Human Capital. It means treating both employees and the community fairly and usefully. TBL means that a company sees the wellbeing of all stakeholders as interdependent. That means 'upstreaming' the benefits to the original producer and 'downstreaming' the benefits to the community. Quantifying this bottom line is relatively new, problematic and often subjective. The Global Reporting Initiative (GRI) has developed guidelines to enable corporations and NGOs alike to comparably report on the social impact of a business.
- 'Planet' refers to Natural Capital and it implies that a TBL firm is actively working towards sustainable environmental practices by doing as much as possible to benefit the planet and/or at the least doing no harm to the environment. A TBL seeks to tread lightly in terms of its ecological footprint; for example, in energy consumption, use of non-renewables, reduction of waste and safe disposal of toxics. TBL firms

FIGURE 11.5: THREE PILLARS OF SUSTAINABLE DEVELOPMENT



must avoid ecologically destructive practices such as relentless resource extraction without regard to sustainability. These 'planet' metrics are better developed than the social ones.

- Profit means Financial and Manufactured Capital and is at the core of all commerce, but profit in this sense goes beyond individual shareholders and includes the economic benefit enjoyed by stakeholders. It is the enduring economic impact that the firm has on its broader environment. This is what separates a TBL approach from what we have discussed up until now in this chapter.

At the centre of this approach lies **sustainable development**, which seeks to produce economic growth and social development while ensuring future generations' ability to do the same by not exceeding the regenerative capacity of nature.

Concrete performance measures for TBL accounting are being developed. These include: life-cycle analysis; gap analysis, such as eco-efficiency ratios and measures; econometric models to evaluate the relative performance of environmental programs; industrial ecology and supply chain linkages; measures of the company's impact on global warming by tracking emissions; identifying sources of greenhouse gas and setting performance targets on reduction; and using an internal carbon dollar value in investment decision making. Well-developed indicators serve multiple purposes for business. They:

- are a management tool that provides the focus for continuous improvement efforts
- set expectations for systematic rather than ad hoc assessment of outcomes
- guide policies and decision-making at different levels of an organisation
- are practical tools and reproducible
- strengthen public accountability by addressing the needs and expectations of external stakeholders.[26]

Global Reporting Initiative has published the most comprehensive set of **TBL indicators** from which entrepreneurs can select the most relevant for their business.[27]

>>ENTREPRENEURSHIP
IN PRACTICE

THE PRICE OF PALM OIL

Palm oil has been touted as the way out of poverty for millions of people in Southeast Asia and the Pacific. Indeed, an entire middle class has emerged as a result of the entrepreneurial and risk-taking efforts of farmers and government in Malaysia, Indonesia, Papua New Guinea and elsewhere. Especially in Indonesian Borneo, thousands of square kilometres of tropical hardwood forest are being cleared for palm oil plantations. This has resulted in massive uncontrolled forest fires plunging Southeast Asia into haze and leading to an international crisis with Malaysia. Here is what the Australian Conservation Foundations says about the impact of palm oil farming.

- **Biodiversity**. Palm oil is a land-intensive industry and any expansion in PNG will almost surely mean the clearing of forest. With the loss of the forest, primary or secondary, habitat for PNG plants and animals also shrinks. The vast majority of PNG native plant and animal species are unlikely to survive long in an oil palm plantation.
- **Land degradation**. The clearing of land to plant oil palm results in erosion of top soils with the rains. Further, oil palm sucks enormous amounts of nutrients from the soil. The combined effects of erosion and nutrient depletion mean that the land will be virtually useless for other plants (native or agricultural) after the oil palm plantation is abandoned.
- **Pollution**. As is the case with most crops of only one species, oil palm is very vulnerable to pests. Large quantities of pesticides and herbicides are required to maintain the plantation. Fertiliser is also used on a large scale to meet the nutrient needs of the palms.
- **Waterway degradation**. Soil, fertiliser, pesticides and fertiliser all run into the rivers with the rains, with the potential to harm river species and local marine environments, especially coral reefs.
- **Loss of livelihood and lifestyle**. The growing, collecting and hunting of food is an important part of PNG culture. Women sell goods in village markets, which is a valued time for socialising with other village women. When customary lands are converted to oil palm many of these age-old traditions are rendered obsolete. Without land for farming, families become dependent on the wage from the plantations to buy food from expensive supermarkets. Some men spend their wages on drinking and gambling, which can cause family disputes.
- **Cultural and family breakdown**. Often there is disagreement over oil palm projects. Sometimes customary land boundaries are crossed in the establishment of oil palm plots. In other instances disputes arise from the conversion of land that has been traditionally used for communal benefit to uses which benefit only those working for the palm oil company. This sudden introduction of a cash economy introduces stark inequalities among villagers. Further downstream other communities bear the brunt of waterway pollution, another source of communal conflict.

Source: Australian Conservation Foundation, 'Oil Palm in PNG', www.acfonline.org.au/default.asp?section_id=96

(See also 'Trouble with Palm Oil', page 75).

New Zealand and Australia are leaders in Triple Bottom Line reporting.[28] The University of Sydney's *Balancing Act* report uses the well-developed analytical approach of 'generalised input–output analysis' to develop a numerate Triple Bottom Line account of the Australian economy for three financial, three social and four environmental indicators. This is an accounting procedure that documents all monetary flows to and from discrete economic sectors and covers all traditional economic activity in an economy. *Balancing Act* produced an analysis of 135 sectors of the Australian economy and assessed each against 10 benchmark indicators of social, financial and environmental sustainability. It is now possible to compare the end impact on the ecology of everything from confectionary and cooking oils to museums and mining.[29] For each sector there is a measure of how much energy, water, land, employment (and so on) is embodied in every dollar in the Australian economy.

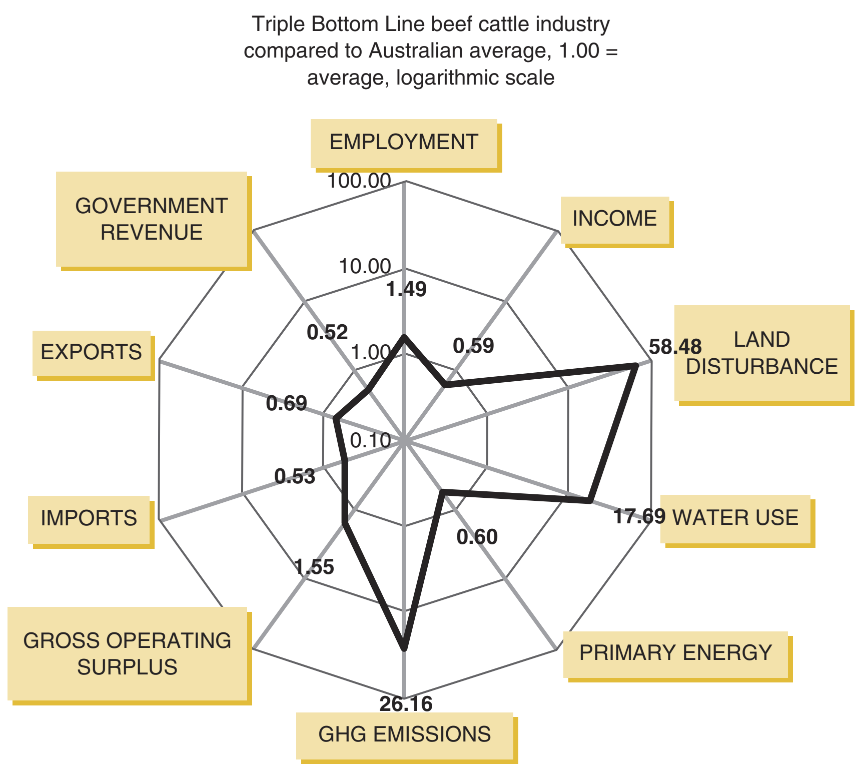
One interesting way to analyse the Triple Bottom Line is the use of spider diagrams. All the data are normalised. The bold line links the circles depicting the total (direct and upstream) requirements for each factor. The lighter line forming a polygon in the centre represents economy-side averages for the requirements of all sectors. If the bold line falls inside the inner polygon, then that factor is doing better than average; if it falls outside, it's doing worse than average. The analysis for each sector is quoted from *Balancing Act* and includes the distillation of key opportunities for technological improvement. Table 11.15 describes the chosen TBL indicators used by the Australians.

TABLE 11.14: TRIPLE BOTTOM LINE INDICATORS USED IN THE SPIDER DIAGRAMS

Primary energy (MJ)	Combustion of all non-renewable fuels
Greenhouse gas emissions (kg CO_2-e)	Carbon dioxide equivalent impact of all gases affecting climate
Water use (L)	Consumption of all mains and self-extracted surface water
Land disturbance (hectares – ha)	Land use, weighted by intensity of impact
Imports (m$)	Value of all goods and services purchased from foreign residents
Exports (m$)	Australian production destined for consumption outside Australia
Surplus (m$)	Operating profits and expenditure on fixed capital
Government revenue (m$)	All taxes less subsidies
Employment (hours)	Full time equivalent employment
Income (m$)	Total compensation for employees

Source: Barney Foran, Manfred Lenzen and Chirs Dey, *Balancing Act: A Triple Bottom Line Analysis Of The Australian Economy*, Centre for Integrated Sustainability Analysis @The University of Sydney, Vol. I, 2005: 28

FIGURE 11.6: TBL ANALYSIS OF THE AUSTRALIAN MEAT INDUSTRY



11 FREDERICK 9780170181570 TXT.indd 415 10/16/09 4:55 PM

ANALYSIS: The environmental indicators per dollar of final demand show greenhouse emissions are 26 times the economy-wide average, water use 18 times and land disturbance 58 times the average. The social indicators show that employment generation is 50 per cent above average, while income and government revenue are 40 per cent and 50 per cent below average, respectively. The financial indicator of surplus is 55 per cent above average, while export propensity and import penetration are 30 per cent and 50 per cent below average respectively. Over the next 50 years Australian beef production may double and this could further inflate environmental indicators. The combination of Western diets, intensive production systems and globalised trade give strong demand for beef products, but market prices do not reflect the full environmental costs of production. The sector is critically important to many regional areas and national export income. There are regional opportunities to design and market beef production systems with lower environmental indicators.

TABLE 11.15: ORGANISATIONS DEVELOPING TRIPLE BOTTOM LINE STANDARDS AND GUIDELINES

Global Reporting Initiative Sustainability Reporting Guidelines	Guidelines from a multi-stakeholder body affiliated with the United Nations	www.globalreporting.org
Standards New Zealand	AS/NZS ISO 14000 Series – Environmental management systems	www.standards.co.nz/news/Standards+information/Environmental/default.htm
Centre for Integrated Sustainability Analysis at the University of Sydney	Leading-edge research and applications for environmental and broader sustainability issues	www.isa.org.usyd.edu.au/
Australian Department of the Environment & Heritage	Australian guidelines for environmental reporting of organisations	www.deh.gov.au/industry/corporate/reporting
The Equator Principles	A collection of banks establishing principles for social and environmental assessment for the financing of projects	www.equator-principles.com www.ifc.org
The Global Compact	A voluntary corporate citizenship initiative aiming to advance TBL principles.	www.unglobalcompact.org
World Business Council for Sustainable Development (WBCSD)	A coalition of 160 international companies with a shared commitment to sustainable development, producing reports and business guides	www.wbcsd.org
Greenhouse Gas Protocol Initiative (GhgProtocol)	Multi-stakeholder group including NGOs and governments, co-convened by World Resources Institute (WRI) and the WBCSD	www.ghgprotocol.org
SIGMA Project – Sustainability – Integrated Guidelines for Management	UK-based partnership providing guidelines and toolkits for examining TBL themes	www.projectsigma.com/
Social Accountability International	SAI is a US-based, non-profit organisation developing voluntary verifiable social accountability standards	www.cepaa.org
Insurance Australia Group		www.iag.com.au

Ecological footprinting

The ecological footprint is a measure of human demand on the Earth's ecosystems. It compares human demand with the Earth's ecological capacity to regenerate. It represents the amount of biologically productive land and sea area needed to regenerate the resources a human population consumes and to absorb and render harmless the corresponding waste.

SUSTAINABILITY PERFORMANCE MEASURES

>>ENTREPRENEURSHIP IN PRACTICE

CARBON FOOTPRINTS

For an entrepreneur wanting to do the right thing by the environment, it's useful to calculate the firm's carbon footprint. That means expressing all business activities in their carbon dioxide equivalent emissions, which gives the firm a way to measure its environmental impact and track progress in adopting sustainable business practices.

The Greenhouse Gas Protocol (GHG Protocol) is the most widely used international accounting tool for government and business leaders to understand, quantify, and manage greenhouse gas emissions. Several methodologies are being used and while they all talk about the same set of emissions, they differ in their boundary definitions.

Different business sectors are dominated by different types of emissions. Those in office-based and service-sector industries, such as accounting firms and other consultancies, will find most of their greenhouse gas emissions come from taxis, transport, flights and outsourcing. On the other hand, manufacturing businesses (for example, aluminium, cement, iron and steel, pulp and paper, refrigeration, semiconductors, wood products) differ greatly in their energy emissions.

On the surface, the task of calculating looks easy enough. However, there are some complexities, such as the fact that greenhouse gas emissions actually differ between countries, even between States and Territories, due mainly to the fuel types and sources used to generate electricity. For example, the Australian State of Tasmania has lower electricity emissions factors than other Australian States because most of its electricity is sourced from hydro-electric power, a relatively low GHG-emitting power source.

How do you get started? This can be as straightforward as using one of the carbon calculators applicable for smaller businesses. The standard emissions categories are energy, fuel, business travel (by vehicle, public transport and air), office space and contents, waste, water and sewerage and food. The calculators work on the dollar spent or quantity purchased in a particular timeframe.

CARBON FOOTPRINT CALCULATORS

- >> Greenhouse Gas Protocol Initiative, www.ghgprotocol.org/calculation-tools/service-sector
- >> Australia: Sydney University Centre for Integrated Sustainability Analysis, www.isa.org.usyd.edu.au/
- >> Australia including Papua New Guinea and Fiji: One Degree (News Limited), http://1degree.com.au/carbon_calculator
- >> Australia: Carbon Reduction Institute, http://noco2.com.au/
- >> Australia: Department of the Environment, Water, Heritage and the Arts, http://www.environment.gov.au/settlements/gwci/calculator.html
- >> Malaysia: Green Journey Malaysia Airlines, www.greenjourney.com.my/about_cc.html
- >> Malaysia: Star Publications (M) Bhd The Star Online > Directory > Science > Environment > Carbon Cycle > Carbon Management
- >> New Zealand: Business Council for Sustainable Development, www.nzbcsd.org.nz
- >> New Zealand: Catalyst R&D ACE Calculator, www.sustainable.org.nz
- >> US: The Clean Planet Trust, www.puretrust.org.uk/Home/Business/Calculator.aspx

FOOD OR PRODUCT MILES

The food in an Australian's shopping basket may have travelled a staggering 70 803 kilometres to reach Melbourne – equivalent to almost two trips around the world.[30] Those food miles take a toll on the environment, through greenhouse gas emissions from road, air and sea freight. Food miles is a term which refers to the distance food (or any product) is transported from the time of its production until it reaches the consumer. But the concept has also been translated into other types of products such as timber miles (for example, Brazilian hardwoods), steel miles (for example, iron ore from Australia through China to the end user) and chocolate miles (for example, cocoa beans from West Africa through Belgium to the rest of the world). One claim heard in UK supermarkets is protein miles; for example, New Zealand lamb to the European market. However, according to one study, New Zealand claims it has greater production efficiency in many food commodities

>>

compared with the UK (fewer fertilisers and animals able to graze year-round outside). In the case of the dairy industry, New Zealand is twice as energy efficient, even including transport cost, than the UK.[31]

Here is the calculation of Cadbury's Chocolate bought in Melbourne, Australia:

Cocoa beans
Kolaka, Sulawesi to Makassar, Sulawesi = 463.00km
Makassar, Sulawesi to Singapore = 1926.08km
Singapore to Melbourne = 7163.54km
Melbourne to Hobart = 877.90km
Hobart to Claremont, Tasmania = 14.22km
Total distance (Sulawesi to Claremont, Tasmania) = 10 444.72km

Milk
Burnie, Tasmania to Claremont, Tasmania = 283.26km

Sugar
Mackay, Qld to Hobart (assumed to be shipped from Mackay) = 2844.67km=
Hobart to Claremont = 14.22km
Total distance (Mackay to Claremont) = 2858.89km

Chocolate bars
Claremont to Hobart = 14.22
Hobart to Melbourne = 877.90km
Total distance (Claremont to Melbourne) = 892.12km
Total average distance for chocolate bars = 14 479.01km

SOCIAL IMPACT ANALYSIS

As part of their reporting, companies can quantify and monetise the *social impact* of a product or service. The methodology for measuring, managing and communicating social and environmental impact is the Social Impact Assessment (SIA). The output measure of the Social Impact Assessment process, the Social Return on Investment (SROI), should be viewed not as a discrete metric, but as part of a larger picture on how to report and improve social value creation. Social impact is any non-financial benefits that a venture will create for society that would otherwise not be created.

According to the World Bank, SIA is based on stakeholder analysis and is particularly useful for disaggregating data on assets (physical, financial) and capabilities (human, organisational) into meaningful social categories. When reasonable national survey data exists, SIA uses a range of qualitative data collection tools (for example, focus groups, semi-structured key informant interviews, ethnographic field research, stakeholder workshops) to determine impacts, stakeholder preferences and priorities and constraints on implementation. In the absence of adequate quantitative data, SIA supplements qualitative, sociological impact analysis with purposive surveys that capture direct impacts and behavioural responses to reform, or specific dimensions (for example, time-use patterns) that affect reform outcomes. The New Economic Foundation has pioneered the use of SROI as a method of proving the wider social value created by companies and organisations with a social purpose.[32] SROI measures the value of the benefits relative to the costs of achieving those benefits. It is a ratio of the net present value of benefits to the net present value of the investment. For example, a ratio of 3:1 indicates that an investment of $1 delivers $3 in social value.

[SROI] = [Net present value of benefits] / [Net present value of investment]

SUMMARY

We began by emphasising the need for performance measures in an entrepreneurial company. These traditionally have been limited only to bottom-line indicators that tell the shareholder how well the company is doing financially without regard to other factors such as society or the environment.

We then described the principles of traditional financial accounting to entrepreneurs. In the first instance, three principal financial statements are important to entrepreneurs: the balance sheet, the income statement and the cash-flow statement. The budgeting process facilitates financial statement preparation. Some key budget forecasts that entrepreneurs should prepare are the operating budget, the cash-flow budget and the capital budget. The operating budget typically has various kinds of forecasts, such as sales expense, production and operating forecasts. A cash-flow budget provides an overview of the inflows and outflows of cash during a specific period. Pro forma financial statements then are prepared as projections of the firm's financial position over a future period (pro forma income statement) or on a future date (pro forma balance sheet). The operating and cash-flow budgets often are used to prepare these pro forma statements. The capital budget is used to help entrepreneurs make investment decisions. The three most common methods of capital budgeting are the payback method, the net present value method and the internal rate of return method.

Another commonly used decision-making tool is break-even analysis, which tells how many units must be sold in order to break even at a particular selling price. It is possible to use this analysis even when fixed or variable costs can only be estimated. We then examined the tax burden in the Asia–Pacific. Ratio analysis can be a helpful analytical tool for entrepreneurs. Ratios are designed to show relationships between financial statement accounts.

Finally, we focused on the new form of performance measurement called 'Triple Bottom Line' accounting that goes beyond financial accounting and has three areas of impact: Planet, People and Profit. We examined some of the new forms of concrete performance measures that have been developed, particularly from Australia. These included carbon footprints and food miles.

KEY TERMS & CONCEPTS

accounts payable
accounts receivable
accrual system of accounting
administrative expenses
allowance for uncollectible accounts
bank loan
break-even analysis
budget
capital
capital budget
capital budgeting
carbon footprint
carrying capacity
cash
cash flow
cash-flow budget
cash-flow statement
common shares
contribution margin approach
cost of goods sold (cogs)
current assets
current liabilities
debt servicing
depreciation
dividends
equity
expenses
financial expense
financial ratio analysis
financial statement
fixed assets
fixed cost
food miles
gross margin
gross profit
horizontal analysis
income statement
interest
internal rate of return (IRR) method
inventory
investing activities
investment
liabilities
linear regression
loan payable
long-term liabilities
mixed costs
net income
net present value (NPV) method
net profit
net worth
note payable
operating budget
operating cash flows
operating expenses
owners' equity
payback method
preferred shares
prepaid expenses
pro forma statements
profit and loss statements
retained earnings
revenues
sales forecast
selling expenses
shareholders
short-term liabilities
social impact assessment
Social Return on Investment (SROI)
stakeholder
sustainable development
taxes payable
Triple Bottom Line
time value of money
variable cost
vertical analysis
working capital

REVIEW & DISCUSSION QUESTIONS

1 What do we mean by performance measures? What are the traditional ones? Why do we need to look beyond these now?
2 What is the importance of financial information for entrepreneurs? Briefly describe the key components.
3 What are the benefits of the budgeting process?
4 How is the statistical forecasting technique of simple linear regression used in making a sales forecast?
5 Describe how an operating budget is constructed.
6 Describe how a cash-flow budget is constructed.
7 What are pro forma statements? How are they constructed? Be complete in your answer.
8 Describe how a capital budget is constructed.

9 One of the most popular capital-budgeting techniques is the payback method. How does this method work? Give an example.

10 Describe the net present value method. When would an entrepreneur use this method? Why? Make up an example similar to the Indian entrepreneur featured in the entrepreneurship in practice box entitled, 'The Indian entrepreneur and the cunning NPV'.

11 Describe the internal rate of return method. When would an entrepreneur use this method? Why?

12 When would an entrepreneur be interested in break-even analysis?

13 If an entrepreneur wants to use break-even analysis, but has trouble assigning some costs as either fixed or variable, can break-even analysis still be used? Explain.

14 What is ratio analysis? How is horizontal analysis different from vertical analysis?

15 What do we mean by Triple Bottom Line accounting? What are its key components and how are they interlinked?

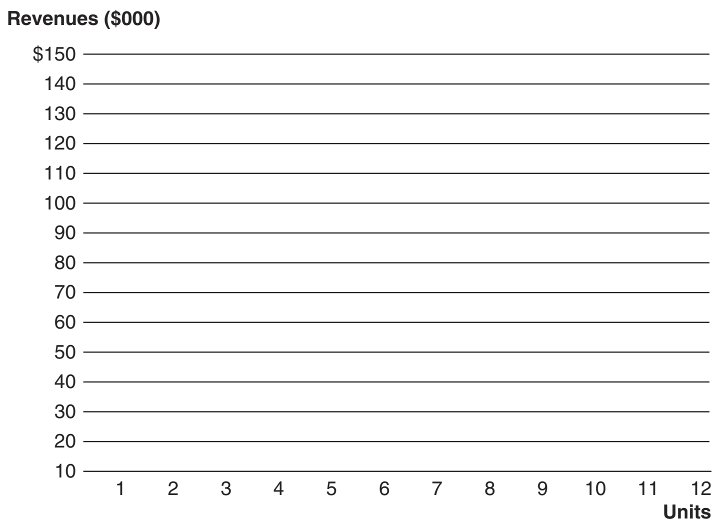
16 What are the main purposes of Triple Bottom Line accounting?

EXPERIENTIAL EXERCISE:
THE PROJECT PROPOSAL

Bill Sergent has just received a request for a proposal from a large computer firm. The firm is looking for a supplier to provide it with high-tech components for a super computer being built for the Department of Defence. Bill's firm, which is only eight months old, was founded by a group of scientists and engineers whose primary expertise is in the area of computers and high technology. Bill is thinking about making a reply to the request for a proposal, but first he wants to conduct a break-even analysis to determine how profitable the venture will be. Here is the information he will be using in his analysis:

- The computer firm wants 12 different components built and the purchase price will be $10 000 per component.
- The total cost of building the first component will be $20 000.
- The cost of building each of the 11 other components will be $8000, $6000, $5000, $4000, $5000, $6000, $8000, $10 000, $28 000, $40 000 and $40 000, respectively.
- Bill's company will not accept any proposal that will give it less than a 10 per cent return on sales.

On the basis of this information, complete the following break-even chart and then answer the two questions.



1 Should Bill bid on the contract? Why or why not?

2 If Bill has some room for negotiation with the computer firm, what would you recommend he do? Why?

EXPERIENTIAL EXERCISE:
HOW TO CALCULATE FOOD MILES

'Food miles' is a term used to measure the transport distance travelled by food products between production and consumption. It can be measured in miles or kilometres. Food miles is one part of a larger complete life-cycle assessment required to compare the sustainability of individual items in food systems and must not be viewed independently of the energy used in each chain in our food system. To estimate how far food products have travelled, contact industry bodies and companies who can provide the most common points of origin, along with any processing points, specifically for your market. Road distance and port-to-port distance calculators are available online. In the table below you will see examples of how to calculate food miles to Melbourne, Australia for chocolate bars and tin cans. In the right hand column, calculate the food miles to your own locale of milk cartons and another product of your choice.

CHOCOLATE BARS TO MELBOURNE	MILK CARTONS TO YOUR LOCALE
Assumptions: According to Cadbury, cocoa beans first to Singapore from Indonesia. It was assumed that this was from South East Sulawesi, Indonesia. The milk chocolate bar is manufactured in Claremont, Tasmania, sourcing milk from Burnie, Tasmania and sugar from Mackay, Queensland.	Assumptions: Tetrapak's long-life milk packaging is produced in Singapore and their standard milk packaging is produced in Taiwan.
Distance calculations:	Distance calculations:
Cocoa beans	
Kolaka, Sulawesi to Singapore = 2389km Singapore to Melbourne = 7163km Melbourne to Hobart = 877km Hobart to Claremont, Tasmania = 14km Total distance (Sulawesi to Claremont) = 10 444.72km	
Milk	
Burnie, Tasmania to Claremont, Tasmania = 283km	
Sugar	
Mackay, Qld to Hobart (assumed to be shipped from Mackay) = 2844km Hobart to Claremont = 14.22km	
Chocolate bars	
Claremont to Hobart = 14km Hobart to Melbourne = 877.km	
Total distance (Claremont to Melbourne) = 892.12km	
Total average distance for chocolate bars = 14 479km	Total average distance for milk cartons:
TIN CANS	**PICK A PRODUCT TO YOUR LOCALE**
Assumptions: In the production of tin cans iron ore and coke (coal) are mined in Western Australia and then sent to Japan for the manufacture of tin plates. Sheets of tin plates are then sent back to Melbourne to be turned into cans. The cans are then sent to the various canning points for the different foods. For food tinned in other countries the food kms would be higher still.	Assumptions:
Distance calculations:	Distance calculations:
Perth to Japan (Hidaki Port) = 7785km Japan (Hidaki Port) to Melbourne = 9285km	
Total distance = 17 107km	

Source: Sophie Gaballa & Asha Bee Abraham, 'Food Miles in Australia: A preliminary study', Melbourne, Victoria. Updated March 2008, www.ceres.org.au/projects/CERES_Report_%20Food_Miles_in_Australia_March08.pdf

CASE 11.1:
IT'S ALL GREEK TO HER

When Regina McDermott opened her car repair shop in Melbourne, she thought her 15 years of experience with cars was all she would need. To a degree she was right. Within six months her shop had more work than it could handle, thanks to her widening reputation. At the same time, however, Regina found it necessary to spend more and more time dealing with financial planning.

Three weeks ago her accountant came to see her to discuss finance-related matters. One of these is the need for cash budgeting. 'I can work up a cash budget for you', he explained. 'However, I think you should understand what I'm doing so you will realise the importance of the cash budget and be able to visualise your cash inflows and outflows. I think you also need to make a decision regarding the new equipment you are planning to purchase. This machinery is state of the art, but, as we discussed last week, you can buy a number of different types of machinery. You are going to have to decide which is the best choice.'

Regina explained to her accountant that she was indifferent about which equipment to buy. 'All of this machinery is good. Perhaps I should purchase the cheapest.' At this point the accountant explained to her that she could use a number of ways to evaluate this type of decision. 'You can base your choice on the payback method – how long it takes to recover your investment in each of these pieces of equipment. You can base it on net present value by discounting future cash flows to the present. Or you can base it on internal rate of return, under which the cash flows are discounted at a rate that makes the net present value of the project equal to zero.'

Regina listened quietly and when the accountant was finished, she told him, 'Let me think about the various ways of evaluating my capital investment and I'll get back to you. Then, perhaps, you and I can work out the numbers together'. Her accountant said this sounded fine to him and he left. Regina began to wish she had taken more accounting courses while in college. As she explained to her husband, 'When the accountant begins to talk, it's all Greek to me'.

Questions

1. What is the purpose of a cash-flow budget? What does it reveal? Of what value would it be to Regina?
2. How does the payback method work? How does the net present value method work? How would you explain each of these methods to Regina?
3. How does the internal rate of return method work? How would you explain it to Regina?

CASE 11.2:
THE CONTRACT PROPOSAL

Dennis Darby owns a small manufacturing firm that produces electronic components for use in helicopters. Most of his business is a result of military and aircraft manufacturer contracts, although 10 per cent of revenues come from firms that own or rent helicopters. The latter are typically large companies or leasing/rental firms that work on a contractual basis for clients.

Dennis would like to increase his revenues from sales to private companies that own their own helicopters. Specifically, he would like to do more business with oil companies that maintain helicopter fleets for ferrying people to and from oil rigs in the Timor Sea off Darwin and other offshore locations. Early this week, Dennis received a request from an oil company for 120 electronic components. He turned the order over to his chief estimator, who estimates that the fixed costs associated with producing these components will be $35 000, the unit variable cost will be $400 and the unit selling price will be $800.

Dennis will not accept any order on which the return on sales is less than 20 per cent. Additionally, the estimator has told him that a $1000 expense can be classified as either fixed or variable. Dennis intends to take this information and make a decision whether to accept the contract from the oil company. He has to make a decision within the next three days.

Questions

1 What is the break-even point for this project? Will the company make money if it manufactures the components? Show your calculations.
2 If the project will be profitable, will it provide Dennis with the desired 20 per cent return? Explain.
3 Of what value is break-even analysis to Dennis? Be complete in your answer.

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Author(s): Ricardo Reisen De Pinho, Robert S. Kaplan
Product number: 9-107-038

This case describes the challenges of using the Balanced Scorecard to implement a Triple Bottom Line strategy for delivering excellent economic, environmental and social performance. The owners and senior executive team of Amanco, a producer of plastic pipe and complete water treatment systems, want strong financial returns, but are also deeply committed to improving the environment and making a difference in people's lives. Robert Salas, CEO, wants a management system that communicates and motivates Amanco's three high-level goals. Initially, he creates a simple scorecard of measures, but he soon migrates to developing a strategy map and Balanced Scorecard that places economic, environmental and social objectives as the highest-level objectives. He faces the challenges of cascading the corporate Balanced Scorecard to operating units throughout Latin America and how to develop better measures of social and environmental impact. Salas must also address whether he can sustain Amanco's balanced strategy while entering the Brazilian market where he faces an entrenched and much larger competitor.

Innovation Killers: How Financial Tools Destroy your Capacity to do New Things

Publication date: 1 January 2008
Author(s): Clayton M. Christensen, Stephen P. Kaufman, Willy Shih
Product number: R0801F

Most companies aren't half as innovative as their senior executives want them to be (or as their marketing claims suggest they are). What's stifling innovation? There are plenty of usual suspects, but the authors point to three financial tools as key accomplices. Discounted cash flow and net present value, as commonly used, underestimate the real returns and benefits of proceeding with an investment. Most executives compare the cash flows from innovation against the default scenario of doing nothing, assuming – incorrectly – that the present health of the company will persist indefinitely if the investment is not made. In most situations, however, competitors' sustaining and disruptive investments over time result in deterioration of financial performance. Fixed- and sunk-cost conventional wisdom confers an unfair advantage on challengers and shackles incumbent firms that attempt to respond to an attack. Executives in established companies, bemoaning the expense of building new brands and developing new sales and distribution channels, seek instead to leverage their existing brands and structures.

Entrants, in contrast, simply create new ones. The problem for the incumbent isn't that the challenger can spend more; it's that the challenger is spared the dilemma of having to choose between full-cost and marginal-cost options. The emphasis on short-term earnings per share as the primary driver of share price and hence shareholder value creation, acts to restrict investments in innovative, long-term-growth opportunities. These are not bad tools and concepts in and of themselves, but the way they are used to evaluate investments creates a systematic bias against successful innovation. The authors recommend alternative methods that can help managers innovate with a much more astute eye for future value.

The Magic of Managing the Balance Sheet: How to Manage Working Capital

Publication date: 7 October 2008
Author(s): Karen Berman, Joe Knight, John Case
Product number: 6568BC

Astute management of the balance sheet is like financial magic – it allows a company to improve its financial performance even without boosting sales or lowering costs. This case teaches entrepreneurs how to manage the working capital area of the balance sheet to powerfully affect their company's profitability and cash position. This case is excerpted from 'Financial Intelligence for Entrepreneurs: What You Really Need to Know About the Numbers'.

Note on Low-Tech Marketing Math

Publication date: 17 December 1998
Author(s): Robert J. Dolan
Product number: 9-599-011

This case describes basic calculations useful in marketing analysis, break-even analysis and price-volume relationships.

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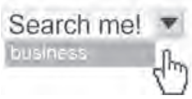


accounts payable
accounts receivable
accrual system
break-even analysis
cash flow
common shares
debt servicing
depreciation
dividends
equity
financial ratio
food miles
gross margin
gross profit
investment
liabilities
net present value
net worth
operating budget
preferred shares
revenues
sales forecast
sustainable development
Triple Bottom Line
time value of money
working capital

12

DEVELOPING A SUSTAINABLE BUSINESS PLAN

The future belongs to those businesses who play a proactive role in devising ways in which we can meet our commercial needs and sustain the world we live in.

The late Richard Pratt, CEO, Visy Industries, Melbourne, the largest private recycling company in the world[1]

chapter objectives

- **01** To define a sustainable business plan and demonstrate its value
- **02** To explore the business planning pitfalls that plague many new ventures
- **03** To describe the benefits of a business plan
- **04** To set forth the viewpoints of those who read a business plan
- **05** To emphasise the importance of coordinating the business plan segments
- **06** To review key recommendations by venture capital experts regarding a business plan
- **07** To present a complete outline of an effective business plan
- **08** To present some helpful hints for writing an effective business plan
- **09** To highlight points to remember in the presentation of a business plan
- **10** To underline some of the contrarian viewpoints on the importance of a business plan.

WHAT IS A SUSTAINABLE BUSINESS PLAN?

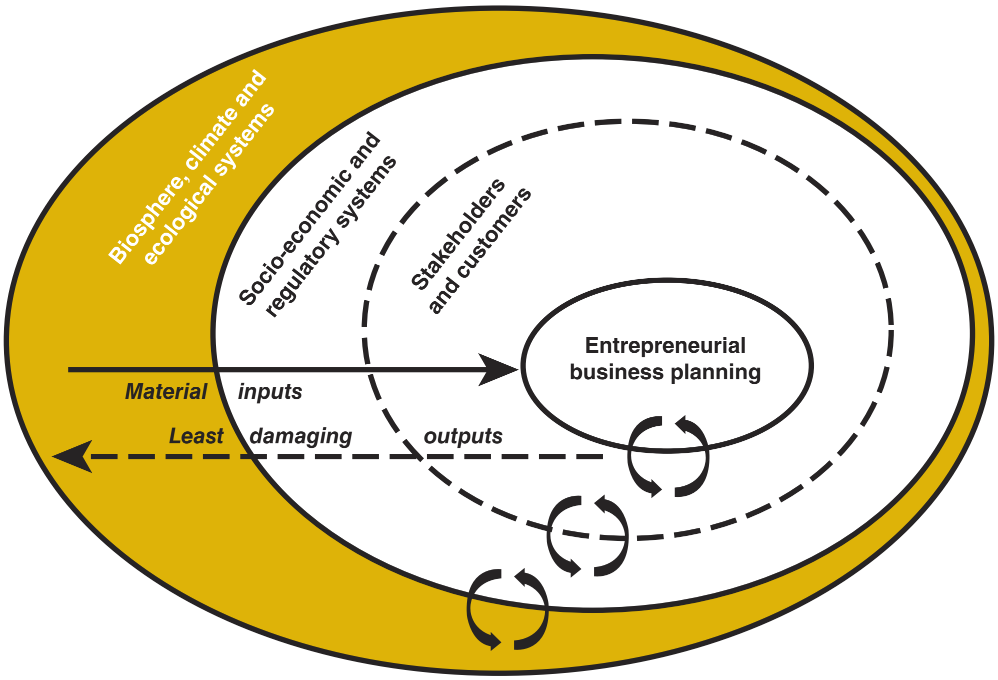
There is no longer any scientific doubt that close to two-thirds of the world's ecosystems are in serious decline.[2] Some maintain that we have only 50 years left in which turn this situation around.[3] With governments and organisations becoming more aware of their global environmental impacts, business planning is no longer just a straightforward exercise of making your business case, describing your operations, engaging a good management team and listing the financials. A fundable business plan now must include sections on greenhouse gases, energy use, clean power and other emissions-reducing strategies. Entrepreneurs should think about every impact the new business will have. What will people do with your product when they have finished using it? A good example are the millions of enormous conventional television sets that are accumulating in landfills and basements as people switch to wide-screen, high-definition TV. In today's business environment, the entire life cycle of the product should be considered – this is called a cradle-to-cradle approach (see Chapter 3).

This can be good for business. The economic logic is already here. **Sustainable development** and competitiveness can merge if enacted wisely, so that there is not an inevitable trade-off. This merger is motivated by the following six observations:

- Throughout the economy there are widespread untapped potential resource productivity improvements to be made and coupled with effective design.
- There has been a significant shift in understanding over the last three decades of what creates lasting competitiveness of a firm.
- There is now a critical mass of enabling technologies in eco-innovations that make integrated approaches to sustainable development economically viable.
- Since many of the costs of what economists call 'environmental externalities' are passed on to governments, in the long term sustainable development strategies can provide multiple benefits to the taxpayer.
- There is a growing understanding of the multiple benefits of valuing social and natural capital, for both moral and economic reasons and including them in measures of national wellbeing.
- There is mounting evidence to show that a transition to a sustainable economy, if conducted wisely, may not harm economic growth significantly. In fact, it could even lead to higher economic growth while at the same time reducing pressures on the environment and enhancing employment.[4]

What underlies sustainable business planning is the realisation that industrial systems (for example, a business, but also an eco-region, or even the economy) are not separate from the **biosphere**. An entrepreneurial firm is just a particular case of an ecosystem. The change in thinking today is that a business has both infrastructural capital *and* natural capital to spend. Ultimately natural systems have no 'waste' since everything is included in the framework. Business systems must model themselves after natural ones to be sustainable. This view, known as **industrial ecology,** views business as a series of interlocking ecosystems – some natural and some man-made (see Figure 12.1). The biosphere within which the climate and other ecological systems exist surrounds the socioeconomic and regulatory systems in which the firm operates. Within this are the stakeholders, including customers. At the core is the entrepreneurial firm engaged in business planning. Each of these ecosystems impinges interactively on its neighbours. Directly from the environment come the material inputs into the business process. Returning to the environment are the outputs of production or service. The goal is to pick the least burdensome environmental and social outputs when designing products and services. See also the sustainable business plan in the Appendix starting on page 600.

FIGURE 12.1: THE ECOLOGY OF ENTREPRENEURIAL BUSINESS PLANNING



THE BUSINESS PLAN AS A TOOL TO SUSTAINABILITY The comprehensive business plan is the major tool for determining the essential operation of a venture. It also is the primary document for managing the venture and raising funds for it. One of the major benefits of this plan is that it helps the enterprise avoid common pitfalls that often undo all previous efforts

A **business plan** is the written document that must describe current status, expected needs and projected results of the new business. Every aspect of the venture needs to be covered: the project, its sustainability, marketing, research and development, manufacturing, management, critical risks, financing and milestones or a timetable. A description of all of these facets of the proposed venture is necessary to demonstrate a clear picture of what that venture is, where it is projected to go and how the entrepreneur proposes it will get there. The business plan is the entrepreneur's roadmap for a successful enterprise.[5]

In some professional areas the business plan is referred to as a venture plan, a loan proposal, or an investment prospectus. Whatever the name, the business plan is the minimum document required by any financial source. The business plan gives the entrepreneur entrance into the investment process. Although it should be used as a working document once the venture is established, the major thrust of the business plan is to encapsulate the strategic development of the project in a comprehensive document for investors to read and understand.

The business plan describes all the events that may affect the proposed venture. Details are needed for various projected actions of the venture, with associated revenues and costs outlined. It is vital to state explicitly the assumptions on which the plan is based. For example, the effects of increases or decreases in the market or upswings or downswings in the economy during the start-up period of the new venture should be stated.

The emphasis of the business plan always should be the final implementation of the venture. In other words, it is not just the writing of an effective plan that is important, but also the translation of that plan into a successful enterprise.[6]

PITFALLS TO AVOID IN PLANNING

A number of pitfalls in the business plan process should be avoided. The six pitfalls include: Green theming, no realistic goals, failure to anticipate roadblocks, no commitment or dedication, lack of demonstrated experience and no market niche. These pitfalls represent the most common points of failure entrepreneurs experience before their business plans ever get reviewed. In other words, these critical areas must be carefully addressed before developing a business plan. If these pitfalls can be avoided then the entire business plan can be written more carefully and thus will be reviewed more thoroughly. This preparation helps entrepreneurs establish a solid foundation on which to develop an effective business plan.

BENEFITS OF A BUSINESS PLAN

The entire business planning process forces the entrepreneur to analyse all aspects of the venture and to prepare an effective strategy to deal with the uncertainties that arise. Thus a business plan may help an entrepreneur avoid a project doomed to failure. As one researcher states: 'If your proposed venture is marginal at best, the business plan will show you why and may help you avoid paying the high tuition of business failure. It is far cheaper not to begin an ill-fated business than to learn by experience what your business plan could have taught you at a cost of several hours of concentrated work'.[7]

It is important that entrepreneurs prepare their own business plan. If an entrepreneurial team is involved, then all of the key members should be part of writing the plan; in this case it is important that the lead entrepreneur understands the contribution of each team member. If

>>ENTREPRENEURSHIP IN PRACTICE

SCIENTISTS NEED BETTER BUSINESS PLANS

A huge capital venture firm is struggling to find winning business ideas that it can invest in from a cash pool soon to grow to $150m. BioPacificVentures (BPV) says the ideas are out there, but New Zealand and Australian scientists need to put more work into the pitching of their business plans.

Of 60 proposals to come across the company's table, 20 presentations were found wanting in detail. Another 15 'one-pager' submissions failed to even make the grade. Executive director Howard Moore said the venture capital group wanted to see detailed plans showing the strength of the management team behind the business idea. The 20 'below-par' proposals could still be revived with good business plans, he said. Scientists should obtain a business plan template and work hard to make it easier for venture capitalists such as BPV to assess its value, he said.

The fund is ready to begin investing mainly through an equity stake in life sciences – health, food and agriculture – in Australasia. Already $104m has been raised to make it the largest capital venture fund in New Zealand, with another $50m expected by the end of the year. Investors in the 12-year fund include Nestlé, Wrightson, which has brought in $14m, ACC and entrepreneurs who have made their money and are looking to back other budding businesses.

Source: Tim Cronshaw, 'Firm Struggles to Find Winning Ideas', *Christchurch Press*, 4 June 2005 consultants are sought to help prepare a business plan, the entrepreneur must remain the driving force behind the plan. Seeking the advice and assistance of outside professionals is always wise, but entrepreneurs need to understand every aspect of the business plan, since it is they who come under the scrutiny of financial sources. Thus the business plan stands as the entrepreneur's description and prediction for their venture and it must be defended by the entrepreneur – simply put, it is the entrepreneur's responsibility.[8]

Other benefits are derived from a business plan for both the entrepreneur and the financial sources that read it and evaluate the venture. Specifically for the entrepreneur, the following benefits are gained:

- The time, effort, research and discipline needed to put together a formal business plan force the entrepreneur to view the venture critically and objectively.
- The competitive, economic and financial analyses included in the business plan subject the entrepreneur to close scrutiny of their assumptions about the venture's success.
- Since all aspects of the business venture must be addressed in the plan, the entrepreneur develops and examines operating strategies and expected results for outside evaluators.
- The business plan quantifies objectives, providing measurable benchmarks for comparing forecasts with actual results.
- The completed business plan provides the entrepreneur with a communication tool for outside financial sources (for example, banks, business angels, venture capital fund managers, equity investors, etc.) as well as an operational tool for guiding the venture towards success.[9]

Potential funding sources who read the plan derive the following benefits from the business plan:

- The business plan provides for financial sources the details of the market potential and plans for securing a share of that market.
- Through prospective financial statements, the business plan illustrates the venture's ability to service debt or provide an adequate return on equity.
- The plan identifies critical risks and crucial events with a discussion of contingency plans that provide opportunity for the venture's success.
- By providing a comprehensive overview of the entire operation, the business plan gives financial sources a clear, concise document that contains the necessary information for a thorough business and financial evaluation.
- For a financial source with no prior knowledge of the entrepreneur or the venture, the business plan provides a useful guide for assessing the individual entrepreneur's planning and managerial ability.[10]

DEVELOPING A WELL-CONCEIVED BUSINESS PLAN

Most investors agree that only a well-conceived and well-developed business plan can gather the necessary support that will eventually lead to financing. The business plan must describe the new venture with excitement and yet with complete accuracy.

Who reads the plan?

It is important to understand the audience for whom the business plan is written. Although numerous professionals may be involved with reading the business plan – such as venture capitalists, bankers, angel investors, potential large customers, lawyers, consultants and suppliers – entrepreneurs need to clearly understand three main viewpoints when preparing the plan.[11]

The first viewpoint is, of course, the entrepreneur's, since they are the ones developing the venture and clearly have the most in-depth knowledge of the technology or creativity involved.

This is the most common viewpoint in business plans and it is essential. However, too many plans emphasise this viewpoint and neglect the viewpoints of potential customers and investors.

More important than high technology or creative flair is the marketability of a new venture. Referred to as 'market-driven', this type of enterprise convincingly demonstrates the benefits to users – the particular group of customers it is aiming for – and the existence of a substantial market. This is the second critical emphasis that an entrepreneur must incorporate into a business plan. Although the actual value of this information is considered high, too many entrepreneurs tend to de-emphasise in-depth marketing information in their business plans.[12] Establishing an actual market (determining who will buy the product or use the service) and documenting that the anticipated percentage of this market is appropriate for the venture's success are valuable components of the business plan.

The third viewpoint is related to the marketing emphasis just discussed. The investor's point of view is concentrated on the financial forecast. Sound financial projections are necessary if investors are to evaluate the worth of their investment. This is not to say an entrepreneur should fill the business plan with spreadsheets of figures. In fact, many venture capital firms employ a 'projection discount factor', which merely represents the belief of venture capitalists that successful new ventures usually reach approximately 50 per cent of their projected financial goals.[13] However, a three- to five-year financial projection is essential for investors to use in making their judgement of a venture's future success.

These three viewpoints have been presented in an order of decreasing significance to point out the emphasis needed in a well-conceived business plan. If they are addressed carefully in the plan, then the entrepreneur has prepared for what experts term the **five-minute reading**. The following six steps represent the typical business plan reading process many venture capitalists use (less than one minute is devoted to each step):

- **Step 1**: Determine the characteristics of the venture and its industry.
- **Step 2**: Determine the financial structure of the plan (amount of debt or equity investment required).
- **Step 3**: Read the latest balance sheet (to determine liquidity, net worth and debt/equity).
- **Step 4**: Determine the quality of entrepreneurs in the venture (sometimes the most important step).
- **Step 5**: Establish the unique feature in this venture (find out what is different).
- **Step 6**: Read the entire plan over lightly (this is when the entire package is paged through for a casual look at graphs, charts, exhibits and other plan components).[14]

These steps provide insight into how the average business plan is read. It appears somewhat unjust that so much of the entrepreneur's effort is put into a plan that is given only a five-minute reading. However, that's the nature of the process for many venture capitalists. Other financial or professional sources (such as bankers) may devote more time to analysing the plan. But keep in mind that venture capitalists read through numerous business plans – thus, knowing the steps in their reading process is valuable for developing any plan. Here is an updated version of an old quote linking entrepreneurs and venture capitalists: 'The people who manage people manage people who manage things, but the people who manage money manage the people who manage people'.[15]

Putting the package together

When presenting a business plan to potential investors, the entrepreneur must realise that the entire package is important. Presented next is a summary of key issues that the entrepreneur needs to watch for if the plan is going to be viewed successfully. A business plan gives financiers their first impressions of a company and its principals.

Potential investors expect the plan to look good, but not too good; to be the right length; to clearly and concisely explain early on all aspects of the company's business; and not to contain bad grammar and typographical or spelling errors.

Investors are looking for evidence that the principals treat their own property with care – and will likewise treat the investment carefully. In other words, form as well as content is important and investors know that good form reflects good content and vice versa. Among the format issues we think most important are the following:

- **Appearance**: The binding and printing must not be sloppy; neither should the presentation be too lavish. A stapled compilation of photocopied pages usually looks amateurish, while bookbinding with typeset pages may arouse concern about excessive and inappropriate spending. A plastic spiral binding holding together a pair of cover sheets of a single colour provides both a neat appearance and sufficient strength to withstand the handling of a number of people without damage.
- **Length**: A business plan should be no more than 40 pages long. The first draft will likely exceed that, but editing should produce a final version that fits within the 40-page ideal. Adherence to this length forces entrepreneurs to sharpen their ideas and results in a document likely to hold investors' attention.

  Background details can be included in an additional volume. Entrepreneurs can make this material available to investors during the investigative period after the initial expression of interest.
- **The cover and title page**: The cover should bear the name of the company, its address and phone number and the month and year in which the plan is issued. Surprisingly, a large number of business plans are submitted to potential investors without return addresses or phone numbers. An interested investor wants to be able to contact a company easily and to request further information or express an interest, either in the company or in some aspect of the plan.

  Inside the front cover should be a well-designed title page on which the cover information is repeated and, in an upper or a lower corner, the copy number provided. Besides helping entrepreneurs keep track of plans in circulation, holding down the number of copies outstanding – usually to no more than 20 – has a psychological advantage. After all, no investor likes to think that the prospective investment is shop-worn.
- **The executive summary**: The two to three pages immediately following the title page should concisely explain the company's current status, its products or services, the benefits to customers, the financial forecasts, the venture's objectives in three to seven years, the amount of financing needed and how investors will benefit.

  This is a tall order for a two-page summary, but it will either sell investors on reading the rest of the plan or convince them to forget the whole thing.
- **The table of contents**: After the executive summary, include a well-designed table of contents. List each of the business plan's sections and mark the pages for each section.

An attractive appearance, an effective length, an executive summary, a table of contents, proper grammar, correct typing and a cover page – all are important factors when putting together a complete package. These points often separate successful plans from unacceptable ones.

Guidelines to remember

Here is a collection of recommendations by experts in venture capital and new-venture development.[16] These guidelines are presented as tips for successful business plan development. Entrepreneurs need to adhere to them in order to understand the importance of the various segments of a business plan they are creating, which will be discussed in the next section.

- **Keep the plan respectably short**: Readers of business plans are important people who refuse to waste time. Therefore entrepreneurs should explain the venture not only carefully and clearly, but also concisely. (As indicated above, the plan should be an ideal 40 pages in length, and certainly no more than 50 pages, excluding the appendix.)
- **Organise and package the plan appropriately**: A table of contents, an executive summary, an appendix, exhibits, graphs, proper grammar, a logical arrangement of segments and overall neatness are elements critical to the effective presentation of a business plan.
- **Orient the plan towards the future**: Entrepreneurs should attempt to create an air of excitement in the plan by developing trends and forecasts that describe what the venture intends to do and what the opportunities are for the use of the product or service.
- **Avoid exaggeration**: Sales potentials, revenue estimates and the venture's potential growth should not be inflated. Many times a best-case, worst-case and probable-case scenario should be developed for the plan. Documentation and research are vital to the plan's credibility. (See Table 12.1 for business plan phrases.)
- **Highlight critical risks**: The critical-risks segment of the business plan is important in that it demonstrates the entrepreneur's ability to analyse potential problems and develop alternative courses of action.
- **Give evidence of an effective entrepreneurial team**: The management segment of the business plan should clearly identify the skills of each key person as well as demonstrate how all such persons can effectively work together as a team in managing the venture.
- **Do not over-diversify**: Focus the attention of the plan on one main opportunity for the venture. A new business should not attempt to create multiple markets or pursue multiple ventures until it has successfully developed one main strength.

TABLE 12.1: COMMON BUSINESS PLAN PHRASES – STATEMENT VERSUS REALITY

STATEMENT	REALITY
We conservatively project . . .	We read a book that said we had to be a $50 million company in five years and we reverse-engineered the numbers.
We took our best guess and divided by 2.	We accidentally divided by 0.5.
We project a 10 per cent margin.	We did not modify any of the assumptions in the business plan template that we downloaded from the Internet.
The project is 98 per cent complete.	To complete the remaining 2 per cent will take as long as it took to create the initial 98 per cent, but will cost twice as much.
Our business model is proven . . .	. . . if you take the evidence from the past week for the best of our 50 locations and extrapolate it for all the others.
We have a six-month lead.	We tried not to find out how many other people have a six-month lead.
We need only a 10 per cent market share.	So do the other 50 entrants getting funded.
Customers are clamouring for our product.	We have not yet asked them to pay for it. Also, all of our current customers are relatives.
We are the low-cost producer.	We have not produced anything yet, but we are confident that we will be able to.
We have no competition.	Only IBM, Microsoft, Netscape and Sun have announced plans to enter the business.
Our management team has a great deal of experience . . .	. . . consuming the product or service.
A select group of investors is considering the plan.	We mailed a copy of the plan to everyone in Pratt's Guide.
We seek a value-added investor.	We are looking for a passive, dumb-as-rocks investor.
If you invest on our terms, you will earn a 68 per cent internal rate of return.	If everything that could ever conceivably go right does go right, you might get your money back.

Source: Reprinted by permission of *Harvard Business Review*. Adapted from William A. Sahlman, 'How to Write a Great Business Plan', July/August 1997: 106.

- **Identify the target market**: Substantiate the marketability of the venture's product or service by identifying the particular customer niche being sought. This segment of the business plan is pivotal to the success of the other parts. Market research has to be included to demonstrate how this market segment has been identified.
- **Keep the plan written in the third person**: Rather than continually stating 'I', 'we', or 'us', the entrepreneur should phrase everything as 'they', or 'them'. In other words, avoid personalising the plan and keep the writing objective.
- **Capture the reader's interest**: Because of the numerous business plans submitted to investors and the small percentage of business plans funded, entrepreneurs need to capture the reader's interest right away by stating the uniqueness of the venture. Use the title page and executive summary as key tools for capturing the reader's attention and creating a desire to read more.

Questions to be answered

A well-written business plan is like a work of art: It's visually pleasing and makes a statement without saying a word. Unfortunately, the two are also alike in that they are worth money only if they are good. Here are the key questions to consider when writing an effective business plan:

- Is your plan organised so key facts leap out at the reader? Appearances do count. Your plan is a representation of yourself, so don't expect an unorganised, less than acceptable plan to be your vehicle for obtaining funds.
- Is your product/service and business mission clear and simple? Your mission should state very simply the value that you will provide to your customers. It shouldn't take more than a paragraph.
- Are you focused on the right things? Determine what phase of the business you are really in, focus on the right tasks and use your resources appropriately.
- Who is your customer? Does the plan describe the business's ideal customers and how you will reach them? Is your projected share of the market identified, reasonable and supported?
- Why will customers buy? How much better is your product/service? Define the need for your product and provide references and testimonial support to enhance it. Try to be detailed in explaining how the customer will benefit from buying your product.
- Do you have a competitive advantage? Focus on differences and any unique qualities. Proprietary processes/technology and patentable items/ideals are good things to highlight as competitive strengths.
- Do you have a favourable cost structure? Proper gross margins are key. Does the break-even analysis take into consideration the dynamics of price and variable costs? Identify, if possible, any economics of scale that would be advantageous to the business.
- Can the management team build a business? Take a second look at the management team to see whether they have relevant experience in small business and in the industry. Acknowledge the fact that the team may need to evolve with the business.
- How much money do you need? Financial statements – including the income statement, cash-flow statement and balance sheet – should be provided on a monthly basis for the first year and on a quarterly basis for the following two or three years.
- How does your investor get a cash return? Whether it's through a trade sale, buyout or an initial public offering, make sure your plan clearly outlines this important question regarding a harvest strategy.[17]

These guidelines and questions have been presented to help entrepreneurs who are preparing to write a business plan. The following section analyses the major segments of a business plan.

ELEMENTS OF A BUSINESS PLAN A detailed business plan usually includes eight to 12 sections (depending on the industry or idea). The ideal length of a plan is 25 pages, although – depending on the need for detail – the overall plan can range from 20 to more than 35 pages if an appendix is included.[18] Table 12.2 provides an outline of a typical plan. The remainder of this section describes the 12 specific parts of the plan.

TABLE 12.2: COMPLETE OUTLINE OF A BUSINESS PLAN

Section I: Executive summary

Section II: Business description

- A. General description of the business
- B. Industry background
- C. Goals and potential of the business and milestones (if any)
- D. Uniqueness of product or service

Section III: Statement on sustainability

- A. Performance measures
- B. Market analysis

Section IV: Marketing

- A. Research and analysis
  - 1. Target market (customers) identified
  - 2. Market size and trends
  - 3. Competitive analysis
  - 4. Estimated market share
- B. Marketing plan
  - 1. Market strategy – sales and distribution
  - 2. Pricing
  - 3. Advertising and promotions

Section V: Operations

- A. Identify location
  - 1. Advantages
  - 2. Zoning
  - 3. Taxes
- B. Proximity to supplies
- C. Access to transportation

Section VI: Sustainable development measures of performance

- A. Plan to deal with emissions
- B. Greenhouse gas reduction goals
- C. Set an internal carbon dollar value for investment decision-making
- D. Carbon footprint measure
- E. Other measures such as food miles
- D. Plan to use renewables

Section VII: Management

- A. Management team – key personnel
- B. Legal structure – stock agreements, employment agreements, ownership
- C. Board of directors, advisors, consultants

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Section VIII: Financial

A. Financial forecast

1. Profit and loss
2. Cash flow
3. Break-even analysis
4. Cost controls
5. Budgeting plans

Section IX: Critical risks

A. Potential problems

B. Obstacles and risks

C. Environmental risks

C. Alternative courses of action

Section X: Harvest strategy

A. Transfer of asset

B. Continuity of business strategy

C. Identify successor

Section XI: Milestone schedule

A. Timing and objectives

B. Deadlines and milestones

C. Relationship of events

Section XII: Appendix or bibliography

Adapted from: Donald F. Kuratko and Robert C. McDonald, *The Entrepreneurial Planning Guide*, Bloomington: Kelley School of Business, Indiana University, 2007

Executive summary

Many people who read business plans (bankers, venture capitalists, investors) like to see a summary of the plan that features its most important parts. Such a summary gives a brief overview of what is to follow, helps put all of the information into perspective and should be no longer than two to three pages. The summary should be written only after the entire business plan has been completed. In this way particular phrases or descriptions from each segment can be identified for inclusion in the summary. Since the summary is the first and sometimes the only part of a plan read, it must present the quality of the entire report. The summary must be a clever snapshot of the complete plan.

The statements selected for a summary segment should briefly touch on the venture itself, the market opportunities, the financial needs and projections and any special research or technology associated with the venture. And this should be done in such a way that the evaluator or investor will choose to read on. If this information is not presented in a concise, competent manner, the reader may put aside the plan or simply conclude the project does not warrant funding.

Business description

First, the name of the venture should be identified, with any special significance related (for example, family name, technical name). Second, the industry background should be presented in terms of current status and future trends. It is important to note any special industry developments that may affect the plan. If the company has an existing business or franchise, this is the appropriate place to discuss it. Third, the new venture should be thoroughly described along with its proposed potential. All key terms should be defined and made comprehensible. Functional specifications or descriptions should be provided. Drawings and photographs also may be included. Fourth, the potential advantages the new venture possesses over the competition should be discussed at length. This discussion may include patents, copyrights and trademarks, as well as special technological or market advantages.

Sustainability

Your sustainable business plan should start with your definition of sustainability, and what you think it means to your business. A sustainable development definition, combined with six to 10 principles, constitutes a company's sustainable development strategy or policy. This definition depends on what type of business you are, what green resources are available to you, your market and industry and your level of commitment to sustainability. If you plan to be certified green in some way, your definition of sustainability may be based on information provided by the certifying agency. This policy is usually a one-page, stand-alone document, which presents a concise overview of the company's commitment to the environment, economy and society. Within a company the policy will generally be placed in strategic locations frequented by employees; externally, it will be distributed to a wide range of stakeholder groups.[19] Once you have defined what sustainability means you can develop a list of practices you will implement or change to bring your business operations more in line with your definition. For example, for a graphic design business the list might include your relationship with a green printer and Web-hosting vendors using energy efficient computers and printers, recycling or composting any waste, sending files to clients via email or online instead of on paper, and so on. It may help to break your list into different levels of commitment. You may not be able to replace equipment with more efficient models just yet, but you can work up to it, so put it on the list.[20] Some concrete measures of sustainability are included in this chapter.

Marketing segment

In the **marketing segment** of the plan the entrepreneur must convince investors that a market exists, that sales projections *can be achieved* and that the competition can be beaten.

This part of the plan is often one of the most difficult to prepare. It is also one of the most critical because almost all subsequent sections of the plan depend on the sales estimates developed here. The projected sales levels, based on market research and analysis, directly influence the size of the manufacturing operation, the marketing plan and the amount of debt and equity capital required.

Most entrepreneurs have difficulty preparing and presenting market research and analyses that will convince investors that the venture's sales estimates are accurate and attainable. The following are aspects of marketing that should be addressed when developing a comprehensive exposition of the market.

Market niche and market share

A **market niche** is a homogeneous group with common characteristics – that is, all the people who have a need for the newly proposed product or service. In describing this niche, the writer should address the bases of customer purchase decisions – price, quality, service, personal contacts, or some combination of these factors.

Next, a list of potential customers who have expressed interest in the product or service, together with an explanation of their interest, should be included. If it is an existing business, the current principal customers should be identified and the sales trend should be discussed. It is important to describe the overall potential of the market. Sales projections should be made for at least three years and the major factors affecting market growth (industry trends, socioeconomic trends, governmental policy and population shifts) should be discussed. A review of previous market trends should be included and any differences between past and projected annual growth rates should be explained. The sources of all data and methods used to make projections should be indicated. Then, if any major customers are willing to make purchase commitments, they

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should be identified and the extent of those commitments should be indicated. On the basis of product or service advantages, market size and trends and customers and sales trends in prior years, the writer should estimate market share and sales in units and dollars for each of the next three years. The growth of the company's sales and its estimated market share should be related to the growth of the industry and the customer base.

Competitive analysis

The entrepreneur should assess the strengths and weaknesses of the competing products or services. Any sources used to evaluate the competition should be cited. This discussion should compare competing products or services on the basis of price, performance, service, warranties and other pertinent features. It should include a short discussion of the current advantages and disadvantages of competing products and services and why they are not meeting customer

>>ENTREPRENEURSHIP IN PRACTICE

HOW DO YOU GATHER COMPETITIVE INTELLIGENCE IN THE ASIA–PACIFIC?

In most many countries (such as Australia and New Zealand) it is relatively easy to get information on publicly held companies. Most information is in the public domain, such as annual reports, sales reports, and company profiles from commerce departments or brokerage houses. But in developing countries of the Asia Pacific, competitor intelligence – information on competitors, their products, and how they do business – is not easy to come by. Be prepared to engage in a little 'espionage' to gather competitor intelligence. Here's how:

- >> Check with government agencies such as commerce or trade to see if any printed information is available.
- >> Ask those who have contact with your customers, such as the sales force; they are the eyes and ears of your social enterprise. They interface directly with customers and often have contact with competitors' salespeople.
- >> Survey competitors' customers; find out what their perceptions and preferences are about the products/services and the company they are purchasing from.
- >> Talk directly to the competitors' senior management or owners. As a small social enterprise you might be surprised that you can gain access simply by asking. A competitor may not see your enterprise as a threat and give you information (and maybe some free advice, too).
- >> Contact low-level employees working for competitors, like support staff, guards, or chauffeurs. They are usually happy to be asked to share their opinions and observations and often do so readily. Chauffeurs and secretaries, especially, may be privy to conversations with important decision makers.
- >> Competitors' former employees are a good source of information; the more disgruntled they were at the time they left, the better for you.
- >> Ask your staff members whether any of them have worked for the competition. You might be surprised at how often this is the case and how often they are overlooked as internal resources.
- >> Ask people in your industry what they know about your competitors. For instance, your raw material suppliers might also sell to your competitors. Maybe they have seen a competitor's site and facilities during a previous delivery.
- >> Network with friends and family members; if you ask enough people you are bound to find someone who knows something. For example, in a hotel restaurant, an employee met a personal friend of the major competitor. The conversation yielded a lot of information on the family's business philosophy and strategy. One tidbit disclosed was that the company's matriarch and president had died the prior week – was this an opportunity or a threat?

A note on ethics: Gather competitive intelligence in an ethical manner. Don't misrepresent who you are or your intentions. For example, don't call a competitor posing as a job applicant, market researcher, or supplier. Companies are good about protecting domains that are proprietary, but you will be surprised at how much information is forthcoming when you merely ask. Besides, the bulk of the information you will need for your competitive analysis is not industry trade secrets.

Source: Sutia Kim Alter, *Managing the Double Bottom Line: A Business Planning Reference Guide for Social Enterprises* , Save the Children, 2000: 115, www.virtueventures.com/files/mdbl-preface.pdf needs. Any knowledge of competitors' actions that could lead to new or improved products and an advantageous position also should be presented.

Finally, a review of competing companies should be included. Each competitor's share of the market, sales and distribution and production capabilities should be discussed. Attention should be focused on profitability and the profit trend of each competitor. Who is the pricing leader? Who is the quality leader? Who is gaining? Who is losing? Have any companies entered or dropped out of the market in recent years?

Marketing strategy

The general marketing philosophy and approach of the company should be outlined in the **marketing strategy**. The marketing strategy is a business's approach to marketing its products and services expressed in broad terms, which forms the basis for developing a marketing plan. Marketing research is the process of systematically gathering, analysing and interpreting data pertaining to the company's market, customers and competitors, with the goal of improving marketing decisions. Market research, the gathering and evaluation of data regarding consumers' preferences for products and services, is a component of marketing research. The marketing philosophy and approach should be developed from market research and evaluation data and should include a discussion of: (1) the kinds of customer groups to be targeted by the initial intensive selling effort, (2) the customer groups to be targeted for later selling efforts, (3) methods of identifying and contacting potential customers in these groups, (4) the features of the product or service (quality, price, delivery, warranty and so on) to be emphasised to generate sales and (5) any innovative or unusual marketing concepts that will enhance customer acceptance (for example, leasing where only sales were previously attempted).

This section also should indicate whether the product or service will initially be introduced nationally or regionally. Consideration also should be given to any seasonal trends and what can be done to promote contra-seasonal sales.

Pricing policy

The price must be *right* in order to penetrate the market, maintain a market position and produce profits. In this discussion a number of pricing strategies should be examined and then one should be convincingly presented. This pricing policy should be compared with the policies of the major competitors. The gross profit margin between manufacturing and final sales costs should be discussed and consideration should be given as to whether this margin is large enough to allow for distribution, sales and warranty and service expenses; for amortisation of development and equipment costs; and for profit. Attention also should be given to justifying any price increases over competitive items on the basis of newness, quality, warranty, or service.

Advertising plan

For manufactured products, the preparation of product sheets and promotional literature, the plans for trade show participation, trade magazine advertisements, direct mailings and the use of advertising agencies should be presented. For products and services in general, a discussion of the advertising and promotional campaign contemplated to introduce the product and the kind of sales aids to be provided to dealers should be included. Additionally, the schedule and cost of promotion and advertising should be presented and, if advertising will be a significant part of the expenses, an exhibit showing how and when these costs will be incurred should be included.

Operations segment

This segment always should begin by describing the location of the new venture. The chosen site should be appropriate in terms of labour availability, wage rate, proximity to suppliers and customers and community support. In addition, local taxes and zoning requirements should be sorted out and the support of area banks for new ventures should be touched on.

Specific needs should be discussed in terms of the facilities required to handle the new venture (plant, warehouse storage and offices) and the equipment that needs to be acquired (special tooling, machinery, computers and vehicles).

Other factors that might be considered are the suppliers (number and proximity) and the transportation costs involved in shipping materials. Also, the labour supply, wage rates and needed skilled positions should be presented.

Finally, the cost data associated with any of the operation factors should be presented. The financial information used here can be applied later to the financial projections.

COMMON BUSINESS PLANNING MISTAKES

>>ENTREPRENEURSHIP IN PRACTICE

Entrepreneurs endure uncertainty in most everything they do. From hiring the right employees to finding reliable suppliers, building a business requires an entrepreneur to handle significant pressure on a daily basis. Given the variability which is inherent in any new venture, a business plan is crucial for effective management. In spite of the importance of business planning, few activities are more daunting for entrepreneurs than formalising their thoughts on paper. In order for entrepreneurs to stay driven to succeed, they have to remain optimistic, so the fear of discovering some insurmountable obstacle while planning leads some management teams to avoid the process altogether. Whether the business is a start-up or a well-established corporation, a business plan, when done correctly, serves as the company's blueprint to ensure that all parties involved are in agreement regarding the business's overarching purpose. In the business plan sections listed below we present some of the common mistakes that entrepreneurs make when developing their plan:

OVERALL MISTAKES

- >> Entrepreneurs are unable to clearly articulate their vision in the plan.
- >> Entrepreneurs fail to provide sufficient details regarding the implementation of their strategy.
- >> Entrepreneurs ineffectively present the goals and objectives that are most important to the business's success.
- >> Entrepreneurs do not convincingly present the basis for their strategy.
- >> Entrepreneurs do not improve their plan based on the feedback from investors.

EXECUTIVE SUMMARY

- >> Entrepreneurs are not precise about their needs and capabilities.
- >> Entrepreneurs waste words with fillers and superfluous information.

MANAGEMENT

- >> Entrepreneurs forget to include their previous successes and or failures.
- >> Entrepreneurs dismiss the importance investors place on an experienced management team.

MARKETING

- >> Entrepreneurs rely heavily on secondary market research rather than soliciting the opinions of their potential customers.
- >> Entrepreneurs claim the percentage of the market their company will own without research support.

FINANCIALS

- >> Entrepreneurs overlook and, in turn, underestimate their cash-flow requirements.
- >> Entrepreneurs inflate or understate their margins in order to arrive at their ideal profitability.

Sources: Adapted from Mark Henricks, 'Build a Better Business Plan', from *Entrepreneur* magazine website, February 2007, www.entrepreneur.com/startingabusiness/businessplans/article174002.html; Andrew Clarke, 'Top 10 Business Plan Mistakes', *Entrepreneur* magazine website, November 2005, www.entrepreneur.com/startingabusiness/businessplans/ article81188.html; and Andrew J. Sherman, *Grow Fast, Grow Right. 12 Strategies to Achieve Breakthrough Business Growth*, Chicago: Kaplan Publishing, 2007: 20–6

Sustainable development measures of performance

This segment should describe your firm's economic contributions to sustainability, its impacts on the economic circumstances of its stakeholders, and its influence on economic systems at the local, national and global levels (see Chapter 11 for guidelines on the right data to gather). Understanding these data in relation to human development issues is the essential next step if the power and resources of the private sector are to be harnessed in the fight for social and economic development. One way to conceive this is to reflect on the impact the firm has on major stakeholder groups, namely customers, suppliers, employees, providers of capital and the public sector. Also see pages 415–18 for a comprehensive list of Triple Bottom Line indicators.

Management segment

This segment identifies the key personnel, their positions and responsibilities and the career experiences that qualify them for those particular roles. Complete résumés should be provided for each member of the management team. Also, this section is where the entrepreneur's role in the venture should be clearly outlined. Finally, any advisers, consultants, or members of the board should be identified and discussed.

The structure of payment and ownership (share agreements, consulting fees and so on) should be described clearly in this section. In summary, the discussion should be sufficient so that investors can understand each of the following critical factors that have been presented: (1) organisational structure, (2) management team and critical personnel, (3) experience and technical capabilities of the personnel, (4) ownership structure and compensation agreements and (5) board of directors and outside consultants and advisers.

Financial segment

The financial segment of a business plan must demonstrate the potential viability of the undertaking. In this part of the plan, three basic financial statements must be presented: the **pro forma balance sheet**, the **income statement** and the **cash-flow statement**. (See detailed discussion in Chapter 11.)

The pro forma balance sheet

Pro forma means 'projected', as opposed to actual. The pro forma balance sheet projects what the financial condition of the venture will be at a particular point in time. Pro forma balance sheets should be prepared at start-up, semi-annually for the first years and at the end of each of the first three years. The balance sheet details the assets required to support the projected level of operations and shows how these assets are to be financed (liabilities and equity). Investors will want to look at the projected balance sheets to determine if debt/equity ratios, working capital, current ratios, inventory turnover and so on are within the acceptable limits required to justify the future financings projected for the venture.

The income statement

The income statement illustrates the projected operating results based on profit and loss. The sales forecast, which was developed in the marketing segment, is essential to this document. Once the sales forecast (earnings projection) is in place, production costs must be budgeted based on the level of activity needed to support the projected earnings. The materials, labour, service and manufacturing overhead (fixed and variable) must be considered, in addition to such expenses as distribution, storage, advertising, discounts and administrative and general expenses – salaries, legal and accounting, rent, utilities and telephone.

The cash-flow statement

The cash-flow statement may be the most important document since it sets forth the amount and timing of expected cash in-flows and out-flows. This section of the business plan should be carefully constructed.

Given a level of projected sales and capital expenditures over a specific period, the cash-flow forecast will highlight the need for and the timing of additional financing and will indicate peak requirements for working capital. Management must decide how this additional financing is to be obtained, on what terms and how it is to be repaid. The total amount of needed financing may be supplied from several sources – part by equity financing, part by bank loans and the balance by short-term lines of credit from banks. This information becomes part of the final cash-flow forecast.

A detailed cash flow, if understood properly, can direct the entrepreneur's attention to operating problems before serious cash crises arise.

In the financial segment it is important to mention any assumptions used for preparing the figures. Nothing should be taken for granted. Also, it should include how the statements were prepared (by a professional accountant or by the entrepreneur) and who will be in charge of managing the business's finances.

The final document that should be included in the financial segment is a break-even chart, which shows the level of sales (and production) needed to cover all costs. This includes costs that vary with the production level (manufacturing labour, materials, sales) and costs that do not change with production (rent, interest charges, executive salaries).

Critical risks segment

In this segment potential risks should be identified, such as effect of unfavourable trends in the industry, design or manufacturing costs that have gone over estimates, difficulties of long lead times encountered when purchasing parts or materials and unplanned-for new competition. As far as sustainability is concerned, regulatory risks are often cited, followed by weather-related physical risks and reputational risks.

In addition to these risks, it is wise to cover the what-ifs. For example, what if the competition cuts prices, the industry slumps, the market projections are wrong, the sales projections are not achieved, the patents do not come through, or the management team breaks up? What if the temperature in the State of Victoria increases by 1˚C in the summer? (See Table 12.3.)

Finally, suggestions for alternative courses of action should be included. Certainly, delays, inaccurate projections and industry slumps all can happen and people reading the business plan will want to know that the entrepreneur recognises these risks and has prepared for such critical events.

TABLE 12.3: SMALL CLIMATE CHANGES CAN DRAMATICALLY INCREASE RISKS

HAZARD	CHANGE IN CLIMATE	RESULTING CHANGE IN HAZARD
Cyclone	2.2ºC mean temperature increase	Increase of 5–10 per cent in cyclone wind speeds
Bushfire	1ºC mean summer temperature increase	17–28 per cent increase in bushfires
Drought	1.3ºC maximum temperature increase	25 per cent increase in evaporation leading to increased bushfire risk
Floods	25 per cent increase in 30-minute precipitation	One in 100-year flood becomes one in 17-year flood

Source: E. Mills, E. Lecomte and A. Peara, 'US Insurance Industry Perspectives on Climate Change', February 2001, US Dept of Energy, Berkeley, California, cited in Tony Coleman, Chairman, Ark – Australia's First Carbon Fund, 'Climate Change: An Investor's Perspective', presented at 'The Low Carbon Economy: Risks and Opportunities for the Financial Services Industry', Institute of Actuaries of Australia, Sydney, 9 October 2008, www.actuaries.asn.au/IAA/upload/public/Tony%20Coleman.pdf

Harvest strategy segment

Every business plan should provide insights into the future harvest strategy. It is important for the entrepreneur to plan the orderly transition of the venture as it grows and develops. This section needs to deal with such issues as management succession and investor exit strategies. In addition, some thought should be given to change management – that is, the orderly transfer of the company assets if ownership of the business changes, continuity of the business strategy during the transition and designation of key individuals to run the business if the current management team changes. With foresight, entrepreneurs can keep their dreams alive, ensure the security of their investors and usually strengthen their businesses in the process. For this reason, a written plan for succession of your business is essential.

Milestone schedule segment

The **milestone schedule segment** provides investors with a timetable for the various activities to be accomplished. It is important to demonstrate that realistic time frames have been planned and that the interrelationship of events within these time boundaries is understood. Milestone scheduling is a step-by-step approach to illustrating accomplishments in a piecemeal fashion. These milestones can be established according to any appropriate time frame, such as quarterly, monthly, or weekly. It is important, however, to coordinate the time frame not only with such early activities as product design and development, sales projections, establishment of the management team, production and operations scheduling and market planning, but with other activities as well:

- incorporation of the venture
- completion of design and development
- completion of prototypes
- hiring of sales representatives
- product display at trade shows
- signing up distributors and dealers
- ordering production quantities of materials
- receipt of first orders
- first sales and first deliveries (dates of maximum interest because they relate directly to the venture's credibility and need for capital)
- payment of first accounts receivable (cash in).

These items are examples of the types of activities that should be included in the milestone schedule segment. The more detailed the schedule, the better the chance the entrepreneur can persuade potential investors that they have thought things out and that they are, therefore, a good risk.

Appendix and/or bibliography segment

The final segment is not mandatory, but it allows for additional documentation that is not appropriate in the main parts of the plan. Diagrams, blueprints, financial data, résumés of management team members and any bibliographical information that supports the other segments of the plan are all examples of material that can be included. It is up to the entrepreneur to decide which, if any, items to put into this segment. However, the material should be limited to relevant and supporting information.

Table 12.4 provides an important recap of the major segments of a business plan, using helpful hints as practical reminders for entrepreneurs. By reviewing this, entrepreneurs can gain a macro view of the planning process. Table 12.5 is a judge's checklist used in business plan competitions that gives entrepreneurs the opportunity to evaluate their business plan for each segment. The step-by-step evaluation is based on coverage of the particular segment, clarity of its presentation and completeness. Compare the judge's checklist to the business plan in the Appendix.

TABLE 12.4: HELPFUL HINTS FOR DEVELOPING THE BUSINESS PLAN

I Executive summary

- No more than three pages. This is the most crucial part of your plan because you must capture the reader's interest.
- What, how, why, where and so on must be summarised.
- Complete this part after you have a finished business plan.

II Business description segment

- The name of your business.
- A background of the industry with history of your company (if any) should be covered here.
- The potential of the new venture should be described clearly.
- Any uniqueness or distinctive features of this venture should be clearly described.

III Sustainability

- Craft a definition of sustainable development that is specific to your firm and that can serve as a guidepost for business conduct.
- What green resources are available?
- Plan for certification.

IV Marketing segment

- Convince investors that sales projections and competition can be met.
- Use and disclose market studies.
- Identify target market, market position and market share.
- Evaluate all competition and specifically cover why and how you will be better than your competitors.
- Identify all market sources and assistance used for this segment.
- Demonstrate pricing strategy since your price must penetrate and maintain a market share to produce profits. Thus the lowest price is not necessarily the best price.
- Identify your advertising plans with cost estimates to validate proposed strategy.

V Operations segment

- Describe the advantages of your location (zoning, tax laws and wage rates). List the production needs in terms of facilities (plant, storage, office space) and equipment (machinery, furnishings, supplies).
- Describe the access to transportation (for shipping and receiving).
- Indicate proximity to your suppliers.
- Mention the availability of labour in your location.
- Provide estimates of operation costs – be careful; too many entrepreneurs underestimate their costs.

VI Sustainable development measures of performance

- Simply ask, 'How do we meet the needs of the present without compromising the ability of future generations to meet their own needs?'
- 'Do stakeholders raise sustainability issues about the firm?'
- Write a section on the laws, regulations and agreements that have strategic significance on the firm or its stakeholders.
- Explain the process your firm might implement to reasonably estimate sustainability impacts, risks and opportunities.

VII Management segment

- Supply résumés of all key people in the management of your venture.
- Carefully describe the legal structure of your venture (sole proprietorship, partnership, or corporation).
- Cover the added assistance (if any) of advisors, consultants and directors.
- Give information on how and how much everyone is to be compensated.

VIII Financial segment

- Give actual estimated statements.
- Describe the needed sources for your funds and the uses you intend for the money.
- Develop and present a budget.
- Create stages of financing for purposes of allowing evaluation by investors at various points.

IX Critical-risks segment

- Discuss potential risks before investors point them out – for example:
  - Price cutting by competitors.
  - Any potentially unfavourable industry-wide trends.
  - Physical, regulatory or reputational risks due to climate change
  - Design or manufacturing costs in excess of estimates.
  - Sales projections not achieved.
  - Product development schedule not met.
  - Difficulties or long lead times encountered in the procurement of parts or raw materials.
  - Greater than expected innovation and development costs to stay competitive.
  - Provide some alternative courses of action.

X Harvest strategy segment

- Outline a plan for the orderly transfer of company assets (ownership).
- Describe the plan for transition of leadership.
- Mention the preparations (insurance, trusts and so on) needed for continuity of the business.

XI Milestone schedule segment

- Develop a timetable or chart to demonstrate when each phase of the venture is to be completed. This shows the relationship of events and provides a deadline for accomplishment.

XII Appendix or bibliography

Source: Adapted from Donald F. Kuratko, Ray V. Montagno and Frank J. Sabatine, *The Entrepreneurial Decision*, Muncie, IN: The Midwest Entrepreneurial Education Center, College of Business, Ball State University, 2002

TABLE 12.5: BUSINESS PLAN ASSESSMENT – COMPLETE EVALUATION OF EACH COMPONENT (JUDGE'S CHECKLIST FOR BUSINESS PLAN COMPETITION)

THE COMPONENTS

There are twelve components of a business plan. As you develop your plan, you should assess each component. Be honest in your assessment since the main purpose is to improve your business plan and increase your chances of success. For instance, if your goal is to obtain external financing, you will be asked to submit a complete business plan for your venture. The business plan will help a funding source to more adequately evaluate your business idea.

Assessment directions: The brief description of each component will help you write that section of your plan. After completing your plan, use the scale provided to assess each component.

5	4	3	2	1
Outstanding	**Very good**	**Good**	**Fair**	**Poor**
Thorough and complete in all areas	Most areas covered, but could use improvement in detail	Some areas covered in detail, but other areas missing	A few areas covered, but very little detail	No written parts

THE 12 COMPONENTS OF A BUSINESS PLAN

1. Executive summary. This is the most important section because it has to convince the reader that the business will succeed. In no more than three pages, you should summarise the highlights of the rest of the plan. This means that the key elements of the following components should be mentioned.

The executive summary must be able to stand on its own. It is not simply an introduction to the rest of the business plan, but rather discusses who will purchase your product or service, what makes your business unique and how you plan to grow in the future. Because this section summarises the plan, it is often best to write it last.

Rate this component:

5	4	3	2	1
Outstanding	**Very Good**	**Good**	**Fair**	**Poor**

2. Description of the business. This section should provide background information about your industry, a history of your company, a general description of your product or service and your specific mission that you are trying to achieve. Your product or service should be described in terms of its unique qualities and value to the customer. Specific short-term and long-term objectives must be defined. You should clearly state what sales, market share and profitability objectives you want your business to achieve.

Key elements	*Have you covered this in the plan?*	*Is the answer clear? (yes or no)*	*Is the answer complete? (yes or no)*
a. What type of business will you have?			
b. What products or services will you sell?			
c. Why does it promise to be successful?			
d. What is the growth potential?			
e. How is it unique?			

Rate this component:

5	4	3	2	1
Outstanding	**Very Good**	**Good**	**Fair**	**Poor**

3. Sustainability. This section gives the reader an idea of your definition of sustainability and the performance measures you intend to take. It should also contain a list of practices you will implement. Be sure that you have a definition of sustainable development that is specific to your firm. Keep this short, practical and specific.

Key elements	*Have you covered this in the plan?*	*Is the answer clear? (yes or no)*	*Is the answer complete? (yes or no)*
a. What does sustainability mean to your business?			
b. Have you included a description of the performance measures?			
c. Have you included a list of the practices you will implement?			

Rate this component:

5	4	3	2	1
Outstanding	**Very Good**	**Good**	**Fair**	**Poor**

>>

4. Marketing. There are two major parts to the marketing section. The first part is research and analysis. Here, you should explain who buys the product or service – in other words, identify your target market. Measure your market size and trends and estimate the market share you expect. Be sure to include support for your sales projections. For example, if your figures are based on published marketing research data, be sure to cite the source. Do your best to make realistic and credible projections. Describe your competitors in considerable detail, identifying their strengths and weaknesses. Finally, explain how you will be better than your competitors.

The second part is your marketing plan. This critical section should include your market strategy, sales and distribution, pricing, advertising, promotion and public awareness efforts. Demonstrate how your pricing strategy will result in a profit. Identify your advertising plans and include cost estimates to validate your proposed strategy.

Key elements	*Have you covered this in the plan?*	*Is the answer clear? (yes or no)*	*Is the answer complete? (yes or no)*
a. Who will be your customers? (target market)			
b. How big is the market? (number of customers)			
c. Who will be your competitors?			
d. How are their businesses prospering?			
e. How will you promote sales?			
f. What market share will you want?			
g. Do you have a pricing strategy?			
h. What advertising and promotional strategy will you use?			

Rate this component:

5	**4**	**3**	**2**	**1**
Outstanding	**Very Good**	**Good**	**Fair**	**Poor**

5. Operations. In this segment you describe the actual operations and outline their advantages. Zoning, taxes, access to transportation and proximity to supplies should all be considered in this section.

Key elements	*Have you covered this in the plan?*	*Is the answer clear? (yes or no)*	*Is the answer complete? (yes or no)*
a. Have you identified a specific location?			
b. Have you outlined the advantages of this location?			
c. Any zoning regulations or tax considerations?			
d. Will there be access to transportation?			
e. Will your suppliers be conveniently located?			

Rate this component:

5	**4**	**3**	**2**	**1**
Outstanding	**Very Good**	**Good**	**Fair**	**Poor**

6. Sustainability measures. Here you have a section on the firm's impacts on the environment and on stakeholders.

Key elements	*Have you covered this in the plan?*	*Is the answer clear? (yes or no)*	*Is the answer complete? (yes or no)*
a. Is there a section on stakeholder interests and impacts?			
b. Does the plan address whether regulations (present and potential) can have an impact on the firm?			
c. Is there a section describing how the firm will address sustainability impacts, risks and opportunities?			

Rate this component:

5	**4**	**3**	**2**	**1**
Outstanding	**Very Good**	**Good**	**Fair**	**Poor**

>>

7. Management. Start by describing the management team, their unique qualifications, and your plans to compensate them (including salaries, employment agreements, stock purchase plans, levels of ownership, and other considerations). Discuss how your organisation is structured; consider including a diagram illustrating who reports to whom. Also include a discussion of the potential contribution of the board of directors, advisors, or consultants. Finally, carefully describe the legal structure of your venture (sole proprietorship, partnership, or corporation).

Key elements	*Have you covered this in the plan?*	*Is the answer clear? (yes or no)*	*Is the answer complete? (yes or no)*
a. Who will manage the business?			
b. What qualifications do you have?			
c. How many employees will you have?			
d. What will they do?			
e. How much will you pay your employees and what type of benefits will you offer them?			
f. What consultants or specialists will you use?			
g. What legal form of ownership will you have?			
h. What regulations will affect your business?			

Rate this component:

5	4	3	2	1
Outstanding	**Very Good**	**Good**	**Fair**	**Poor**

8. Financial. Three key financial statements must be presented: a balance sheet, an income statement, and a cash-flow statement. These statements typically cover a one-year period. Be sure you state any assumptions and projections made when calculating the figures.

Determine the stages where your business will require external financing and identify the expected financing sources (both debt and equity sources). Also, clearly show what return on investment these sources will achieve by investing in your business. The final item to include is a break-even analysis. This analysis should show what level of sales will be required to cover all costs.

If the work is done well, the financial statements should represent the actual financial achievements expected from your business plan. They also provide a standard by which to measure the actual results of operating your business. They are a very valuable tool to help you manage and control your business.

Key elements	*Have you covered this in the plan?*	*Is the answer clear? (yes or no)*	*Is the answer complete? (yes or no)*
a. What is your total expected business income for the first year? Quarterly for the next two years? (forecast)			
b. What is your expected monthly cash flow during the first year?			
c. Have you included a method of paying yourself?			
d. What sales volume will you need to make a profit during the three years?			
e. What will be the break-even point?			
f. What are your projected assets, liabilities, and net worth?			
g. What are your total financial needs?			
h. What are your funding sources?			

Rate this component:

5	4	3	2	1
Outstanding	**Very Good**	**Good**	**Fair**	**Poor**

9. Critical risks. Discuss potential risks before they happen. Here are some examples: price cutting by competitors, potentially unfavourable industry-wide trends, design or manufacturing costs that could exceed estimates and sales projections that are not achieved. The idea is to recognise risks and identify alternative courses of action. Your main objective is to show that you can anticipate and control (to a reasonable degree) your risks. Be sure to include a section on climate change risks (physical, regulatory and reputational). >>

Key elements	*Have you covered this in the plan?*	*Is the answer clear? (yes or no)*	*Is the answer complete? (yes or no)*
a. What potential problems have you identified?			
b. Have you calculated the risks?			
c. What alternative courses of action exist?			

Rate this component:

5	4	3	2	1
Outstanding	**Very Good**	**Good**	**Fair**	**Poor**

10. Harvest strategy. Ensuring the survival of a venture is hard work. A founder's protective feelings for an idea built from scratch make it tough to grapple with issues such as management succession and harvest strategies. With foresight, however, an entrepreneur can keep the dream alive, ensure the security of his or her venture, and usually strengthen the business in the process. Thus a written plan for succession of your business is essential.

Key elements	*Have you covered this in the plan?*	*Is the answer clear? (yes or no)*	*Is the answer complete? (yes or no)*
a. Have you planned for the orderly transfer of the venture assets if ownership of the business is passed to this corporation? b. Is there a continuity of business strategy for an orderly transition?			

Rate this component:

5	4	3	2	1
Outstanding	**Very Good**	**Good**	**Fair**	**Poor**

11. Milestone schedule. This section is an important segment of the business plan because it requires you to determine what tasks you need to accomplish to achieve your objectives. Milestones and deadlines should be established and monitored on an ongoing basis. Each milestone is related to all others, and together all of them provide a timely representation of how your objective is to be accomplished.

Key elements	*Have you covered this in the plan?*	*Is the answer clear? (yes or no)*	*Is the answer complete? (yes or no)*
a. How have you set your objectives?			
b. Have you set deadlines for each stage of your growth?			

Rate this component:

5	4	3	2	1
Outstanding	**Very Good**	**Good**	**Fair**	**Poor**

12. Appendix. This section includes important background information that was not included in the other sections. It is where you would put such items as résumés of the management team, names of references and advisors, drawings, documents, licences, agreements, and any materials that support the plan. You may also wish to add a bibliography of the sources from which you drew information.

Key elements	*Have you covered this in the plan?*	*Is the answer clear? (yes or no)*	*Is the answer complete? (yes or no)*
a. Have you included any documents, drawings, agreements, or other materials needed to support the plan?			
b. Are there any names of references, advisors, or technical sources you should include?			
c. Are there any other supporting documents?			

>>

Rate this component:

5	4	3	2	1
Outstanding	**Very Good**	**Good**	**Fair**	**Poor**

SUMMARY: YOUR PLAN

Directions: For each of the business plan sections that you assessed earlier, circle the assigned points on this review sheet and then total the circled points.

COMPONENTS		POINTS				
1.	Executive summary	5	4	3	2	1
2.	Description of the business	5	4	3	2	1
3.	Sustainability	5	4	3	2	1
4.	Marketing	5	4	3	2	1
5.	Operations	5	4	3	2	1
6.	Management	5	4	3	2	1
7.	Financial	5	4	3	2	1
8.	Critical risks	5	4	3	2	1
9.	Succession planning	5	4	3	2	1
10.	Milestone schedule	5	4	3	2	1
11.	Appendix	5	4	3	2	1
Total points:						

Scoring:	50 pts:	Outstanding! The ideal business plan. Solid!
	45–49 pts:	Very good.
	40–44 pts:	Good. The plan is sound with a few areas that need to be polished.
	35–39 pts:	Above average. The plan has some good areas but needs improvement before presentation.
	30–34 pts:	Average. Some areas are covered in detail yet other areas show weakness.
	20–29 pts:	Below average. Most areas need greater detail and improvement.
	Below 20 pts:	Poor. Plan needs to be researched and documented much better.

Source: Expanded on Donald F. Kuratko and Robert C. McDonald, *The Entrepreneurial Planning Guide,* Bloomington: Kelley School of Business, *Indiana University, 2007*

UPDATING THE BUSINESS PLAN The business plan should serve as a planning tool to help guide the start-up and execution of a new venture. Once the venture is started, the business plan is still a vital tool for planning continued growth and/or profitability. There are several reasons to update the business plan:

- **Financial changes**. Update your plan on at least a yearly basis to project financials and plan for fiscal needs.
- **Additional financing**. If continued capital is needed, an updated business plan needs to reflect the current numbers and not the ones projected before the venture was started.
- **Changes in the market**. Changes in the customer base and competition should be tracked and strategised with regard to how they might affect your venture.
- **Launch of a new product or service**. Updating the business plan is an essential method to assess the feasibility of any proposed new product or service and determine its viability.
- **New management team**. Any new members of the management team should develop their own plan to initiate strategies for growth.
- **Reflect the new reality**. Business plans are written based on estimated numbers and projections that may not be accurate after the venture has started. Business plans should be updated to reflect the new reality that the entrepreneur experiences.[21]

A practical example of a business plan

Every new venture should have a business plan; however, many entrepreneurs have no idea about the details required for a complete business plan. An example of an actual business plan is included in Appendix 1: 'Red River Optical: Affordable reading glasses for Vietnam', which describes how an Australian firm can penetrate the Vietnamese market for social benefit and for economic profit. Each part of a business plan discussed earlier in this chapter is illustrated in this detailed example. By carefully reviewing this business plan, you will gain a much better perspective of the final appearance that an entrepreneur's plan must have.

PRESENTATION OF THE BUSINESS PLAN: THE 'PITCH' Once a business plan is prepared, the next major challenge is presenting the plan to either a single financial person or, in some parts of the country, a forum at which numerous financial investors have gathered. The oral presentation – commonly known as an **elevator pitch** (because of the analogy of riding an elevator and having only two minutes to get your story told to another person in the elevator) – provides the chance to sell the business plan to potential investors.

The presentation should be organised, well prepared, interesting and flexible. Entrepreneurs should develop an outline of the significant highlights that will capture the audience's interest. Although the outline should be followed, they also must feel free to add or remove certain bits of information as the presentation progresses – a memorised presentation lacks excitement, energy and interest.

An entrepreneur should use the following steps to prepare an oral presentation:

- Know the outline thoroughly.
- Use keywords in the outline that help recall examples, visual aids, or other details.
- Rehearse the presentation to get a feel for its length.
- Be familiar with any equipment to be used in the presentation – use your own laptop.
- The day before, practise the complete presentation by moving through each slide.

Suggestions for presentation

Entrepreneurs are naturally anxious to tell (and sell) their story. However, most venture capitalists agree that the content should be focused and the delivery should be sharp. In the content of the presentation it is important to be brief and to the point, to summarise the critical factor or unique 'hook' of your venture up front, and to use no more than 12 to 15 PowerPoint slides. Following are some key suggestions about the actual delivery of the pitch to prospective investors:

- Focus on the **pain** for which your venture will be the solution. Investors want to know exactly what problem is being solved by your venture. Pinpoint the target of your solution.
- Demonstrate the **reachable market**. Instead of a dramatic potential market, outline the immediate reachable group of customers that will be targeted.
- Explain the **business model**. How this venture is designed to make money is critical to investors. Demonstrating a clear method of getting to the market for sales will indicate a successful beginning to the new venture.
- Tout the **management team**. Every investor wants to know the skills and ability of the venture's team to deliver and operationalise the concept. Emphasise the experienced people on your team as well as any technical advisors who are on board.

- Explain your **metrics**. Rather than using generic assumptions, such as the famous '1% rule' (when someone claims that he or she will simply get 1 per cent of a huge market with no research to back up the claim), highlight the metrics that were used to calculate any revenue projections.
- Motivate the audience. The entire purpose of a venture pitch is to move the audience to the next step – another meeting to discuss everything in detail. Therefore, you must remember that enthusiasm is hugely important. The investors must believe that you are excited before they can be excited.
- Why *you* and why *now*? The final point must answer the daunting questions in the minds of the investors: Why are you the right venture and why is this the right time for it to be launched? Be confident in yourself and your team. Always demonstrate a timeline to show the speed with which your venture plans to capture a significant market.[22]

What to expect

Entrepreneurs should realise that the audience reviewing their business plan is antagonistic. The venture capital sources pressure them in order to test their venture as well as the entrepreneurs. Thus, entrepreneurs must expect and prepare for a critical, sometimes sceptical, audience of financial sources. When you make your pitch and submit your business plan, the funder will listen and then glance at the plan briefly before beginning any initial comments. No matter how good you think your plan is, an investor is not going to look at it and say, 'This is the greatest business plan I've ever seen!' Do not expect enthusiastic acceptance or even polite praise. It's highly likely that the remarks will be critical and even if they aren't they'll seem that way. Don't panic. Even if it seems like an avalanche of objections, bear in mind that some of the best venture capital deals of all time faced the same opposition. Never expect results in 20 minutes. Each pitch will be a learning experience that will build your confidence for the next one.

Entrepreneurs must be prepared to handle the questions from the evaluators and learn from the criticism. They should never feel defeated but rather should make a commitment to improving the business plan for future review. Table 12.6 outlines some of the key questions that might be asked when a business plan is turned down. Entrepreneurs should use the answers to these questions to revise, rework and improve their business plan. The goal is not so much to succeed the *first* time as it is to *succeed*.[23]

TABLE 12.6: WHAT TO DO WHEN A VENTURE CAPITALIST TURNS YOU DOWN – 10 QUESTIONS

EVENT	QUESTIONS TO ASK
Confirm the decision	'That means you do not wish to participate at this time?'
Sell for the future	'Can we count you in for the second round of financing, after we've completed the first?'
Find out why you were rejected	'Why do you choose not to participate in this deal?' (Timing? Fit? All filled up?)
Ask for advice	'If you were in my position, how would you proceed?'
Ask for suggestions	'Can you suggest a source who invests in this kind of deal?'
Get the name	'Whom should I speak to when I'm there?'
Find out why	'Why do you suggest this firm and why do you think this is the best person to speak to there?'
Work on an introduction	'Who would be the best person to introduce me?'
Develop a reasonable excuse	'Can I tell him that your decision to turn us down was based on . . .?'
Know your referral	'What will you tell him when he calls?'

Source: Joseph R. Mancuso, *How to Write a Winning Business Plan*, Englewood Cliffs, NJ: Prentice-Hall, 1985: 37. Reprinted with permission of Simon & Schuster Adult Publishing Group, Copyright © 1985 by Prentice Hall, Inc.

STRAYING FROM YOUR BUSINESS PLAN?

>>ENTREPRENEURSHIP IN PRACTICE

A well-written, thoughtful business plan is an important tool for any entrepreneur; however, even the most conservative strategy can fail to address some obstacles that are encountered between the inception of a concept and the eventual harvest of the business. One example of such a hurdle is when a business encounters an economic downturn. What is the appropriate strategy when the general economy has begun to falter, leading consumers to tuck away dollars that they would have otherwise spent at your business?

The answer is that there is not one solution for dealing with an ailing economy. Despite the need for a business plan, entrepreneurs often find that strict adherence to their plan is as dangerous as not having one at all. The key is to know when to stray from your plan. Following are steps to take when your plan does not effectively address the environment in which you find your business:

- **Band together.** Partnering with companies that offer complementary products to your own is an effective way to share the responsibility of building the market. Not only can advertising expenses be split, but you also can introduce consumer incentives that encourage crossover purchasing from customers who otherwise would not have bought from your company. A common strategy is to determine what purchases your customers are currently making at other establishments that are closely associated with their purchases at your business. For instance, if you own a coffee shop and your customers are regularly walking in with pastry purchases from a local bakery, a partnership with the bakery could be a logical fit. The key is to take advantage of the existing behaviour of your customers rather than try to change it.
- **Talk to customers**. When times are lean your existing customers are your lifeblood, so keeping them happy becomes increasingly important. If your marketing budget will not allow for extravagant advertising, shift your focus to working closely with your current customers. Often you will find that your customers are more than willing to share their perspective on your business, which could lead to easy and cheap modifications that will build loyalty. By keeping track of prospective customers, you will be in a better position to follow up with them when times are slow. For instance, if your business involves providing quotes to potential customers, make note of those who chose not to make a purchase. When speaking with them, you will gain insight into reasons they went elsewhere, and your efforts might convince them to rethink doing business with you.
- **Be flexible**. When the economy slackens, consumers become more conservative with their purchases and are more inclined to base their shopping on price alone. The problem with cutting prices during an economic downturn is that consumers will expect them to remain low when the economy improves. One way to avoid having to resort to cost-cutting measures is by offering more for the same price. For instance, extending your business's hours to better accommodate your customers' schedules or offering free in-home estimates for service-related businesses are both quick measures to take that could help set your business apart from the competition.
- **Build relationships**. As an entrepreneur, the ability to network is an important skill, especially when your business begins to wane. One important forum for many new ventures is the local chamber of commerce. By interacting with local businesses, entrepreneurs can keep close tabs on what the local economic trends are as well as gain access to potential commercial customers. In addition, working with other businesses can help you locate resources in your community, such as local talent and sources of funding; moreover, having a group of fellow entrepreneurs can be useful for vetting ideas as well as for moral support.

This list is not meant to be exhaustive. The underlying theme is that entrepreneurs need to maintain the versatility that they had when first starting their businesses. Developing a strategy is important for entrepreneurs to effectively manage their business, and formally documenting that strategy is important for ensuring the continuity of their business; however, entrepreneurs who depend solely on their business plan to direct their business decisions run the risk of locking themselves into a strategy that could quickly become obsolete due to a shift in the environment. Planning is crucial for your business, but knowing when to change your plan is equally important.

Source: Adapted from Rich Sloan, 'Bad Economy? Time to Get Aggressive,' *Fortune Small Business*, 3 March 2008, money.cnn.com/2008/03/03/smbusiness/startup_nation.fsb/index.htm

>>ENTREPRENEURSHIP IN PRACTICE

BUSINESS PLANNING RESOURCES

- >> Australian Venture Capital Association Limited, www.avcal.com.au: > I NeedVenture Capital > VC & How to get it > The business plan
- >> Business Town, www.business.gov.sg. One of its resources is the Start-up eAdvisor, a website which tells you how to start a business in Singapore
- >> Business.Gov.Au, www.business.gov.au: > How-to guides > Thinking of starting a business
- >> New Zealand Trade and Enterprise, Investment Ready Guide, www.escalator.co.nz
- >> New Zealand Trade and Enterprise, Planning for Success (with excellent templates), www.nzte.govt.nz/
- >> Small Business Counselling Service, Business Plan Guide, www.sbcs.org.au
- >> Women in Small Business Information Site, www.wisbis.qut.edu.au > Contents > Search by Category > Starting A Business
- >> NSW Small Business, www.smallbiz.nsw.gov.au > Starting in Business > Business Planning

SUMMARY

This chapter provided a thorough definition and examination of a sustainable business plan. The critical factors in planning and the pitfalls to be avoided were discussed. Indicators of these pitfalls and ways to avoid them also were presented. In particular, the question of business sustainability in the era of climate change was discussed.

Next, a business plan was defined and benefits for both entrepreneurs and financial sources were discussed. Developing a well-conceived plan was presented from the point of view of the audience for whom the plan is written. The typical reading process of a business plan was presented to help entrepreneurs better understand how to put the business plan together. Guidelines in developing a business plan were provided, collated from the advice of experts in venture capital and new-business development.

The next section illustrated some of the major questions that must be answered in a complete and thorough business plan. The business plan was outlined with every major segment addressed and explained.

The chapter then presented some helpful hints for preparing a business plan, along with a judge's checklist used in business plan competitions.

The chapter concluded with a review of how to present a business plan to an audience of venture capital sources. Some basic presentation tips were listed, together with a discussion of what to expect from the plan evaluators.

KEY TERMS & CONCEPTS

biosphere
business model
business plan
cash-flow statement
five-minute reading
income statement
industrial ecology
management team
market niche
marketing segment
marketing strategy
metrics
milestone schedule segment
pain
pro forma balance sheet
reachable market
sustainable development

REVIEW AND DISCUSSION QUESTIONS

1 What do you believe the difference is between a 'regular' business plan and a 'sustainable' business plan?
2 What is the importance of sustainability in business planning?
3 What are the top three planning pitfalls that entrepreneurs often encounter, in your opinion. If 'green-theming' is not one of them, please justify.
4 Identify an indicator of each pitfall named in question 2. What would you do about each?

5 Identify the benefits of a business plan:
   a for an entrepreneur
   b for financial sources.
6 What are the three major viewpoints to be considered when developing a business plan? Describe how they can conflict.
7 Describe the six-step process venture capitalists follow when reading a business plan.
8 What are some of the components to consider in the proper packaging of a plan?
9 Identify five of the 10 guidelines to be used for preparing a business plan.
10 Which are the top 'deal-killers' in Table 12.1: 'Common business plan phrases – statement versus reality'?
11 Briefly describe each of the major segments to be covered in a business plan.
12 Why is the summary segment of a business plan written last? Why not first?
13 What are five elements included in the marketing segment of a business plan?
14 What are some critical factors covered in the management segment of a business plan?
15 Pick a company or industry sector that you know. Can you describe which risks in Table 12.3: 'Small climate changes can dramatically increase risks' would apply to it? What other risks can you name?
16 What is the meaning of the term 'critical risks'? What are the risks related to climate change?
17 Describe each of the three financial statements that are mandatory for the financial segment of a business plan.
18 Why are milestones important to a business plan?
19 Outline some of the critical points to capture in an elevator pitch.

EXPERIENTIAL EXERCISE: THE ONE-PAGE IDEA

Many times the entrepreneur is the only person who can see the opportunity. The problem is how to persuade your boss, the banker, your auntie, or your classmates, who often have little time, that the idea is profitable and sustainable. If you can distil your idea down to one page, you'll have a better chance of scoring that support. The example of a one-page idea presented here was based on a new product for the fishing industry:

- **The product** (the Rod Mate) is a fishing rod holder that enables you to hold your outfit above your waist and out of the water and elements. It has five holding applications built in: around the neck, the waist, behind the back, over the shoulder or pinned on the vest. It works with all type of fishing rods.
- **The market demand** is huge and growing at double digits. American Sportfishing Association reports that there are an estimated 44 million US recreational anglers. Sportfishing is growing annually. There are other rod holders on the market, but none have the Rod Mate's unique features.
- **Product benefit** (Here you tell the audience about the value of the new product/venture.) We all have seen those horrible pictures of a proud angler showing off their prize catch and the tackle they caught it on, wearing a fly rod in their mouth rather than a big smile. Handling a prize game fish for release, or trying to record it in a photograph with tackle in hand sometimes demands the skill of a juggler with three hands while your expensive gear is taking a soaking in the salt or bouncing off the rocks in a trout stream. Rod Mate acts to hold your rod securely, out of harm's way in several applications, while you release your catch, change flies or pose for that priceless photo of your catch and the tackle used to capture it.
- **Marketing strategies** (Here you tell them how you are going to market your product.) We are going to offer this product via Direct TV or infomercial to anglers. The Rod Mate comes complete with webbed-belt, side-release buckle. We do not know the price as of yet. We plan on getting our product into many different media within a very short time and then moving it into the big box retailers after that.
- **Management team** (Here you tell them about your motives, your expertise and the capability of the new venture team). I have been encouraged to start my own business and came upon this idea after a fishing trip with my father. We fished together for many years. I had just landed a prize trout when I tried to juggle my rod, my tackle and my net. The prize-winning fish got

away because I was unable to maintain my balance in the stream and remove the fly from the mouth of my catch.

- **The raise** (This is when you tell them the next steps, how much you think you are going to need to raise and what they can contribute to the new venture. You also include the action step or what you desire to happen as a result of the presentation. This is a very important part of the 90-second pitch.) I am in the early stage of developing my new product. I want to attract others to help me develop my product. I will need to attract outside investors and need to construct an agreement with them. I want to develop a financing plan that provides a ROI on the sales projections. If you are interested in learning more about my product or service, please feel free to give me your business card and we will be glad to set up an appointment to talk with you more. (This is the close, but you need to try to get them to set up an appointment or talk with you after the meeting. It all depends on how the meeting is set up or what type of position you are in when speaking with this person: in an elevator, an airplane, at lunch, in a bar or whatever.) This is a template to learn from and it can be adjusted accordingly.

Source: Peter H. Hackbert, The University of Illinois–Academy for Entrepreneurial Leadership, 3rd Annual Conference of the International Society for Exploring Teaching and Learning, 19–21 October 2006

EXPERIENTIAL EXERCISE

PUTTING TOGETHER A BUSINESS PLAN

The 12 major segments of a business plan are listed in the following left column. Identify the order in which each segment will appear in the plan by placing a 1 next to the first part and so on down to 12 next to the last part.

Then match each of the 24 items or descriptions on the right with the segments on the left. For example, if an item would appear in the first segment, put a 1 next to this description. Two items or descriptions are listed for each segment of the report. Answers are provided at the end of the chapter.

SEGMENTS OF THE REPORT		CONTENTS OF THE SEGMENTS	
1	Financial segment	a	Describes the potential of the new venture
2	Marketing segment	b	Discusses the advantages of location
3	Management segment	c	Discusses price cutting by the competition
4	Executive summary	d	Provides bibliographical information
5	Operations segment	e	Most crucial part of the plan
6	Business description segment	f	Orderly transfer of a company
7	Critical-risks segment	g	Analyses case if any sales projections are not attained
8	Appendix and/or bibliography	h	Shows the relationship between events and deadlines for accomplishment
9	Harvest strategy segment	i	Provides résumés of all key personnel
10	Milestone schedule segment	j	Contains support material such as blueprints and diagrams
11	Sustainability statement	k	Discusses pricing strategy
12	Sustainable performance measures	l	Should be written after the business plan is completed
		m	Provides a budget
		n	Explains proximity to suppliers
		o	Sets forth timetables for completion of major phases of the venture
		p	Provides industry background
		q	Preparations for continuity
		r	Identifies target markets
		s	Describes legal structure of the venture
		t	Provides balance sheet and income statement
		u	Performance measures to control emission
		v	Philosophy on sustainable development
		w	Estimate for sustainability impacts
		x	Plan for green certification

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

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

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

Source: Dave King, 'Getting It Right by Doing It Wrong', *The Dominion Post* (Wellington), 1 July 2004

CASE 12.1: GETTING IT RIGHT BY DOING IT WRONG

Questions

1. Based on Brigit's experience, would you still recommend writing a business plan or would you just 'wing it'?
2. What were the secrets of her success without a business plan?

CASE 12.2: IT'S JUST A MATTER OF TIME

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

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

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

Pedro agrees with his friend, but believes he should not discuss the matter with a venture capitalist until he has thought through answers to the various types of questions likely to be asked. In particular, Pedro believes he should be able to provide the venture capitalist with projected sales for the first three years and be able to explain the types of expenses that would be incurred. Once he has done this, Pedro feels he will be ready to talk to the individual. 'Right now', he told his friend, 'it's just a matter of time. I'd think that within seven to 10 days I'll be ready to present my ideas and discuss financial needs.'

Questions

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

CASE 12.3: THE INCOMPLETE PLAN

When Katrina Bulaong drew up her business plan, she was certain it would help her get financing from her uncle, a famous Philippines industrialist. Katrina is in the throes of putting together a monthly magazine directed towards Philippine executive women. The objective of the periodical is to provide information useful to women who are pursuing careers. The first issue is scheduled to go to press in 90 days. Some of the articles included in this issue are 'Managing your time for fun and profit', 'What you need to know about dressing for success' and 'Money management: Do it like the experts'. A section also is devoted to successful women at work. It is titled 'Women in the news'. Other features include a question-and-answer section that responds to letters and inquiries from readers (the first issue's questions were submitted by a group of women executives, each of whom had been asked to help get the column started by sending in a question), a stock market section that reviews industries or companies and points out the benefits and risks associated with investing in them, and a column on the state of the economy and the developments or trends expected over the next 12 months.

Katrina's business plan consisted of six parts: a summary, a business description, a manufacturing segment, a management segment, a milestone schedule segment and an appendix. When her uncle returned it to her with a polite rejection letter, he wrote: 'Without a marketing segment, attention to critical risks and a financial segment, this plan is incomplete and cannot be favourably reviewed by me. If you would provide me with this additional information and submit the rewritten plan within the next 60 days, I will be happy to review the plan and give you my opinion within 10 working days'.

Questions

1. What should Katrina put in the marketing segment? What types of information will she need?
2. For the critical-risks assessment segment, what key areas does Katrina have to address? Discuss two of these.
3. For the financial segment, what suggestions would you make to Katrina regarding the kinds of information to include? Be as specific as possible.
4. Do you think there might be some family dynamics involved?

RECOMMENDED CASES FROM HARVARD BUSINESS SCHOOL ONLINE

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Vivaldi Food Concepts – the Start-Up of an Asian Venture (A)

Publication date: 31 January 2006
Author(s): Daniel J. Isenberg
Product number: 9-806-118
Revision date: 4 August 2008

Joel Silverstein needs to raise an additional $1.5 million from private investors to round out the equity financing for his new Quick Service Restaurant venture in China, Korea and Japan. How should he pitch the opportunity? What should be the terms?

ZenG Business Plan

Publication date: 27 March 2008
Author(s): Lynda M. Applegate
Product number: 808146

This business plan, which was prepared to accompany the CommonAngels case (HBS #807149), enables students to decide whether to invite an entrepreneur to present to potential angel investors.

LinkedIn Corp, 2008

Publication date: 7 August 2008
Author(s): David B. Yoffie, Michael Slind, Nitzan Achsaf
Product number: 9-709-426

In June 2008, the online professional networking service LinkedIn became a $1 billion company. But CEO Dan Nye understood that LinkedIn faced several strategic dilemmas. Founded in 2002, LinkedIn by 2008 had become the world's leading professional networking service (PNS), with more than 23 million members. Aiming to 'dominate the business of business networking', in Nye's words, LinkedIn allowed individual members to post a profile on the LinkedIn site and then to use the site's tools to search for job opportunities; to recruit job candidates; to find suppliers, partners and customers; and to seek out expert advice. The company was also expanding into corporate services that would enable companies to build and manage their own online networks. With revenue sources that included advertising, premium subscriptions, job posting services and business solutions, LinkedIn was on track to bring in revenues in 2008 of up to $100 million. A new funding round in mid-2008 yielded a $1 billion valuation for the company. However, three key dilemmas confronted LinkedIn. First, at a time when the 'walled garden' model of online community building was under siege, it had to decide how far it should open its platform to users. Second, in light of competition from highly popular social network services such as Facebook and MySpace, LinkedIn had to decide whether to incorporate social networking into its value proposition. Third, in an increasingly global business environment, it had to weigh the option of merging with its leading international competitor, XING.com.

Answers to 'Putting together a business plan'

1	8
2	4
3	7
4	1
5	5
6	2
7	9
8	12
9	10
10	11
11	3
12	6

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c	7
d	8
e	4
f	9
g	7
h	10
i	3
j	8
k	2
l	4
m	1
n	5
o	10
p	6
q	9
r	2
s	3
t	1
u	12
v	11
w	11
x	12

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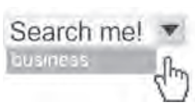
SEARCH ME!



business model
business plan
cash-flow statement
industrial ecology
market niche
marketing segment
marketing strategy
metrics
reachable market
sustainable development

PART 3

ENTRPRENEURIAL CASE ANALYSIS

10PIN CONFRONTS THE ASIAN FINANCIAL MELTDOWN[1]

Phil E. Stetz, Todd A. Finkle, Larry R. O'Nea

On 2 July 1997, Rick Baker, the president and founder of 10Pin Bowling Corporation (a US manufacturer and an international supplier of wood and synthetic bowling lanes), was having his morning coffee when he read the devastating news that Thailand had devalued its currency, the baht, by 11 per cent. This spark ignited the Asian financial crisis that gripped much of East and Southeast Asia at the end of the millennium and raised fears of a worldwide economic meltdown. He didn't know it, but within one year, the baht would collapse by 40 per cent. GDP per capita would fall by a third and Asian economies would be set back many years.

Baker realised that the company faced several critical issues. First, 80 per cent of 10Pin's sales were derived from countries in and around the Asia-Pacific. Second, the company had over $1 million in accounts receivable from this region. Third, in 1996 the company had taken out a loan for $500 000 on a new manufacturing facility to capitalise on the popularity and growth of bowling centres in Korea, China, and Taiwan.

The combination of these issues, in conjunction with the cut-throat competition within the Asian bowling equipment industry, placed Baker in a position to make a critical decision about the future of his company. He narrowed his decision to three options: (1) he could liquidate his company, (2) he could sell the company, or (3) he could stay in business and try to weather the impending storm. Which course of action should he take? To make his decision, he reflected on his company's history, its competitors, the manufacturing process and, of course, on his financials.

COMPANY BACKGROUND In 1985, Baker and two investors founded 10Pin Bowling in a chicken coop in the town of Rusk, a small community of 5000 people in Cherokee County, East Texas. Rusk's biggest assets were the surrounding state forests. The company's main products were high-grade wood and technologically advanced synthetic indoor bowling lanes in international markets. Why go into the competitive Asian market?

> We pursued international markets because the margins were better, receivables were more reliable, and the additional volume meant a healthier bottom line.

In addition, Texas had the forests. Lane construction required the use of specific types and grades of maple and pine. The necessary maple is found only in the US, while the preferred southern yellow pine is found only in the south-eastern region of the US. Furthermore, Asian bowling operators showed little interest in purchasing bowling lanes from outside the US.

BOWLING IN ASIA Tenpin bowling is a competitive sport popular in America in which players roll a large bowling ball down the lane to knock down as many of the ten pins as possible. It is distinct from bowls, played in ex-Commonwealth nations such as Malaysia, which uses slightly asymmetric balls and is commonly played outdoors on grass.

In the late 1980s, industry giants American Machine Foundry (AMF) and Brunswick began to expand into the Asia-Pacific by developing bowling centres throughout the region. The pivotal event that triggered Asian interest was the inclusion of bowling as a trial event in the 1988 Seoul Olympics.[2] After the Olympics, a bowling boom began in East Asia. US bowling exports increased by 27 per cent from 1988 to 1993, and China accounted for almost one-third. It was estimated that there were approximately 15 000 lanes in China and most industry analysts expected this demand to blossom into a 100 000+ lane market. With a population of 1.3 billion, 100 000 lanes would amount to approximately one lane per 13 000 people, much lower than the US rate of one lane per 1800 people. Table A estimates the 'population per lane' for selected international markets in 1997.[3]

The population per lane is a better statistic than 'bowling centres' because it gives an idea of literally how many people can actually bowl and a good indication of a saturation point for bowling centres in a given area.

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TABLE A: SELECTED MARKETS IN THE INTERNATIONAL BOWLING INDUSTRY IN 1997

COUNTRY	CENTERS	LANES	LANES PER CENTRE	TOTAL (000)	PER LANE
Japan	1123	32 200	29	125 000	3900
Korea	1104	16 300	15	45 350	2800
Taiwan	370	11 567	31	21 120	1800
UK	210	4400	21	58 160	12 900

Source: 10Pin Company Literature

Many social and cultural demographics helped to explain the bowling's popularity. Half of the Asian population was younger than 25 years, an optimal age range for introducing the sport to new bowlers. An Asian market analyst explained:

> Bowling is popular in the Asian market because many young urban people complain there isn't much to do with their leisure time (and increased disposable income). Disco is dead, the nightclubs are intimidating, and foreign movies are expensive and largely incomprehensible. There are very few mid-price restaurants. Bowling has filled this recreational void with a vengeance.[4]

ASIAN FINANCIAL CRISIS OF 1997–98 Baker was shocked by the events of July 1997. Following the rapid growth in the 1980s of Taiwan, Korea, Singapore, and Hong Kong – the so-called Four Tigers – a new wave of economic growth swept across Asia. This wave was driven primarily by the newly industrialising economies of Malaysia, Thailand, Indonesia, and others. Thailand's growth was especially noticeable. Thailand became known as the 'Fifth Tiger' during the 1990s.[5]

The early 1990s also marked the globalisation of financial markets. Global private capital flows turned to emerging markets, which offered higher interest rates and economic growth.[6] From 1990 to 1997, capital flows to developing countries rose more than fivefold. The most mobile forms of flow, commercial bank debt and portfolio investments, set the pace,[7] with East Asia absorbing nearly 60 per cent of all short-term capital.[8]

The Thai government in 1993 allowed banks to make loans in US dollars and other currencies through the Bangkok International Banking Facilities.[9] However, with the Thai government continuing to maintain high interest rates on baht-denominated loans to keep inflation in check,[10] the policy in reality allowed Thai companies to obtain foreign loans at lower interest rates than in baht.[11] With access to low-interest loans, readily available capital, and high demand, foreign capital flowed in and accounted for as much as 13 per cent of Thailand's gross domestic product, reaching a peak of $25.5 billion in 1995. Nearly 75 per cent of these capital inflows were from international banks in the form of bank loans with short maturities of less than one year. The majority of these loans were made to Thai banks and finance companies, which in turn made domestic loans of much longer duration.[12] So they were in danger of getting 'caught out'. Yet luxury hotels and high-rises became plentiful as development companies borrowed and invested at breakneck pace.[13]

The year 1996 marked the beginning of an economic downturn in Thailand.[14] Exports began to stagnate and growth slowed.[15] The Asian Development Bank attributed the decline in exports to several factors, including a slump in the electronic sector, tight monetary policies in other countries, and the appreciation of the US dollar against the Japanese yen.[16]

The rising value of the US dollar had a serious effect on Thailand's economy because the Thai baht was pegged to a basket of currencies with strong ties to the US dollar.[17] As the dollar strengthened, so did the baht. That meant that Japanese exports, priced in yen, became more attractive to consumers in the US.[18] Another disadvantage was that Thai interest rates were far higher than US rates, which caused distortion of the real worth of the baht. Nevertheless, the combination of exchange-rate stability and high interest rates continued to attract vast capital inflows.[19] The International Monetary Fund (IMF) suggested that a key economic problem confronting the developing countries was how to prevent big foreign capital inflows from

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fuelling inflation, blowing out their current accounts and producing a repeat of the Latin American debt crisis of the early 1980s, when foreign debt exceeded earning power. The IMF also stated that the rapid growth of spending on real estate – a classic sign of speculative excess – in Indonesia, Malaysia and Thailand and the appearance of skilled labour bottlenecks in the region were early signs of overheating.[20] Foreign investors knew what was coming and took a net $6 billion foreign investment out of the country. Short-term loans were not being renewed. Baker watched all this and was confident at the time that the Thai government would be able to maintain the value of the baht. However, the Bank of Thailand began to run out of reserves and on 2 July 1997 massively devalued the currency.[21]

For American bowling manufacturers exporting to East Asia, this was a major concern on three accounts. First, US firms feared that their Asian customers would be unable to pay off their accounts (usually payable in US dollars). Second, a significant devaluation would make US exports substantially more expensive across the entire region. Finally, governments usually raise interest rates in conjunction with any devaluation to assist in the stabilisation of their currency. Manufacturers worried that the higher prices of capital equipment and higher interest rates could quash Asian investment in bowling centres (and new bowling equipment) almost overnight, especially if governments acted quickly.

10PIN'S INTERNATIONAL EXPANSION Baker reflected how 10Pin got into this mess. Following the 1988 Olympics, 10Pin began shipping lanes to Taiwan. From 1990 to 1992, the company concentrated on developing contacts through Dacos Technologies Co., Ltd., the established Korean distributor (with a presence in Europe) of bowling equipment and accessories, which offered a complete turn-key package to bowling centre owners and developers all over the world. This enabled 10Pin to compete directly with the largest firms in the industry, Brunswick and AMF. It also gave 10Pin an advantage over smaller competitors who lacked Dacos' distribution channels.

Increasing sales to Korea and Taiwan more than offset 10Pin's declining sales to Europe, where the market was saturated. By the end of 1992, Taiwan and South Korea were also reaching saturation point for new wooden bowling lanes. But China had a growing interest in bowling, and AMF and Brunswick had already developed centres in China. However, 10Pin was able to penetrate this market in 1993–94, mainly through its partnership with Dacos.

10Pin had developed a synthetic lane called UltraLane, an increasingly popular substitute for wood flooring. As a result of this innovation, 10Pin was one of only three companies in the world to supply both wood and synthetic lanes. By 1995, Asia was the company's main market. In 1996, 10Pin's sales increased to $12.4 million, 33 per cent above the previous year.

From 1995 to 1996, AMF slashed prices of its wood and synthetic flooring, driving down prices and profitability across the industry. 10Pin matched AMF's pricing, but its profits suffered substantially. In spite of the region's problems, Baker and his Asian distributors saw increasing interest in bowling in Singapore and Malaysia. At this time, 10Pin had 80 per cent of its sales volume in the Asian markets and 20 per cent in the United States.

10PIN'S SITUATION Rick Baker contemplated the unthinkable: his firm's very viability. 10Pin's domestic sales were primarily of synthetic overlay systems. He wondered how 10Pin could survive the Asian financial crash and continue to make a profit, or at the very least, generate a positive cash flow.

Manufacturing facilities

10Pin was operating at about 60 per cent capacity at its state-of-the-art plant and could quickly meet demand in Singapore and Malaysia. Rusk, Texas, was an ideal location because of its proximity to southern yellow pine. In Baker's mind, this gave 10Pin a distinct advantage over rivals in the northern states due to low inbound costs of lumber and easy access to the mills.

Products and innovation

To address some of the shortcomings associated with wood lanes, such as marring and gouging, synthetic lanes were introduced during the 1980s. However, 10Pin did not introduce its first synthetic flooring, UltraLane, until 1992. Baker was especially proud that this innovation was developed within the company and that the resin could be used not only for the construction of new lanes, but also for refurbishing existing wood lanes. By 1996, synthetic sales accounted for 42 per cent of 10Pin's total revenue, up from 25 per cent of total sales in 1994. New synthetic lanes sold by the company were typically shipped in sections, installed on site, and cost $7000 per lane (see Figure A).

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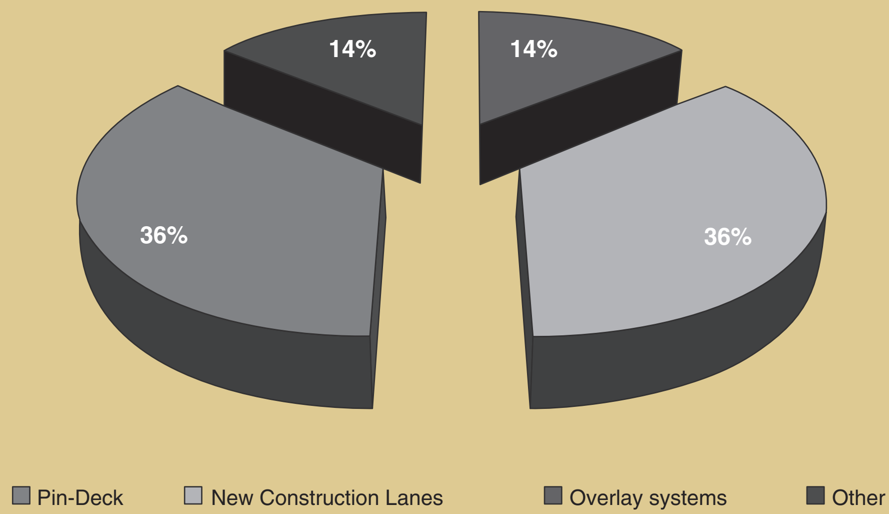
FIGURE A: REVENUE FROM VARIOUS SYNTHETIC LANE PRODUCTS



In addition to UltraLane, Baker and his team continuously innovated to improve existing products. For instance, 10Pin developed a unique 'snap on' ball return capping system and engineered changes in lane components that made the system less costly to manufacture. The capping system, made of high-impact plastic, covers (caps) the gutter dividers and ball returns that are positioned alternately between lanes. Baker thought it incongruous that the entire industry could be undermined by currency devaluation rather than by radical innovation. Why hadn't he been prepared for that?

Marketing

10Pin did little of its own advertising because of positive coverage in trade publications However, 10Pin did buy display space at trade shows and at regional and international meetings of national bowling associations. 10Pin's ongoing relationship with Dacos was 'win-win' too. By 1996, 50 per cent of 10Pin's sales were channelled through this partnership.

Service and sales

10Pin's sales force was smaller than its competitors. The company's top three executives were its sales force and in Baker's mind this was especially important because business in Asia was primarily based on relationships. Since 10Pin was so small, all encounters with the company were with executives.

Performance metrics

Baker thought it was amazing how a small firm from rural East Texas could sell millions of dollars of product to customers halfway around the world. Even so, he now felt helpless in the currency crisis. 10Pin's net profit reached an all-time high in 1995. Baker was sure that his decision to cut prices had hurt the bottom line, but he surmised that everyone in the industry was experiencing slimmer margins. The real question, he figured, was how long AMF would pursue its price-cutting policy.

Another troublesome aspect of the financials was the increase in operating expenses as a percentage of sales. Baker knew that these expenditures were needed to modernise 10Pin's facilities and enable the firm to meet the expected increase in sales. In fact, 10Pin had increased production to bring its finished inventory to 25 per cent of projected sales. Baker reasoned that if 10Pin were unable to meet demand, customers could easily go elsewhere. The outlay of $554 000 to modernise the plant was financed by a 10 per cent note payable over 10 years. Or was he now 'caught out'?

Credit and currency risk

Although sales contracts with foreign customers specified payment in US dollars, the fluctuations of foreign currencies against the dollar produced risk for both the customer and for 10Pin. A large appreciation in the US dollar could affect the collectability of foreign accounts

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receivable. Hedging techniques to reduce 10Pin's transaction exposure would entail too much work; already he was too busy growing his business and filling orders.

10PIN'S FUTURE Although Baker knew he did not fully understand the story within 10Pin's financials, he was growing uncomfortable with how the crash in Asian currency markets could affect his company. Should he have monitored the Asian economic environment more closely? Should he have expanded manufacturing operations in 1996? Should he have extended credit to his selected foreign customers? How could he have protected his company?

Baker recalled that his management professor once told him: there is a story behind each set of financial statements – especially when you compare your company with the industry averages. So Baker visited the library and collected the industry ratios and laid them next to 10Pin's financial statements (see Table B). On this humid East Texas summer night, he grabbed an ice cream bar from the freezer and sat down to ponder his next move.

TABLE B: 10PIN INCOME STATEMENT 1994–96

Ending December 31	1994	1995	1996
Sales	$7 781 131	$9 326 649	$12 359 561
COGS	$6 035 549	$6 460 768	$9 887 649
Gross Profit	$1 745 582	$2 865 881	$2 471 912
Op Expenses	$742 081	$1 325 557	$1 680 900
EBIT	$1 003 501	$1 540 324	$791 012
Interest Expense	$70 322	$45 113	$111 340
Income Tax Expense	$317 281	$447 779	$203 902
Net Income	$615 898	$1 047 432	$475 770

TABLE C: 10PIN BALANCE SHEET 1994–96

As of December 31	1994	1995	1996
Cash	$73 411	$95 847	$277 603
Accounts Receivable	$950 180	$1 416 523	$2 101 125
Inventory	$1 571 758	$2 418 940	$2 050 636
Other Current	$25 000	$58 752	$84 622
Total Current Assets	$2 620 349	$3 990 062	$4 513 986
Fixed Assets	$462 939	$567 877	$1 121 783
Accumulated Depreciation	−$258 981	−$301 163	−$496 993
Net Fixed Assets	$203 958	$266 714	$624 790
TOTAL ASSETS	$2 824 307	$4 256 776	$5 138 776
Accounts Payable	$1 043 776	$1 440 354	$1 382 526
ST Notes Payable	$249 000	$0	$0
Taxes Payable	$336 905	$271 529	$11 711
Other Current	$227 957	$56 083	$38 008
Total Current Liabilities	$1 857 638	$1 767 966	$1 432 245
Long-term Notes Payable	$72 740	$547 449	$1 289 400
Common Stock	$15 000	$15 000	$15 000
Excess of Par	$60 000	$60 000	$60 000
Retained Earnings	$818 929	$1 866 361	$2 342 131
Total Equity	$893 929	$1 941 361	$2 417 131
TOTAL LIABILITIES & EQUITY	$2 824 307	$4 256 776	$5 138 776

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TABLE D: 10PIN CASH FLOW STATEMENT 1995–96

Cash Flow from Operating Activities	**1995**	**1996**
Net Income	$1 047 432	$475 770
Depreciation	$42 182	$195 830
(Increase) AR	−$466 343	−$684 602
Other Current	−$33 752	−$25 870
(Increase) decrease Inv	−$847 182	$368 304
Increase (decrease) AP	$396 578	−$57 828
Taxes Payable	−$65 376	−$259 818
Net Cash From Operating Activities	$73 539	$11 786
Purchase of Fixed Assets	−$104 938	−$553 906
Financial Proceeds		
Decrease ST Notes	−$249 000	$0
Increase LT Debt	$474 709	$741 951
(Decrease) Other Current Liabilities	−$171 874	−$18 075
Total Fixed Proceeds (payments)	$53 835	$723 876
Net Change in Cash	$22 436	$181 756
Cross Check To Balance Sheet	$22 436	$181 756

TABLE E: COMPARISON OF RATIOS BETWEEN 10PIN AND INDUSTRY

	10Pin			Industry Averages[22]			Similar-size firms[23]
	1994	1995	1996	1994	1995	1996	1996
1. Firm Liquidity							
Current Ratio	1.41	2.26	3.15	1.7	1.7	1.8	1.8
A/R – Av. Collection Pd	44.57	55.44	62.05	NA	NA	NA	NA
2. Operating profitability							
Operating Income return on Investment	35.53%	36.19%	15.39%	9.30%	11.10%	7.20%	10.00%
Operating Profit Margin	12.90%	16.52%	6.40%	4.43%	4.63%	3.60%	5.56%
Total Asset Turnover	2.76	2.19	2.41	2.1	2.4	2	1.8
A/R Turnover	8.19	6.58	5.88	12.2	12.5	13	12.9
Inventory Turnover	3.84	2.67	4.82	5.9	6.3	5.1	7
Fixed assets Turnover	38.15	34.97	19.78	6.5	6.6	7.2	6.8
3. Financing Decisions							
Debt Ratio	2.58%	12.86%	25.09%	20.80%	20.30%	20.1	15.60%
Times Interest Earned	14.27	34.14	7.1	6	4.5	3.1	14.6
4. Return on Equity[24]	112.26%	79.34%	32.73%	23.13%	25.06%	17.31%	18.28%

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DISCUSSION QUESTIONS

1. What events and/or trends in the macro-environment were important to the bowling industry?
2. Using Porter's Five Forces Model, describe the dynamics of the industry environment.
3. Analyse the financial ratios for 10Pin. Compare them to industry averages and to similar firms. Is the firm financially healthy? Why or why not?
4. What are the internal strengths and external opportunities for 10Pin? What are the internal weaknesses and external threats?
5. What were the major problems facing 10Pin? Is the Irrevocable Letter of Credit the best means by which a firm can protect the collection of its international accounts receivable? Or, as an alternative to Letters of Credit, how might 10Pin protect its transaction exposure?
6. What should Baker do now? Why?

Source: Phil E. Stetz, Todd A.Finkle and Larry R. O'Neal, 'A-1 Lanes and the Currency Crisis of the East Asian Tigers', *Entrepreneurship Theory and Practice*, 32(2), March 2008: 369–84; and Phil E. Stetz, Todd A.Finkle and Larry R. O'Neal, 'Note to Instructors: A-1 Lanes and the Currency Crisis of the East Asian Tigers', *Entrepreneurship Theory and Practice*, 32(2), March 2008: 385–9

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23 This information is reported for the current year (1996) of firms with sales of 10–25 million.
24 RMA (Robert Morris Associates) does not report net income (after taxes) nor stockholders equity. Therefore, a derivative was used – profit before taxes/net worth as an indicant for return on equity. NA, not applicable.

PART FOUR: GROWTH STRATEGIES FOR ENTREPRENEURIAL VENTURES

13 STRATEGIC ENTREPRENEURIAL GROWTH

I have often heard it said that big companies, the corporate giants, are the ones that need to think about their business strategically. Smaller, more entrepreneurial companies, by contrast, do not need strategy; they can pursue other routes to business success.

In my view, that is exactly backward. Unlike the giants, small businesses cannot rely on the inertia of the marketplace for their survival. Nor can they succeed on brute force, throwing resources at problems. On the contrary, they have to see their competitive environment with particular clarity and they have to stake out and protect a position they can defend. That is what strategy is all about.

Michael E. Porter, Harvard Business School

chapter objectives

- **01** To introduce the importance of strategic planning for an entrepreneurial venture
- **02** To discuss some of the reasons why entrepreneurs do not carry out strategic planning
- **03** To discuss the five stages of a typical venture life cycle – development, start-up, growth, stabilisation and innovation or decline
- **04** To relate some of the benefits of strategic planning
- **05** To examine the transition that occurs in the movement from an entrepreneurial style to a managerial approach
- **06** To identify the key factors that play a major role during the growth stage
- **07** To discuss the complex management of paradox and contradiction
- **08** To introduce the steps useful for breaking through the growth wall
- **09** To identify the unique managerial concerns with a growth business
- **10** To outline ways to incorporate sustainability into business strategy.

Although most entrepreneurs do some form of planning for their ventures, it often tends to be informal and unsystematic.[1] The actual need for systematic planning will vary with the nature, size and structure of the business. In other words, a small two-person operation may successfully use informal planning because little complexity is involved. But an emerging venture that is rapidly expanding with constantly increasing personnel size and market operations will need to formalise its planning because a great deal of complexity exists.

An entrepreneur's planning will need to shift from an informal to a formal systematic style for other reasons. First, there's the degree of uncertainty with which the venture is attempting to become established and to grow. With greater levels of uncertainty, entrepreneurs have a stronger need to deal with the challenges facing their venture and a more formal planning effort can help them to do this. Second, the strength of the competition (in both numbers and quality of competitors) will add to the importance of more systematic planning in order for a new venture to monitor its operations and objectives more closely.[2] Finally, the amount and type of experience the entrepreneur has may be a factor in deciding the extent of formal planning. A lack of adequate experience, either technological or business, may constrain the entrepreneur's understanding and thus necessitate formal planning to help determine future paths for the organisation. It is only through this type of planning that entrepreneurs can manage entrepreneurial growth.

As the world evolves and develops, entrepreneurial strategy is in need of an urgent makeover in the new age. Sustainability must be integrated into the strategy of an entrepreneurial firm from the beginning. Sustainable development demands that the needs of the present generation be fulfilled in such a way that future generations will also be able to meet their needs. This requires interrelated technological, cultural, organisational and institutional strategies.

STRATEGIC PLANNING

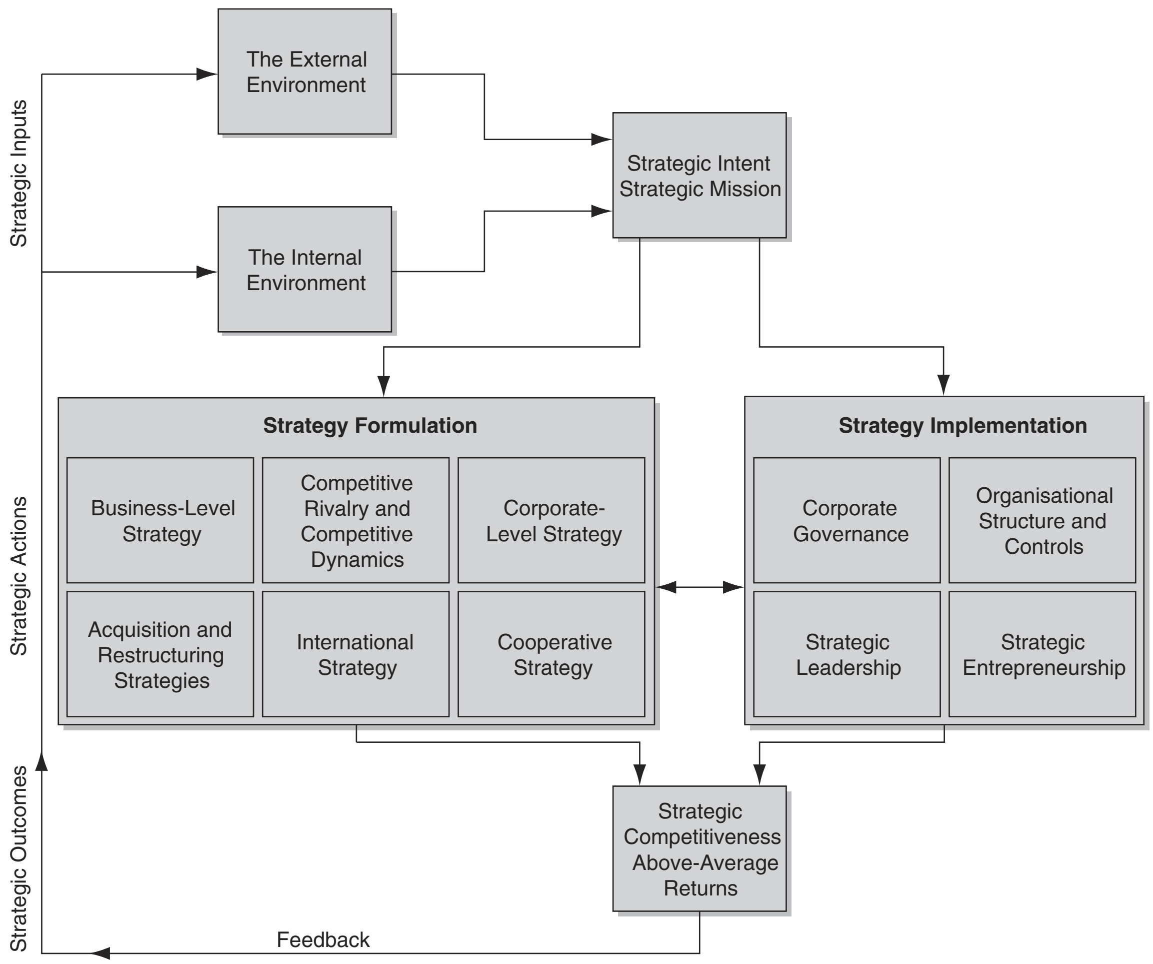
Strategic planning is the formulation of long-range plans for the effective management of environmental opportunities and threats in light of a venture's strengths and weaknesses. It includes defining the venture's mission, specifying achievable objectives, developing strategies and setting policy guidelines. Dynamic in nature, the strategic management process (Figure 13.1) is the full set of commitments, decisions and actions required for a firm to achieve strategic competitiveness and earn above-average returns. Relevant strategic inputs derived from analyses of the internal and external environments are necessary for effective strategy formulation and implementation. In turn, effective strategic actions are a prerequisite of achieving desired outcomes. Thus, the strategic management process is used to match the conditions of an ever-changing market and competitive structure with a firm's continuously evolving resources, capabilities and core competencies (the sources of strategic inputs).

Effective strategic actions that take place in the context of carefully integrated strategy formulation and implementation actions result in desired strategic outcomes.[3] Strategic planning is the primary step in determining the future direction of a business. The 'best' strategic plan will be influenced by many factors, among them the abilities of the entrepreneur, the complexity of the venture and the nature of the industry. Yet, whatever the specific situation, five basic steps must be followed in strategic planning:

1. Examine the internal and external environments of the venture (strengths, weaknesses, opportunities, threats).
2. Formulate the venture's long-range and short-range strategies (mission, objectives, strategies, policies).
3. Implement the strategic plan (programs, budgets, procedures).
4. Evaluate the performance of the strategy.
5. Take follow-up action through continuous feedback.

Figure 13.1 illustrates these basic steps in a flow diagram.[4]

FIGURE 13.1: THE STRATEGIC MANAGEMENT PROCESS



Source: Michael A. Hitt, R. Duane Ireland and Robert E. Hoskisson, *Strategic Management: Competitiveness and Globalisation*, 8th edn, Mason, OH: Cengage Learning, 2009: 5. Reprinted with permission of South-Western, a division of Cengage Learning: http://permission.cengage.com/permissions

The first step – examining the environment – can be one of the most critical for an emerging venture. Analyses of its external and internal environments provide a firm with the information required to develop its strategic intent and strategic mission. As shown in Figure 13.1, strategic intent and strategic mission influence strategy formulation and implementation actions. A clear review of a venture's internal and external factors is needed and both sets of factors must be considered when performing an environment analysis. This analysis is often called a **SWOT analysis**; SWOT is an acronym for a venture's internal *strengths* and *weaknesses* and its external *opportunities* and *threats*. The analysis should include not only the external factors most likely to occur and have a serious impact on the company, but also the internal factors most likely to affect the implementation of present and future strategic decisions. By focusing on this analysis, an emerging venture can proceed through the other steps of formulation, implementation, evaluation and feedback.[5]

The greatest value of the strategic planning process is the *strategic thinking* it promotes among business owners. Although not always articulated formally, strategic thinking synthesises the intuition and creativity of an entrepreneur into a vision for the future.[6]

The lack of strategic planning

The importance of new ventures to the economy is substantial in terms of innovation, employment, sales and effective planning can help these new firms survive and grow. Unfortunately, research

>>ENTREPRENEURSHIP IN PRACTICE

A CLIMATE-CHANGE SWOT

One way to look at how climate-related forces will affect your company is to consider their impact on both costs and revenue. A company's ability to find opportunities in a carbon-constrained world will depend on its skill at hedging against physical climate risk, mitigating regulatory costs, avoiding expensive litigation and other threats to corporate reputation, managing climate risk in the supply chain, investing capital in low-carbon assets and innovating around new technology and product opportunities. Here are some prototype questions companies might ask themselves.

STRENGTHS AND WEAKNESS

You need to think about your competition in two ways: reducing exposure to climate-related risks more so than your competitors, and finding more business opportunities within climate change than your competitors. The various aspects of climate-related risks will affect the firm's cost of capital and ultimately its valuation. Investors will factor in your company's 'climate exposure' into their estimates of future cash flow.

Potential revenue drivers:

- >> How will changes in customer-demand patterns affect pricing?
- >> What percentage of climate-related costs will you be able to pass through to the consumer?
- >> How can you generate new revenue streams for low-carbon products?
- >> How can you generate new income streams, such as from the sale of carbon credits?
- >> What threats do you face from low-carbon substitute products?
- >> What will be the impact on your revenue from weather changes?

Potential cost drivers:

- >> How will regulatory policy affect your bottom line? (For example, will you have to purchase emissions allowances?)
- >> What is the likelihood that emissions will be taxed?
- >> What capex will you face as you reduce your emissions?
- >> How will the cost of your raw materials be affected?
- >> How much will your energy costs escalate?
- >> Do you have a risk profile that might increase your insurance premiums?

OPPORTUNITIES AND THREATS

- >> Regulatory – mandatory emissions-reduction legislation
- >> Supply chain – suppliers passing their higher carbon-related costs to you
- >> Product and technology – rivals developing climate-friendly offering before you do
- >> Litigation – lawsuits charging you with negligence, public nuisance or trespass
- >> Reputation – destructive consumer or shareholder backlash
- >> Physical – damage to your assets through climate change-related drought, floods or storms.

Source: Jonathan Lash and Fred Wellington, 'Competitive Advantage on a Warming Planet', *Harvard Business Review*, March 2007 has shown a distinct lack of planning on the part of new ventures. Five reasons for this lack of strategic planning have been found.

1 **Time scarcity**: Managers report that their time is scarce and difficult to allocate to planning in the face of day-to-day operating schedules.
2 **Lack of knowledge**: Small firm owners/managers have minimal exposure to and knowledge of the planning process. They are uncertain of the components of the process and the sequence of those components. The entrepreneurs are also unfamiliar with many planning information sources and how they can be used.
3 **Lack of expertise/skills**: Small-business managers typically are generalists and they often lack the specialised expertise necessary for the planning process.
4 **Lack of trust and openness**: Small firm owners/managers are highly sensitive and guarded about their businesses and the decisions that affect them. Consequently, they are hesitant to formulate a strategic plan that requires participation by employees or outside consultants.
5 **Perception of high cost**: Small-business owners perceive the cost associated with planning to be very high. This fear of expensive planning causes many business owners to avoid or ignore planning as a viable process.[7]

Other factors have been reported as difficulties of the planning process. For example, both high-performing and low-performing small ventures have problems with long-range planning. Both time and expense are major obstacles. Additionally, low-performing firms report that a poor planning climate, inexperienced managers and unfavourable economic conditions are problems. Clearly, strategic planning is no easy chore for new ventures. On the other hand many benefits can be gained from such planning.

The value of strategic planning

Does strategic planning pay off? Research shows it does. A number of studies have focused on the impact of planning on entrepreneurial firms.[8] These studies support the contention that strategic planning is of value to a venture. Most of the studies imply – if they do not directly state – that planning influences a venture's survival. A 2004 Dun & Bradstreet survey indicates that lack of planning is one of the top reasons for small business failures,[9] and still another investigation demonstrated that firms engaged in strategic planning outperformed those that did not use such planning.[10] In a study of Australian small-scale businesses, Griggs found that strategic planning intensity does have an effect on organisational performance and that Victorian firms used it more intensively than Tasmanian equivalents.[11] A study of 220 small firms further established the importance of selecting an appropriate strategy (niche strategy) for a venture to build distinctive competence and a **sustainable competitive advantage**.[12] Another research study examined the dynamic effects of strategies on company performance in the software industry and found that when focus or differentiation strategies were established performance by those firms was enhanced.[13] Finally, there was a study that examined 253 smaller firms to determine the relationship between performance and planning sophistication. The study classified companies into the following categories:

- **Category I:** No written plan (40 per cent).
- **Category II:** Moderately sophisticated planning, including a written plan and/or some quantified objectives, some specific plans and budgets, identification of some factors in the external environment and procedures for anticipating or detecting differences between the plan and actual performance (35 per cent).
- **Category III:** Sophisticated planning, including a written plan with all of the following: some quantified objectives, some specific plans and budgets, identification of some

factors in the external environment and procedures for anticipating or detecting differences between the plan and actual performance (25 per cent).

The results demonstrated that more than 88 per cent of firms with Category II or Category III planning performed at or above the industry average, compared with only 40 per cent of those firms with Category I planning.[14]

In summary, all of the research indicates that emerging firms that engage in strategic planning are more effective than those that do not. Most importantly, the studies emphasise the significance of the planning process, rather than merely the plans, as a key to successful performance.[15]

Fatal vision in strategic planning

The actual execution of a strategy is almost as important as the strategy itself. Many entrepreneurs make unintentional errors while applying a specific strategy to their own specific venture. Competitive situations differ and the particular application of known strategies must be tailored to those unique situations.

Porter has noted five fatal mistakes entrepreneurs continually fall prey to in their attempt to implement a strategy.[16] Here are these mistakes and an explanation of them:

- **Fatal Vision 1**: Misunderstanding industry attractiveness. Too many entrepreneurs associate attractive industries with those that are growing the fastest, appear to be glamorous, or use the fanciest technology. This is wrong, because attractive industries have high barriers to entry and the fewest substitutes. The more high-tech or high-glamour a business is, the more likely a lot of new competitors will enter and make it unprofitable.
- **Fatal Vision 2**: No real competitive advantage. Some entrepreneurs merely copy or imitate the strategy of their competitors. That may be an easy tactic and it is certainly less risky, but it means an entrepreneur has no competitive advantage. To succeed, new ventures must develop unique ways to compete.
- **Fatal Vision 3**: Pursuing an unattainable competitive position. Many aggressive entrepreneurs pursue a position of dominance in a fast-growing industry. However, they are so busy getting off the ground and finding people to buy their products that they forget what will happen if the venture succeeds. For example, a successful software program will be imitated quickly. So the advantage it alone gives cannot be sustained. Real competitive advantage in software comes from servicing and supporting buyers, providing regular upgrades and getting a company online with customers so their computer departments depend on the organisation. That creates barriers to entry. Sometimes, small companies simply cannot sustain an advantage.
- **Fatal Vision 4**: Compromising strategy for growth. A careful balance must exist between growth and the competitive strategy that makes a new venture successful. If an entrepreneur sacrifices their venture's unique strategy in order to have fast growth, then the venture may grow out of business. Although fast growth can be tempting in certain industries it is imperative that entrepreneurs maintain and grow their strategic advantage as well.
- **Fatal Vision 5**: Failure to explicitly communicate the venture's strategy to employees. It is essential for every entrepreneur to clearly communicate the company's strategy to every employee. Never assume employees already know the strategy. Always be explicit. As Porter says:

> One of the fundamental benefits of developing a strategy is that it creates unity, or consistency of action, throughout a company. Every department in the organisation works toward the same objectives. But if people do not

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know what the objectives are, how can they work toward them? If they do not have a clear sense that low cost, say, is your ultimate aim, then all their day-to-day actions are not going to be reinforcing that goal. In any company, employees are making critical choices every minute. An explicit strategy will help them make the right ones.[17]

Entrepreneurial and strategic actions

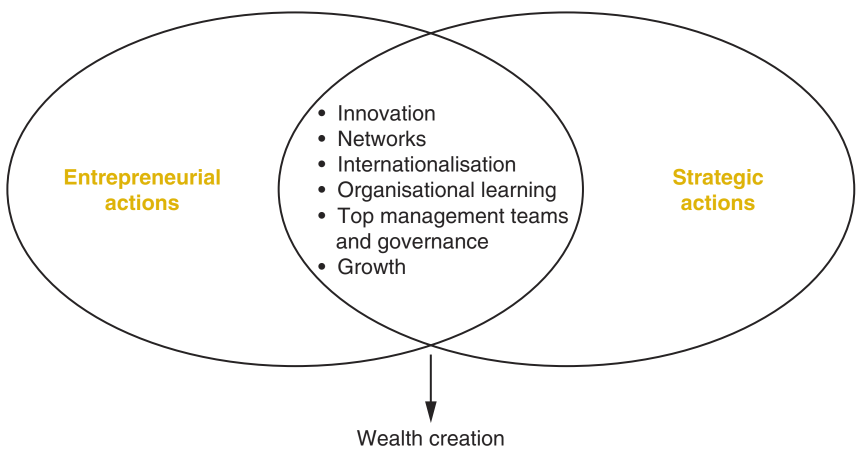
Entrepreneurship and strategic management are both dynamic processes concerned with firm performance. Strategic management calls for firms to establish and exploit competitive advantages within a particular environmental context. Entrepreneurship promotes the search for competitive advantages through product, process and market innovation. A new venture is typically created to pursue the marketplace promise from innovations.

Researchers argue that entrepreneurial and strategic actions often are intended to secure new market or competitive space for the firm to create wealth. Firms try to find fundamentally new ways of doing business that will disrupt an industry's existing competitive rules, leading to the development of new business models that create new competitive life forms. The degree to which the firm acts entrepreneurially in terms of innovativeness, risk-taking and pro-activity is related to dimensions of strategic management. Specific domains have been delineated from the commonalities of entrepreneurial and strategic actions. These domains are: innovation, networks, internationalisation, organisational learning, top management teams and governance and growth (see Figure 13.2). Understanding the critical intersections of these specific domains allows entrepreneurs to increase their knowledge, which, in turn, leads to higher quality entrepreneurial and strategic actions.[18]

Strategic positioning: The entrepreneurial edge

Strategic competition can be thought of as the process of perceiving new positions that attract customers from established positions or draw new customers into the market. In principle, incumbents and entrepreneurs face the same challenges in finding new strategic positions. In practice, entrepreneurs often have the edge.

FIGURE 13.2: THE INTEGRATION OF ENTREPRENEURIAL AND STRATEGIC ACTIONS



Source: R. Duane Ireland, Michael A. Hitt, S. Michael Camp and Donald L. Sexton, 'Integrating Entrepreneurship and Strategic Management Actions to Create Firm Wealth', *Academy of Management Executive*, 15(1), February 2001: 51

TABLE 13.1: STRATEGIC APPROACHES – POSITION, LEVERAGE, OPPORTUNITIES

STRATEGIC LOGIC	Establish position	Leverage resources	Pursue opportunities
STRATEGIC STEPS	Identify an attractive market Locate a defensible position Fortify and defend	Establish a vision Build resources Leverage across markets	Jump into the confusion Keep moving Seize opportunities Finish strongly
STRATEGIC QUESTION	Where should we be?	What should we be?	How should we proceed?
SOURCE OF ADVANTAGE	Unique, valuable position with tightly integrated activity system	Unique, valuable, inimitable resources	Key processes and unique simple rules
WORKS BEST IN	Slowly changing, well-structured markets	Moderately changing, well-structured markets	Rapidly changing, ambiguous markets
DURATION OF ADVANTAGE	Sustained	Sustained	Unpredictable
RISK	It will be too difficult to alter position as conditions change	Company will be too slow to build new resources as conditions change	Managers will be too tentative in executing on promising opportunities
PERFORMANCE GOAL	Profitability	Long-term dominance	Growth

Source: Reprinted by permission of *Harvard Business Review* from Kathleen M. Eisenhardt and Donald N. Sull, 'Strategy as Simple Rules', January 2001: 109.

Strategic positionings are often not obvious and finding them requires creativity and insight. Entrepreneurs often discover unique positions that have been available, but simply overlooked by established competitors. In addition, entrepreneurial ventures can prosper by occupying a position that a competitor once held, but has ceded through years of imitation and straddling.

Fundamental approaches to strategic positioning include establishing and defending a defensible position, leveraging resources to dominate a market and pursuing opportunities to establish new markets (see Table 13.1). Entrepreneurs must understand that the pursuit of opportunities provides the best choice for capitalising on change.

Most commonly, new positions open up because of change. New customer groups or purchase occasions arise, new needs emerge as societies evolve, new distribution channels appear, new technologies are developed and new machinery or information systems become available. When such changes happen, entrepreneurial ventures unencumbered by a long history in the industry can often more easily perceive the potential for a new way of competing. Unlike incumbents, these organisations can be more flexible because they face no trade-offs with their existing activities.[19]

MANAGING ENTREPRENEURIAL GROWTH

Managing entrepreneurial growth may be the most critical tactic for the future success of business enterprises. After initiation of a new venture, the entrepreneur needs to develop an understanding of management change. This is a great challenge, because it often encompasses the art of balancing mobile and dynamic factors.[20]

Thus, the survival and growth of a new venture require that the entrepreneur possess both strategic and tactical skills and abilities. Which specific skills and abilities are needed depend in part on the venture's current development. Figure 13.3 illustrates the typical venture life cycle. Managing growth can be a formidable challenge to successful development of any venture.

VENTURE DEVELOPMENT STAGES As noted, Figure 13.3 presents the traditional **life cycle stages** of an enterprise. These stages include new-venture development, start-up activities, growth, stabilisation and innovation or decline. Other authors have described these stages in different terms. For example, Alfred Chandler has presented a firm's evolution in the following stages:

1. initial expansion and accumulation of resources
2. rationalisation of the use of resources
3. expansion into new markets to assure the continued use of resources
4. development of new structures to ensure continuing mobilisation of resources.[21]

These four phases are, in effect, the same major stages illustrated in Figure 13.3, with the exception of stabilisation. In short, authors generally agree regarding a venture's life cycle. Here are the five major stages.

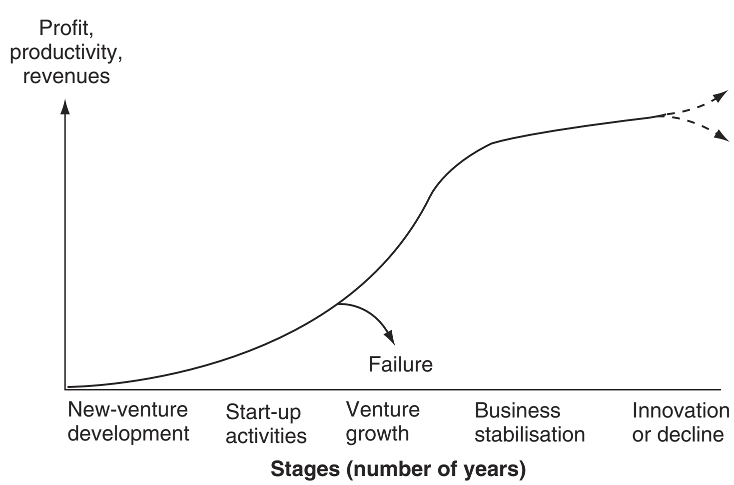
New-venture development

The first stage, **new-venture development**, consists of activities associated with the initial formulation of the venture. This initial phase is the foundation of the entrepreneurial process and requires creativity and assessment. In addition to the accumulation and expansion of resources, this is a creativity, assessment and networking stage for initial entrepreneurial strategy formulation. The enterprise's general philosophy, mission, scope and direction are determined during this stage.

Start-up activities

The second stage, **start-up activities**, encompasses the foundation work needed for creating a formal business plan, searching for capital, carrying out marketing activities and developing an effective entrepreneurial team. These activities typically demand an aggressive entrepreneurial strategy with maximum effort devoted to launching the venture. It is typified by strategic and operational planning steps designed to identify the firm's competitive advantage and to

FIGURE 13.3: A VENTURE'S TYPICAL LIFE CYCLE



uncover funding sources. Marketing and financial considerations tend to be paramount during this stage.[22]

Growth stage

The **growth stage** often requires major changes in entrepreneurial strategy. Competition and other market forces call for the reformulation of strategies. For example, some firms find themselves 'growing out' of business because they are unable to cope with the growth of their ventures. Highly creative entrepreneurs sometimes are unable, or unwilling, to meet the administrative challenges that accompany this growth stage. As a result, they leave the enterprise and move on to other ventures.

This growth stage presents newer and more substantial problems than those the entrepreneur faced during the start-up stage.[23] These newer challenges force the entrepreneur into developing a different set of skills while maintaining an entrepreneurial perspective for the organisation.[24] The growth stage is a transition from entrepreneurial one-person leadership to managerial team-oriented leadership.

Business stabilisation

The **stabilisation stage** is a result of both market conditions and the entrepreneur's efforts. During this stage a number of developments commonly occur, including increased competition, consumer indifference to the entrepreneur's good(s) or service(s) and saturation of the market with a host of 'me too' look-alikes. Sales often begin to stabilise and the entrepreneur must begin thinking about where the enterprise will go over the next three to five years. This stage is often a *swing* stage in that it precedes the period when the firm either swings into higher gear and greater profitability or swings towards decline and failure. During this stage, innovation is often critical to future success.

Innovation or decline

Firms that fail to innovate will die. Financially successful enterprises often will try to acquire other innovative firms, thereby ensuring their own growth. In addition, many firms will work on new product/service development in order to complement current offerings.

All of a venture's life cycle stages are important strategic points and each requires a different set of strategies. However, this chapter concentrates specifically on the growth stage since entrepreneurs need it most. We now will examine the key factors affecting the ability to manage this stage.

THE ENTREPRENEURIAL COMPANY IN THE 21ST CENTURY

Breathless? The pace and magnitude of change will continue to accelerate in the new millennium. It is critical that entrepreneurial firms are able to evolve and transform to match this pace. How to build dynamic capabilities that are differentiated from those of the emerging competitors is the major challenge for growing firms that seek to adapt to the changing landscape. Two ways of building dynamic capabilities are *internal* (utilisation of the creativity and knowledge from employees) and *external*[25] (the search for external competencies such as joint ventures and strategic alliances to complement the firm's existing capabilities).[26] The trend towards globalisation, the advent of new technology and the information movement are all examples of forces in this new millennium that are causing firms to examine their culture, structure and

A GLIMPSE INTO THE FUTURE

>>ENTREPRENEURSHIP IN PRACTICE

It's 15 May 2020. It's dawn in Sydney. While you yawn and sip your fair-trade organic espresso from Northern Queensland, you see that your business partners have been busy in time zones all over the world from Brazil to Turkey. You fell asleep four hours ago, tired of responding to your video-mails and watching more depressing news on the climate. Working with people of different cultures and different environmental conditions – and trying to achieve a consensus – can be aggravating.

You check your decision support robot (DSR) to see that your operations are rolling smoothly. Then you are shocked to find an order from China through your California agent that could require you to double yesterday's production. This exceeds your fuel burn threshold, even if temporarily, which would cost extra. You suspect something is awry and on intuition you don't increase production; in fact, you scale it back. Better safe than sorry – in a just-in-time world, no one can afford to be stuck with excess inventory for a whole day or needlessly pay energy credits.

You sit down to write a presentation to your banker in London that you have to give this afternoon – well, his afternoon. Better for you to do it than to delegate it, as vision and mission are your baby.

Then all hell breaks loose. Your partner – better said, a well-paid spy – in Hong Kong alerts you that a competitor is about to launch a 'green' copycat of your foundation product. You tell DSR to organise a video conference of managers ASAP. Then a pop-up on your screen flashes that the Chinese yuan is revaluing upward – again. Can you ramp up enough production in your Brazilian factory to take advantage of this short-term currency wrinkle and put more credits into your biofuel bank?

systems for flexibility and adaptability. Innovation and entrepreneurial thinking are essential elements in the strategies of growing ventures.

It has been noted that entrepreneurs: (1) perceive an opportunity, (2) pursue this opportunity and (3) believe that success of the ventures is possible.[27] This belief is often due to the uniqueness of the idea, the strength of the product, or some special knowledge or skill the entrepreneur possesses. These same factors must be translated into the organisation itself as the venture grows.

It is important for the growth-oriented entrepreneur to keep the entrepreneurial frame of mind and not relapse into being a manager or bureaucrat who stifles innovation (see Figure 13.4). Table 13.2 provides a delineation of the differences between a managerial mind-set versus

FIGURE 13.4: THE ENTREPRENEURIAL MIND-SET

		Future goals	
		Change	Status quo
Perceived capability	Possible	Entrepreneur	Satisfied manager
	Blocked	Frustrated manager	Classic bureaucrat

TABLE 13.2: THE MANAGERIAL VERSUS THE ENTREPRENEURIAL MIND-SET

	MANAGERIAL MIND-SET	ENTREPRENEURIAL MIND-SET
Decision-making assumptions	The past is the best predictor of the future. Most business decisions can be quantified.	A new idea or an insight from a unique experience is likely to provide the best estimate of emerging trends.
Values	The best decisions are those based on quantitative analyses. Rigorous analyses are highly valued for making critical decisions.	New insights and real-world experiences are more highly valued than results based on historical data.
Beliefs	Law of large numbers: Chaos and uncertainty can be resolved by systematically analysing the right data.	Law of small numbers: A single incident or several isolated incidents quickly become pivotal for making decisions regarding future trends.
Approach to problems	Problems represent an unfortunate turn of events that threaten financial projections. Problems must be resolved with substantiated analyses.	Problems represent an opportunity to detect emerging changes and possibly new business opportunities.

Source: Mike Wright, Robert E. Hoskisson and Lowell W. Busenitz, 'Firm Rebirth: Buyouts as Facilitators of Strategic Growth and Entrepreneurship', *Academy of Management Executive*, 15(1), 2001: 114

an entrepreneurial mind-set from the perspective of decision-making assumptions, values, beliefs and approaches to problems.

In some cases, success will affect an entrepreneur's willingness to change and innovate. This is particularly true when the enterprise has developed a sense of complacency or lifestyle and the entrepreneur likes this environment. The person does not want to change. In fact, some entrepreneurs will create a bureaucratic environment where orders are issued from the top down and change initiated at the lower levels is not tolerated.[28] As a result, no one in the venture is willing (or encouraged) to become innovative or entrepreneurial because the owner–founder stifles such activity.

One study found that the entrepreneur directly affects the firm's growth orientation as measured by profitability goals, product/market goals, human resource goals and flexibility goals.[29] If the entrepreneur hopes to maintain the creative climate that helped launch the venture in the first place, specific steps or measures must be taken.

BUILDING THE ADAPTIVE FIRM

It is important for entrepreneurs to establish a business that remains flexible beyond start-up. An **adaptive firm** increases opportunity for its employees, initiates change and instils a desire to be innovative. Entrepreneurs can build an adaptive firm in several ways.[30] The following six methods are not inflexible rules, but they do enhance a venture's chance of remaining adaptive and innovative both through and beyond the growth stage.

Share the entrepreneur's vision

The entrepreneur's vision must be permeated throughout the organisation in order for employees to understand the company's direction and share in the responsibility for its growth. The entrepreneur can communicate the vision directly to the employees through meetings, conversations, or seminars. It also can be shared through symbolic events or activities such as social gatherings, recognition events and displays. Whatever the format, having shared vision allows the venture's personnel to catch the dream and become an integral part of creating the future.[31]

Increase the perception of opportunity

This can be accomplished with careful job design. The work should have defined objectives for which people will be responsible. Each level of the hierarchy should be kept informed of its role in producing the final output of the product or service. This is often known as *staying close to the customer*. Another way to increase the perception of opportunity is through a careful coordination and integration of the functional areas. This allows employees in different functional areas to work together as a cohesive whole.

Continuous 'morphing'

Hyper-competition is a key feature of a new economy. In hypercompetitive environments, traditional paradigms of competitive advantage may have limited applicability. **Morphing** means 'comprehensive ongoing transformations through which the focal firms sought to regenerate their transient competitive advantage', particularly for firms on the Internet. This means that firms can change their functions often, even to the point of changing their organisational form. For example, a firm could change from a search engine to a media company. 'Shifting competitive and resource conditions required them to continuously alter their form and function.'[32]

Institutionalise change as the venture's goal

This entails a preference for innovation and change rather than preservation of the status quo. If opportunity is to be perceived the environment of the enterprise must not only encourage it, but also establish it as a goal. Within this context a desire for opportunity can exist if resources are made available and departmental barriers are reduced.

Instil the desire to be innovative

The desire of personnel to pursue opportunity must be carefully nurtured. Words alone will not create the innovative climate.[33] Specific steps such as the following should be taken.

A reward system

Explicit forms of recognition should be given to individuals who pursue innovative opportunities. For example, bonuses, awards, salary advances and promotions should be tied directly to the innovative attempts of personnel.

An environment that allows for failure

The fear of failure must be minimised by the general recognition that often many attempts are needed before a success is achieved. This does not imply that failure is sought or desired. However, learning from failure, as opposed to expecting punishment for it, is promoted. When this type of environment exists, people become willing to accept the challenge of change and innovation.

Flexible operations

Flexibility creates the possibility of change taking place and having a positive effect. If a venture remains too rigidly tied to plans or strategies it will not be responsive to new technologies, customer changes, or environmental shifts. Innovation will not take place because it will not 'fit in'.

The development of venture teams

In order for the environment to foster innovation, venture teams and team performance goals need to be established. These must be not just work groups, but visionary, committed teams with the authority to create new directions, set new standards and challenge the status quo.[34]

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>>ENTREPRENEURIAL **EDGE**

THE DIFFICULTY OF GROWTH AT MICROSOFT

When a company gets as large as Microsoft, continuing to grow can prove difficult. Microsoft has benefited from selling the most widely used operating system and office productivity suite, which has resulted in its fortified position for the last two decades. Microsoft has been able to continue its strategy of evolutionary changes to Microsoft Windows and Microsoft Office, which primarily consisted of adding features to necessitate that its customers pay for upgrades.

This model proved effective for Microsoft until it brought its most recent operating system – called Vista – to market. For the first time in the company's history, its customers demanded that computer manufacturers such as Dell, which had begun shipping computers with Vista, return to providing XP, the preceding operation system, as an option. Clearly, Microsoft's strategy was no longer going to provide the growth that it had once enjoyed.

Microsoft will not be shutting down any time soon, given that it generated net profits of $14 billion in 2007. Yet, outside of the lacklustre sales of Vista, the company is facing some significant hurdles. The first of these is Google, which is by far the largest threat to Microsoft's technical dominance. Google has slowly encroached on Microsoft's territory, but Microsoft's core products have remained insulated. As more software becomes freely available via the Internet, Microsoft has been forced to recognise that its revenue model of charging licensing fees may no longer be viable.

The difficulty for Microsoft in taking the approach that Google has taken is that it requires it to recreate its culture. When an organisation has operated for more than 30 years by charging its customers for its products, restructuring the company to focus on ways in which customers can instead receive products for free by generating advertising revenue is no easy task. Microsoft's early attempts at building an online advertising business have not proven effective, which partly explains its recent $44 billion bid for Yahoo. By acquiring Yahoo, Microsoft would gain a company already familiar with building a Web-based business and generating revenue through advertising.

In 2005, Ray Ozzie – one of the creators of Lotus Notes, a popular email client – was brought into Microsoft as one of three chief technology officers. His addition to Microsoft's executive team was touted as a major coup for the company and a clear indication of its commitment to being proactive as the market shifted to an open-source platform. In June 2006, Ozzie took over as Microsoft's chief software architect, a position previously held by Bill Gates. Shortly thereafter, the company announced a historic partnership with Novell that would make Microsoft's products more compatible with Novell's open-source SUSE Linux software. Ironically, Microsoft discovered that it sold more products when it allowed Windows to operate freely with Linux.

The reality is that Microsoft has not willingly transitioned to a new model. In fact, the company's tor management was reportedly comparing open-source software to socialism; yet, with its recent strategic decisions Microsoft has revealed that it has decided to embrace rather than fight what the market has been indicating for several years, which is that its old business model will no longer be effective. Ozzie has been given the daunting task of 'Webifying' everything Microsoft has to offer, from its business and consumer software to its Xbox gaming systems.

The company appears to be further plagued by the departure of its long-time CEO Bill Gates, who plans to transition to part-time chairman of the board. When Microsoft recently announced that it was promoting greater interoperability, Gates did not participate. Some analysts would point to Gate's departure as a sure sign of more trouble ahead for Microsoft; however, others have argued that Gates is ill-equipped to take the company where it needs to go, which is an important consideration for all entrepreneurs. No matter how successful a company becomes, it has to be willing to change to continue to grow. If current management cannot make the transition, they have to be willing to allow those who can to take over.

Source: Adapted from David Kirkpatrick, 'Microsoft Is Finally Growing Up', *Fortune*, 22 February 2008, http://money.cnn.com/2008/02/22/technology/kirkpatrick_microsoft.fortune/index.htm

THE TRANSITION FROM ENTREPRENEUR TO MANAGER The transitions between stages of a venture are complemented (or in some cases retarded) by the entrepreneur's ability to make a transition in style. A key transition occurs during the growth stage of a venture when the entrepreneur shifts into a managerial style. This is not easy to do. As Hofer and Charan have noted:

> Among the different transitions that are possible, probably the most difficult to achieve and also perhaps the most important for organisational

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development is that of moving from a one-person, entrepreneurially managed firm to one run by a functionally organised, professional management team.[35]

A number of problems can occur during this transition, especially if the enterprise is characterised by factors such as: (1) a highly centralised decision-making system, (2) an over-dependence on one or two key individuals, (3) an inadequate repertoire of managerial skills and training and (4) a paternalistic atmosphere.[36] Although these characteristics are often effective in the new venture's start-up and initial survival, they pose a threat to the firm's development during the growth stage. Quite often, these characteristics inhibit development by detracting from the entrepreneur's ability to manage the growth stage successfully.

Balancing the focus – entrepreneurial versus managerial

When managing the growth stage, entrepreneurs must remember two important points. First, an adaptive firm needs to retain certain entrepreneurial characteristics in order to encourage innovation and creativity. Second, the entrepreneur needs to translate this spirit of innovation and creativity to their personnel while personally making a transition towards a more managerial style.[37] This critical entrepreneur/manager balance is extremely difficult to achieve. Although every firm wants to be as innovative, flexible and creative as Apple, Google and Facebook, there are thousands of new restaurants, Internet businesses, retail stores and high-tech ventures that presumably have tried to be innovative, to grow and to show other characteristics that are entrepreneurial in the dynamic sense, but have failed.

Remaining entrepreneurial while making the transition to some of the more administrative traits is vital to the successful growth of a venture. Table 13.3 provides a framework for comparing the entrepreneurial and administrative characteristics and pressures relative to five major factors: strategic orientation, commitment to seize opportunities, commitment of resources, control of resources and management structure. Each of these five areas is critical to the balance needed for managing entrepreneurially. At the two ends of the continuum (from entrepreneurial focus to administrative focus) are specific points of view. One study characterised these in question format.

- **The entrepreneur's point of view**:
  - Where is the opportunity?
  - How do I capitalise on it?
  - What resources do I need?
  - How do I gain control over them?
  - What structure is best?
- **The administrative point of view**:
  - What resources do I control?
  - What structure determines our organisation's relationship to its market?
  - How can I minimise the impact of others on my ability to perform?
  - What opportunity is appropriate?[38]

The logic behind the variance in the direction of these questions can be presented in a number of different ways. For example, the commitment of resources in the entrepreneurial frame of mind responds to changing environmental needs, whereas the managerial point of view is focused on the reduction of risk. In the control of resources, entrepreneurs will avoid ownership because of the risk of obsolescence and the need for more flexibility, whereas managers will view ownership as a means to accomplish efficiency and stability. In terms of structure, the entrepreneurial emphasis is placed on a need for flexibility and independence, whereas the administrative focus is placed on ensuring integration with a complexity of tasks, a desire for order and controlled reward systems.

TABLE 13.3: THE ENTREPRENEURIAL CULTURE VERSUS THE ADMINISTRATIVE CULTURE

	ENTREPRENEURIAL FOCUS		ADMINISTRATIVE FOCUS	
	CHARACTERISTICS	PRESSURES	CHARACTERISTICS	PRESSURES
Strategic orientation	Driven by perception of opportunity	Diminishing opportunities	Driven by controlled resources	Social contracts
		Rapidly changing technology, consumer economics, social values and political rules		Performance measurement criteria
				Planning systems and cycles
Commitment to seize opportunities	Revolutionary, with short duration	Action orientation	Evolutionary, with long duration	Acknowledgement of multiple constituencies
	Narrow decision windows			Negotiation about strategic course
	Acceptance of reasonable risks			Risk reduction
	Few decision constituencies			Coordination with existing resource base
Commitment of resources	Many stages, with minimal exposure at each stage	Lack of predictable resource needs	A single stage, with complete commitment out of decision	Need to reduce risk
		Lack of control over the environment		Incentive compensation
		Social demands for appropriate use of resources		Turnover in managers
		Foreign competition		Capital budgeting systems
		Demands for more efficient use		Formal planning systems
Control of resources	Episodic use or rent of required resources	Increased resource specialisation	Ownership or employment of required resources	Power, status and financial rewards
		Long resource life compared with need		Coordination of activity
		Risk of obsolescence		Efficiency measures
		Risk inherent in the identified opportunity		Inertia and cost of change
		Inflexibility of permanent commitment to resources		Industry structures
Management structure	Flat, with multiple informal networks	Coordination of key non-controlled resources	Hierarchy	Need for clearly defined authority and responsibility
		Challenge to hierarchy		Organisational culture
		Employees' desire for independence		Reward systems
				Management theory

Source: Reprinted by permission of the *Harvard Business Review*. An exhibit from Howard H. Stevenson and David E. Gumpert, 'The Heart of Entrepreneurship', March/April 1985: 89.

These examples of differences in focus help establish the important issues involved at both ends of the managerial spectrum. Each point of view – entrepreneurial and administrative – has important considerations that need to be balanced if effective growth is going to take place.

UNDERSTANDING THE GROWTH STAGE The growth stage often signals the beginning of a metamorphosis from a personal venture to a group-structured operation. Domination by the lead entrepreneur gives way to a team approach based heavily on coordination and flexibility.

Key factors during the growth stage

Entrepreneurs must understand four key factors about the specific managerial actions necessary during the growth stage. These factors are control, responsibility, tolerance of failure and change.

Control

Growth creates problems in command and control. When dealing with them entrepreneurs need to answer three critical questions: Does the control system imply trust? Does the resource allocation system imply trust? Is it easier to ask permission than to ask forgiveness? These questions reveal a great deal about the control of a venture. If they are answered with 'yes', the venture is moving towards a good blend of control and participation. If they are answered with 'no', the reasons for each negative response should be closely examined.

Responsibility

As the company grows, the distinction between authority and responsibility becomes more apparent. This is because authority always can be delegated, but it is most important to create a sense of responsibility. This action establishes flexibility, innovation and a supportive environment. People tend to look beyond the job alone if a sense of responsibility is developed, so the growth stage is better served by the innovative activity and shared responsibility of all of the firm's members.

Tolerance of failure

Even though a venture has avoided the initial start-up pitfalls and has expanded to the growth stage, it is still important to maintain a tolerance of failure. The same level of failure the entrepreneur experienced and learned from at the start of the venture should be the same level expected in the growth stage. Although no firm should seek failure, to continually innovate and grow it should tolerate a certain degree of failure as opposed to punishment for failure.

Three distinct forms of failure should be distinguished:

- **Moral failure:** This form of failure is a violation of internal trust. Since the firm is based on mutual expectations and trust, this violation is a serious failure that can result in negative consequences.
- **Personal failure:** This form of failure is brought about by a lack of skill or application. Usually responsibility for this form of failure is shared by the firm and the individual. Normally, therefore, an attempt is made to remedy the situation in a mutually beneficial way.
- **Uncontrollable failure:** This form of failure is caused by external factors and is the most difficult to prepare for or deal with. Resource limitations, strategic direction and market changes are examples of forces outside the control of employees. Top management must carefully analyse the context of this form of failure and work to prevent its recurrence.

Change

Planning, operations and implementation are all subject to continual changes as the venture moves through the growth stage and beyond. Retaining an innovative and opportunistic posture during growth requires a sense of change and variation from the norm. It should be realised, however, that change holds many implications for the enterprise in terms of resources, people and structure. It is therefore important during growth that the flexibility regarding change be preserved. This allows for faster managerial response to environmental conditions.

Managing paradox and contradiction

When a venture experiences surges in growth, a number of structural factors begin to present multiple challenges. These include cultural elements, staffing and development of personnel and appraisal and rewards. Entrepreneurs constantly struggle over whether to organise these factors in a rigid, bureaucratic design or a flexible, organic design.

Research has shown that new-venture managers experiencing growth, particularly in emerging industries, need to adopt flexible, organic structures.[39] Rigid, bureaucratic structures are best suited for mature, stabilised companies. Thus, the cultural elements need to follow a flexible design of autonomy, risk taking and entrepreneurship. This type of culture is a renewal of the entrepreneur's original force that created the venture. Although the entrepreneur's focus makes a transition towards a more administrative style, as mentioned earlier, the culture of the organisation must be permeated with a constant renewal of the virtues of innovation and entrepreneurship.

When designing a flexible structure for high growth, entrepreneurs must realise that a number of contradictory forces are at work in certain other structural factors. Consider the following.

Bureaucratisation versus decentralisation

Increased hiring stimulates bureaucracy. Firms formalise procedures as staffing doubles and triples. Employee participation and autonomy decline and internal labour markets develop. Tied to growth, however, is also an increased diversity in product offering. This favours less formalised decision processes, greater decentralisation and the recognition that the firm's existing human resources lack the necessary skills to manage the broadening portfolio.

Business environment versus strategy

High turbulence in the business environment coupled with competitive conditions favour company cultures that support risk taking, autonomy and employee participation in decision making. Firms confront competitors, however, through strategies that depend on the design of formal systems that inhibit risk taking and autonomy.

Strategic emphases: Quality versus cost versus innovation

Rapidly growing firms strive to simultaneously control costs, enhance product quality and improve product offerings. Minimising costs and undercutting competitors' product prices, however, are best achieved by traditional hierarchical systems of decision making and evaluations. Yet these strategies conflict with the kinds of autonomous processes most likely to encourage the pursuit of product quality and innovation.[40]

These factors emphasise the importance of managing paradox and contradiction. Growth involves the multiple challenges of: (1) the stresses and strains induced by attempts to control costs while simultaneously enhancing quality and creating new products to maintain competitive parity and (2) centralising to retain control while simultaneously decentralising to encourage the contributions of autonomous, self-managed professionals to the embryonic corporate culture. Rapidly growing firms are challenged to strike a balance among these multiple pulls when designing their managerial systems.

Confronting the growth wall

In attempting to develop a managerial ability to deal with venture growth, many entrepreneurial owners confront a **growth wall** that seems too gigantic to overcome. Thus, they are unable to begin the process of handling the challenges that growth brings about.

Researchers have identified a number of fundamental changes that confront rapid-growth firms, including instant size increases, a sense of infallibility, internal turmoil and extraordinary

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resource needs. In addressing these changes that can build a growth wall, successful growth-oriented firms have exhibited a few consistent themes:

- The entrepreneur is able to envision and anticipate the firm as a larger entity.
- The team needed for tomorrow is hired and developed today.
- The original core vision of the firm is constantly and zealously reinforced. New 'big-company' processes are introduced gradually as supplements to, rather than replacements for, existing approaches.
- Hierarchy is minimised.
- Employees hold a financial stake in the firm.[41]

These themes are important for entrepreneurs to keep in mind as they develop their abilities to manage growth.

One researcher found that internal constraints such as lack of growth capital, limited spans of control and loss of entrepreneurial vitality occur in growth firms that struggle to survive versus those that successfully achieve high growth. In addition, fundamental differences exist in the firms' approach to environmental changes and trends.[42] Thus a few key steps are recommended for breaking through the inability to handle environmental changes or trends. These include: *creating a growth task force* to organise and interpret the environmental data, to identify the venture's strengths and weaknesses, to brainstorm new ideas that leverage the firm's strengths and to recommend key ideas that should be developed further; *planning for growth* with strategies to resolve the stagnation, a set of potential results and identification of the necessary resources; *maintaining a growth culture* that encourages and rewards a growth-oriented attitude; and *developing an outside board of advisors* to become an integral part of the venture's growth. This board should help determine, design and implement an organisational structure to enhance the desire for growth.[43]

UNIQUE MANAGERIAL CONCERNS OF GROWING VENTURES

Emerging businesses differ in many ways from larger, more structured businesses. Several unique managerial concerns involve growing businesses in particular. These concerns may seem insignificant to the operation of a large business, but often they become important to emerging entrepreneurs.

The distinctiveness of size

The distinction of smallness gives emerging businesses certain disadvantages. The limited market, for example, restricts a small firm. Because a small size limits a company's ability to geographically extend throughout a region or state, the firm must recognise and service its available market. Another disadvantage is the higher ordering costs that burden many small firms. Because they do not order large lots of inventory from suppliers, small businesses usually do not receive quantity discounts and must pay higher prices. Finally, a smaller staff forces small firms to accept less specialisation of labour. Thus, employees and managers are expected to perform numerous functions.

However, the distinction of small size is not all bad, and the advantages to smallness should be recognised and capitalised on. One advantage is greater flexibility. In smaller ventures, decisions can be made and implemented immediately, without the input of committees and the delay of bureaucratic layers. Production, marketing and service are all areas that can be adjusted quickly for a competitive advantage over larger businesses in the same field. A second advantage is constant communication with the community.[44] An entrepreneur lives in the community and is personally involved in its affairs. The special insight of this involvement allows the entrepreneur to adjust products or services to suit the specific needs or desires of the particular community. This leads to the third and probably most important advantage of closeness to the customer: the ability to offer personal service. The personal service that an entrepreneur can provide is one of the key elements of success today. Major corporations work feverishly to duplicate or imitate the idea of personal service. Because the opportunity to provide personal service is an advantage that emerging firms possess by nature of their size, it *must* be capitalised on.

The one-person-band syndrome

Most entrepreneurs start their businesses alone or with a few family members or close associates. In effect, the business *is* the entrepreneur and the entrepreneur is the business.[45] However, a danger arises if the entrepreneur refuses to relinquish any authority as the emerging business grows. The **one-person-band syndrome** exists when an entrepreneur fails to delegate responsibility to employees, thereby retaining all decision-making authority. One study revealed that most planning in entrepreneurial firms is done by the owner alone, as are other operational activities.[46] This syndrome often is derived from the same pattern of independence that helped start the business in the first place. However, the owner who continues to perform as a one-person band can restrict the growth of the firm, because the owner's ability is limited. How can proper planning for the business be accomplished if the owner is immersed in daily operations? Thus, the entrepreneur must recognise the importance of delegation. If the owner can break away from the natural tendency to do *everything*, then the business will benefit from a wider array of that person's abilities.

Time management

Effective time management is not exclusively a challenge to entrepreneurs. However, limited size and staff force the entrepreneur to face this challenge most diligently. It has been said a person never will *find* time to do anything but must, in fact, *make* time. In other words, entrepreneurs should learn to use time as a resource and not allow time to use them.[47] To perform daily managerial activities in the most time-efficient manner, owner/managers should follow four critical steps:

1. *Assessment*. The business owner should analyse his or her daily activities and rank them in order of importance. (A written list on a notepad is recommended.)
2. *Prioritisation*. The owner should divide and categorise the day's activities based on his or her ability to devote the necessary time to the task that day. In other words, the owner should avoid a procrastination of duties.
3. *Creation of procedures*. Repetitive daily activities can be handled easily by an employee if instructions are provided. This organising of tasks can be a major time-saver for the owner that would allow the fourth and last step to be put into effect.
4. *Delegation*. Delegation can be accomplished after the owner creates procedures for various jobs. As mentioned in the description of the one-person-band syndrome, delegation is a critical skill entrepreneurs need to develop.

All of these steps in effective time management require self-discipline on the part of entrepreneurs.

Community pressures

Proximity to the community was mentioned earlier as a size advantage for small emerging ventures. However, unlike major corporations with public relations departments, the entrepreneur is involved with community activities directly. The community presents unique pressure to emerging entrepreneurs in three ways: participation, leadership and donations. (See experiential exercise 'A community-level analysis' at the end of this chapter.)

Each of these expectations from the community requires entrepreneurs to plan and budget carefully. Many community members believe that the entrepreneur has 'excess' time because he or she owns the business. They also believe that the owner has leadership abilities needed for various community activities. Although the latter may be true, the owner usually does not have excess time. Therefore, entrepreneurs need to plan carefully the activities they believe would be most beneficial. One consideration is the amount of advertising or recognition the business will receive for the owner's participation. When the owner can justify his or her community involvement, both the business and the community benefit.

Financial donations also require careful analysis and budgeting. Again, because consumers have access to the entrepreneur (as opposed to the chief executive officer of a major corporation), he or she may be inundated with requests for donations to charitable and community organisations. Although each organisation may have a worthy cause, the entrepreneur cannot support every one and remain financially healthy. Thus, the owner needs to decide which of the organisations to assist and to budget a predetermined amount of money for annual donations. Any other solicitations for money must be placed in writing and submitted to the entrepreneur for consideration. This is the only way entrepreneurs can avoid giving constant cash donations without careful budget consideration.

The critical fact to remember is that time and money are extremely valuable resources for an entrepreneur. They should be budgeted in a meaningful way. Therefore, entrepreneurs need to analyse their community involvement and to continuously reassess the costs versus the benefits.[48]

Continuous learning

A final unique concern for the entrepreneur is continuous learning. All of the previously mentioned concerns leave very little time for owners to maintain or improve their managerial and entrepreneurial knowledge. However, the environment of the 21st century has produced dramatic changes that can affect the procedures, processes, programs, philosophy and even the product of a growing business. As the ancient Greek philosopher Epictetus said, 'It is impossible for a man to learn what he thinks he already knows'. This quote illustrates the need for entrepreneurs to dedicate time to learning new techniques and principles for their businesses. Trade associations, seminars, conferences, publications and university courses all provide opportunities for entrepreneurs to continue their entrepreneurial education. Staying abreast of industry changes is another way in which entrepreneurs can maintain a competitive edge.

ACHIEVING ENTREPRENEURIAL LEADERSHIP

Entrepreneurial leadership may be the most critical element in the management of high-growth ventures. Terms such as '*visionary*' and '*strategic*' have been used when describing different types of leaders. Table 13.4 provides a comprehensive description of strategic leaders, visionary leaders and managerial leaders. It is the concept behind strategic leadership that research has demonstrated to be the most effective in growing organisations.[49] Researchers have identified some of the most important concepts in effective strategic leadership.[50] This type of leadership can be classified as entrepreneurial leadership, which arises when an entrepreneur attempts to manage the fast-paced, growth-oriented company.[51]

Entrepreneurial leadership can be defined as the entrepreneur's ability to anticipate, envision, maintain flexibility, think strategically and work with others to initiate changes that will create a viable future for the organisation. If these leadership processes are difficult for competitors to understand and imitate, the firm will create a competitive advantage.

Today's fast-paced economy has created a new competitive landscape – one in which events change constantly and unpredictably. These changes are revolutionary in nature; that is, they happen swiftly and are relentless in their frequency, affecting virtually all parts of an organisation simultaneously. The ambiguity resulting from revolutionary changes challenges firms and their strategic abilities to increase the speed of the decision-making processes through which strategies are formulated and implemented.[52]

TABLE 13.4: STRATEGIC, VISIONARY AND MANAGERIAL LEADERSHIP

STRATEGIC LEADERS	VISIONARY LEADERS	MANAGERIAL LEADERS
Synergistic combination of managerial and visionary leadership Emphasis on ethical behaviour and value-based decisions Oversee operating (day-to-day) and strategic (long-term) responsibilities Formulate and implement strategies for immediate impact and preservation of long-term goals to enhance organisational survival, growth and long-term viability Have strong, positive expectations of the performance they expect from their superiors, peers, subordinates and themselves Use strategic controls and financial controls, with emphasis on strategic controls Use and interchange tacit and explicit knowledge on individual and organisational levels Use linear and non-linear thinking patterns Believe in strategic choice; that is, their choices make a difference in their organisations and environment	Are proactive, shape ideas, change the way people think about what is Desirable, possible and necessary Work to develop choices, fresh approaches to long standing problems; work from high-risk positions Are concerned with ideas; relate to people in intuitive and empathetic ways Feel separate from their environment; work in, but do not belong to, organisations; sense of who they are does not depend on work Influence attitudes and opinions of others within the organisation Concerned with ensuring future of organisation, especially through development and management of people More embedded in complexity, ambiguity and information overload; engage in multifunctional, integrative tasks Know less than their functional area experts More likely to make decisions based on values More willing to invest in innovation, human capital and creating and maintaining an effective culture to ensure long-term viability Focus on tacit knowledge and develop strategies as communal forms of tacit knowledge that promote enactment of a vision Utilise non-linear thinking Believe in strategic choice; that is, their choices make a difference in their organisations and environment	View work as an enabling process involving some combination of ideas and people interacting to establish strategies Are reactive; adopt passive attitudes towards goals; goals arise out of necessities, not desires and dreams; goals based on past Relate to people according to their roles in the decision-making process See themselves as conservators and regulators of existing order; sense of who they are depends on their role in organisation Influence actions and decisions of those with whom they work Involved in situations and contexts characteristic of day-to-day activities Concerned with and more comfortable in, functional areas of responsibilities Expert in their functional area Less likely to make value-based decisions Engage in and support short-term, least-cost behaviour to enhance financial performance figures Focus on managing the exchange and combination of explicit knowledge and ensuring compliance to standard operating procedures Utilise linear thinking Believe in determinism; that is, the choices they make are determined by their internal and external environments

Source: W. Glenn Rowe, 'Creating Wealth in Organisations: The Role of Strategic Leadership', *Academy of Management Executive*, 15(1), 2001: 82

Growth-oriented firms need to adopt a new competitive mind-set – one in which flexibility, speed, innovation and strategic leadership are highly valued. With this mind-set, firms can identify and completely exploit opportunities that emerge in the new competitive landscape. These opportunities surface primarily because of the disequilibrium that is created by continuous changes (especially technological changes). More specifically, although uncertainty and disequilibrium often result in seemingly hostile and intensely rivalrous conditions, these conditions may simultaneously yield significant product-driven growth opportunities. Through effective entrepreneurial leadership, growth firms can adapt their behaviours and exploit such opportunities.[53]

STRATEGIC SUSTAINABLE DEVELOPMENT

Our understanding is just now growing about the physical impacts of climate change on entrepreneurial strategy. It is important to focus on how entrepreneurs can use environmental benchmarking to guide long-term development of competitive advantage. It is important to integrate environmental with other corporate goals, including other sustainability and social goals.

Entrepreneurial businesses face not only direct, biophysical impacts. They also face indirect impacts, which are just as enormous. These include: (1) competitive impacts offering strategic advantages or disadvantages in product innovation in terms of costs of goods and services produced, (2) psychographic impacts such as sudden change in needs and behaviour of stakeholders and (3) legal/regulatory changes (see Chapter 7).[54]

What advantage or disadvantage do you have in the competitive environment in such things as product innovation and costs of goods/services produced? What is the changing nature of your customers in their involvement in climate change or in their reaction to your brand image? How is the regulatory regime changing for your company? These are all questions of strategy in the era of climate change and global warming. This emerging area is called Strategic Sustainable Development (SSD).

One of the key goals for any entrepreneur is to be able to set a future direction for the enterprise. The problem is that the ground rules have shifted. Entrepreneurial strategy used to be the art of managing assets that one did not own. Now there is an increasing realisation that the Earth's resources also fall into this category. We do not own them; they belong to our grandchildren and we must not deplete them. New millennial entrepreneurs have to confront the challenges of how to put a strategy in place that at the same time grows the company as well as protects those resources that we do not own. Today, many companies have accepted their responsibility to do no harm to the environment. Products and production processes are becoming cleaner; and where such change is under way, the environment is on the mend. In industrialised nations, more and more companies are going green as they realise that they can reduce pollution and increase profits simultaneously.[55]

Stages of sustainability strategy

Hart graphically leads us through four stages of a firm's possible environmental strategy (see Table 13.5). The first three stages propel the company towards the fourth stage.

TABLE 13.5: FOUR STAGES OF A SUSTAINABILITY GROWTH STRATEGY

This diagnostic tool can help the entrepreneur determine whether his strategy is consistent with sustainability. First, assess your capability in each of the four quadrants by answering the questions in each box. Then rate yourself on the following scale for each quadrant: 1 – non-existent, 2 – emerging, 3 – established, or 4 – institutionalised. Ultimately, we seek balance in all four quadrants.

	INTERNAL	EXTERNAL
Today	**Stage one: Pollution prevention** *The first step for most companies is to make the shift from pollution control to pollution prevention. Pollution control means cleaning up waste after it has been created. Pollution prevention focuses on minimising or eliminating waste before it is created.* Where are the most significant waste and emission streams from our current operations? Can we lower costs and risks by eliminating waste at the source or by using it as useful input?	**Stage two: Product stewardship** *Product stewardship focuses on minimising not only pollution from manufacturing but also all environmental impacts associated with the full life cycle of a product. As companies in stage one move closer to zero emissions, reducing the use of materials and production of waste requires fundamental changes in underlying product and process design.* What are the implications for product design and development if we assume responsibility for a product's entire life cycle? Can we add value or lower costs while simultaneously reducing the impact of our products?
Tomorrow	**Stage three: Clean technology** *Companies with their eye on the future can begin to plan for and invest in tomorrow's technologies. Clean technologies are desperately needed in the emerging economies of Asia. Urban pollution there has reached oppressive levels.* Is the environmental performance of our products limited by our existing competency base? Is there potential to realise major improvements through new technology?	**Stage four: Sustainability vision** *A vision of sustainability is like a road map to the future, showing the way products and services must evolve and what new competencies will be needed to get there.* Does our corporate vision direct us towards the solution of social and environmental problems? Does our vision guide the development of new technologies, markets, products and processes?

Source: Adapted from Stuart L. Hart, 'Beyond Greening: Strategies for a Sustainable World', *Harvard Business Review*, 75(1), January 1997: 74

The Sustainability Helix

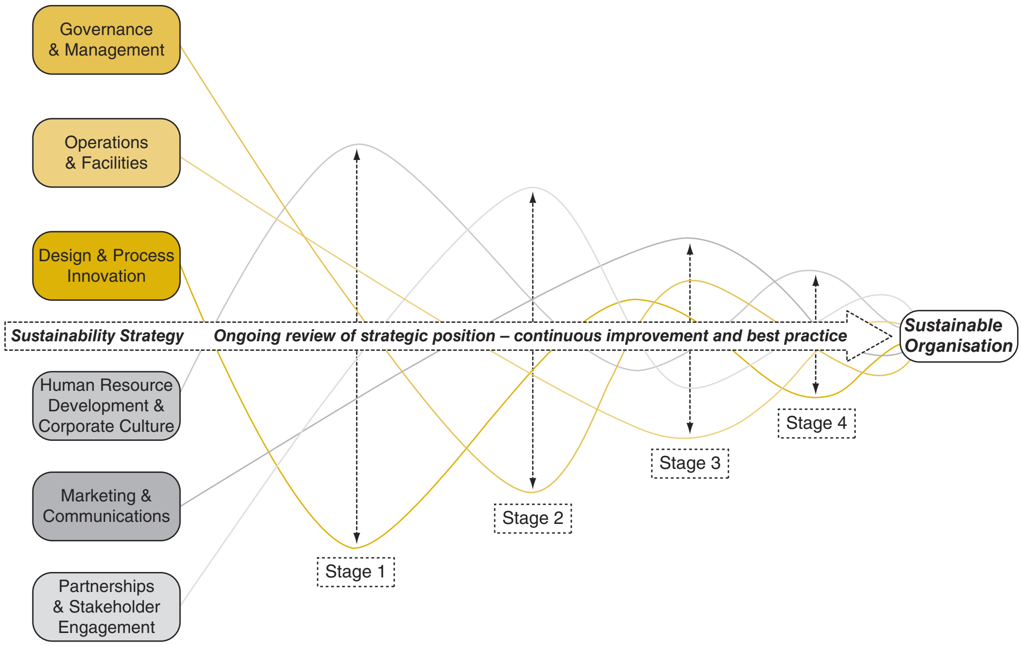
The Sustainability Helix (see Figure 13.5) helps us understand how business can become more sustainable.[56] Using the biological metaphor, the helix shows the interactions between the various strands that are complex and interactive. Each strand is supported by a series of strategies and tools. Taken together they are a mutually reinforcing process towards genuine sustainability development within the business.

The six strands

Down the left-hand side of the helix are the six strands or areas within a firm that help create the sustainable organisation.

- **Governance and management**: Corporate governance in the 21st century requires a broad set of management tools and processes to ensure that companies not only prosper economically, but are also socially and environmentally responsible.
- **Operations and facilities**: There is an enormous scope for improving the efficiency and effectiveness of most business practices and operations and in doing so to reduce costs and external impacts.
- **Design and process innovation**: Businesses that can rapidly translate customer needs into new or improved products and services, in light of constraints (present or anticipated), reap the benefits of first-mover advantage.

FIGURE 13.5: MANAGEMENT HELIX FOR THE SUSTAINABLE ORGANISATION (SUSTAINABILITY HELIX)



Management Helix for the Sustainable Organisation

A mutually reinforcing process to achieve lasting competitive advantage through lowering cost and differentiating products and services while delivering genuinely sustainable progress.

Source: The Natural Edge Project, www.naturaledgeproject.net/images/SustainabilityHelix.jpg

- **Human resource development and corporate culture**: Sustainability strategies often dramatically improve productivity by creating healthier and more inspiring workplaces, fostering feedback and employee contributions to continuous improvement, encouraging strategic risk-taking cultures, improving knowledge of global developments and technological advances, and aligning corporate goals with long-term societal and personal values.
- **Marketing and communications**: Competitive advantage arises out of the value that a firm continues to provide to its customers. Trust is now an underpinning value between an organisation and its consumers, and sustainability offers opportunities for businesses to strengthen their competitive advantage by meeting customer needs to feel good about their consumption choices.
- **Partnerships and stakeholder engagement**: In order to remain competitive in a market growing in complexity an organisation must take advantage of developing relationships, partnerships and alliances with a range of other organisations, institutions and groups within society.

Sustainability management stages

Across the bottom of the helix are the four stages that an entrepreneurial firm would go through on the way to achieving a sustainable business.

- **Stage 1**: Exploration of sustainability operations and business cases, development of internal tools procedures and capabilities, and commitment to sustainability journey. The willingness to embark on the sustainability journey typically arises when a change agent within the company has determined that this is a process worth exploring. The work of this stage is to develop an understanding of what sustainability is (to the company), and to then explore the value of sustainability to the mission and business model of the company.
- **Stage 2**: Quiet learning-mode implementation through experimentation, capability development and assembling whole-systems starting with pilot projects; and solidifying commitments and momentum. At this stage, the company becomes willing to make a commitment to operating in more sustainable ways. The company undertakes to commit resources to set clear indicators of success, assess its social and environmental impacts and prove through the pilot projects the validity of the business case for sustainability.
- **Stage 3**: Public commitments anchor momentum for use of sustainability throughout operations and value chain; and natural and human capital impacts are understood and being neutralised. At this stage, the company has assured itself that there is a strong business case for sustainability and is ready to make a systemic commitment to behave responsibly towards the planet and society through its operations and influence. In this stage, a company implements its sustainability strategy throughout its operations, activities and its value chain. It builds upon its responsibility to enhance shareholder value by taking a public leadership role within its industry and the world at large. Public commitments perpetuate momentum towards minimising impacts on natural and human capital and beginning to behave in ways that reinvest in all forms of capital.
- **Stage 4**: Full competitive advantage realised through integration such that 'sustainability management' no longer is necessary; and improving natural and human capital through operations. At this stage, a company is in a position to ensure that a high level of competitive advantage has been realised through integration of sustainability concepts, methodologies and processes into business practice. By the end of this level, the goal is for the company to become a truly sustainable corporation. Through its activities the

company restores human and natural capital, maximises shareholder value and finds its rightful place in the whole of society in which business, civil society, government and all other stakeholders contribute to achieving genuine progress.

New strategic tools

There are many new types of tools that an entrepreneurial strategist can use. Many of the most interesting ones are emerging from the needs of firms to come to grips with climate change. In Table 13.6 we present five such tools which are intended to facilitate setting up, financing, managing or monitoring biodiversity business investments. Simply change the word *biodiversity* to 'water', 'food', 'energy', 'population' etc. and you will see the power of this instrument for entrepreneurial planning.

Strategic backcasting

Business is nothing more than a highly designed part of the natural ecosystem. It is dependent on and influenced by the same laws that are in operation in nature itself. A new technique called **strategic backcasting** is an excellent approach to exploring the strategic implications of sustainability.[57] Backcasting is a methodology for planning under uncertain circumstances and it means looking back from the future. It is the opposite of forecasting, which means looking to the future from the present, something that the conventional business strategist has done

TABLE 13.6: BIOTOOLS FOR BIODIVERSITY BUSINESSES

TOOL	PURPOSE
BioDefinition	To establish the biodiversity context of the business and identify potential linkages between the business and biodiversity in the bioregion. The BioDefinition tool is used to guide early decisions about creating or investing in a biodiversity business. It provides businesses and investors with an initial idea of the biodiversity-related risks and opportunities associated with the business. Potential investors and sponsors can use results to screen potential investments for their positive contribution to biodiversity.
BioSwot	To analyse the key strengths, weaknesses, opportunities and threats in the linkages between the business and the biodiversity in the bioregion. The BioSwot is used to guide the further development of a Biodiversity Business Plan (BBP) or to prepare a more detailed analysis of an investment opportunity.
Biodiversity Management Plan	To define a set of actions by which biodiversity performance of the business can be optimised, and to assist in integrating the Biodiversity Management Plan (BMP) with the business development plan. The BMP is usually developed during the later stages of business planning or as a key element of pre-investment appraisal, following the application of the BioDefinition and BioSwot tools.
BioGovernance	To put in place structures to preserve the biodiversity integrity of the business and to secure achievement of biodiversity performance. The BioGovernance tool is applied when institutional arrangements for the biodiversity business are developed and is closely linked to the development of the BMP and BBP.
BioPerformance Monitoring	To evaluate and report on the business' achievement of objectives. The tool is applied throughout the life of the project from the time business activity commences, or at any time during the lifetime of the biodiversity business, after the completion of the key inputs, namely determination of biodiversity objectives and BMP completion.

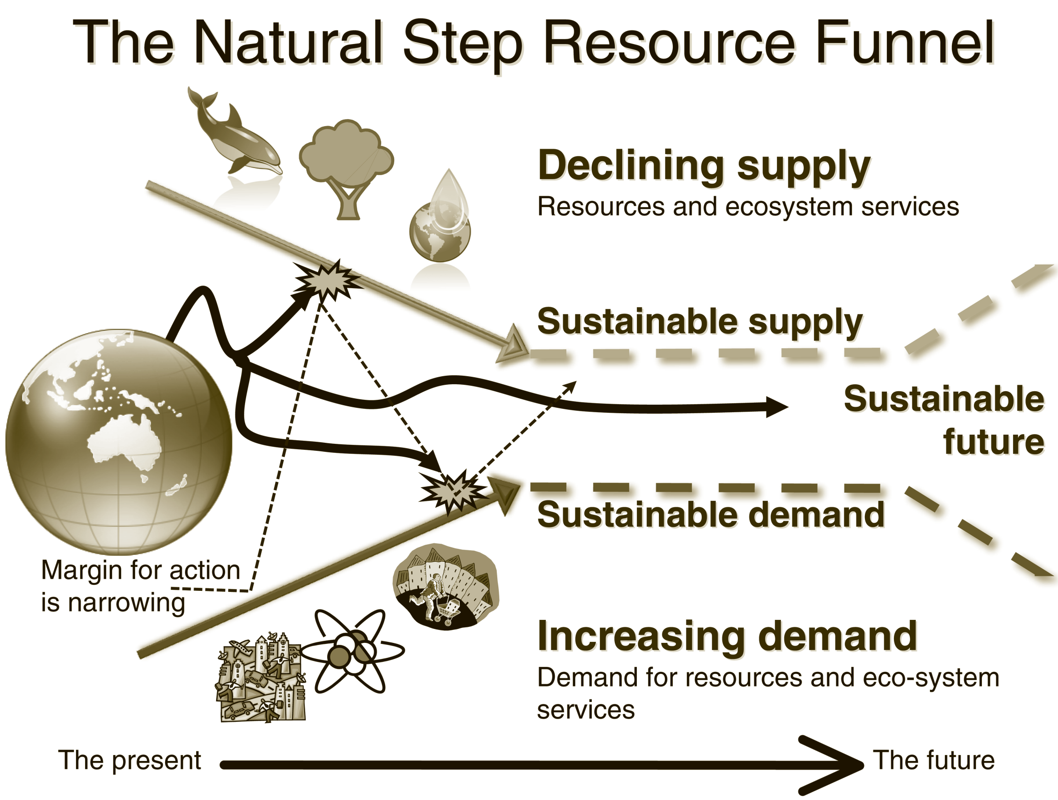
Source: Joshua Bishop, Sachin Kapila, Frank Hicks, Paul Mitchell and Francis Vorhies, *Building Biodiversity Business*, London and Gland(Switzerland): Shell International Limited and the World Conservation Union, 2007: 119, http://data.iucn.org/dbtw-wpd/edocs/2008-002.pdf for decades. Whereas forecasting is the process of predicting the future based on current trend analysis, backcasting approaches the challenge from the opposite direction. Backcasting is 'a method in which the future desired conditions are envisioned and steps are then defined to attain those conditions, rather than to take steps that are merely a continuum of present methods extrapolated into the future'.[58]

The method begins by examining several alternative future scenarios usually from a normative (or desirable) perspective. Then quantitative analysis kicks in. The question is asked: If we want to arrive at Scenario A, what trends would need to change to get us there? For example, if Scenario A was a future in which CO_2 emissions were stabilised at X part per million, and Scenario B was CO_2 stabilisation at Y parts per million, then a quantitative analysis could help assess which one was more plausible under any given set of assumptions.

This is now known as 'The Natural Step' Framework (see Figure 13.6 and Table 13.7). The Framework uses **The Natural Step Funnel** as a metaphor to describe its methodology:

> Imagine looking at a giant funnel from the side. The upper wall is the availability of resources and the ability of the ecosystem to continue to provide them. The lower wall is our demand for these resources which we

FIGURE 13.6: THE NATURAL STEP FUNNEL AS A STRATEGIC PLANNING TOOL



need to make clothes, shelter, food, transportation and other items and the ecosystems that create them. The things we need to survive – food, clean air and water, productive topsoil and others – are in decline. So is nature's ability to regenerate them. But at the same time, our demand for these resources is growing. There are more than six billion people on the planet and the population is increasing. Our level of consumption is increasing. As our demand increases and the capacity to meet this demand declines, society moves into a narrower portion of the funnel. As the funnel narrows there are fewer options and less room to manoeuvre. Organisations that continue business-as-usual are likely to hit the walls of the funnel, and fail. Every one of us lives and works in this funnel and every one of us has the opportunity to be more strategic about our choices and long-term plans. Through innovation, creativity and the unlimited potential for change, we can shift toward sustainability and begin to open up the walls of the funnel. Forward-looking organisations can position themselves to avoid the squeeze of the funnel and invest toward opening the walls and creating a truly sustainable and rewarding future.[59]

>>ENTREPRENEURIAL EDGE

NEW ZEALAND SUSTAINABLE BUSINESS AWARDS

New Zealand depends on its clean, green image for the majority of its export base and therefore its economic and social wellbeing. New Zealand is a leader in sustainable businesses. Here are some of the recent awardees in the 2008 NZI National Sustainable Business Network Awards:

>> **Paraoa Bakehouse** in Kapiti produces a range of organic, wheat and gluten-free breads including the popular 'Purebread', which is sold nationwide. Challenge: Minimise and mitigate the impact of their business activities. Some responses: Paraoa Bakehouse sources grain and other elements that have been grown using sustainable organic farming practices and baked with traditional baking methods. It has made remarkable waste reduction efforts. Although it produces some 4000 kilograms of food products weekly, its waste reduction efforts have reduced the amount of rubbish going to landfill each week to less than the size of a basketball (less than 1kg of waste).

>> **Resene Paints** has been in the business of paint production since 1946. Resene is a family-owned business and a well-known name in the New Zealand paint industry. The challenge: waste minimisation and responsible waste disposal. Some responses: Cardboard boxes are now expected to last 12 uses and are marked each time they are in transit. Paint pails have been built to last. Resene encourages reuse or will arrange for recycling. Resene and 3R Group have launched a new product called 'Paintcrete'. Paintcrete is concrete that has been manufactured with the addition of waste paint in order to divert the paint from landfill, as well as making the concrete product stronger.

>> **Express Couriers** is one of New Zealand's leading express courier, logistic and distribution companies with over 1700 staff and 39 depots nationwide. The Challenge: Express Couriers is inevitably dependant on transport infrastructure and equipment and especially fuel. Some responses: Express Couriers has released a range of packaging products that are recyclable and made from fewer raw materials. Additionally, any returned and recycled materials are sold and the income is donated to charities. The company has developed a five-year strategy for sustainability, and has invested considerable resources into measuring and managing every aspect of their business. The refit of their headquarters building has incorporated many environmental options.

Source: 'NZI National Sustainable Business Network Awards', www.sustainable.org.nz/cms/index.php?page=2008-awards

TABLE 13.7: BUSINESSES USING THE NATURAL STEP FRAMEWORK TO STRATEGIC BACKCASTING

Climate and Insurance	www.climateandinsurance.org www.thenaturalstep.org/en/canada/climate-and-insurance-co-operators
Electrolux	www.electrolux.com/node18.aspx www.thenaturalstep.org/en/usa/electrolux
IKEA	www.ikea.com/ms/en_US/about_ikea/social_environmental/the_ikea_way.html www.thenaturalstep.org/en/usa/ikea
Interface	www.interfaceglobal.com/ www.thenaturalstep.org/en/usa/interface-atlanta-georgia-usa
Nike	www.nikeresponsibility.com/ www.thenaturalstep.org/en/system/files/Nike+Case+Study_Jan2009.pdf
Panasonic	www.panasonic.com/environmental/edb07e.pdf www.thenaturalstep.org/en/panasonic
RioTinto Alcan	www.riotintoalcan.com/ENG/ourapproach/360_sustainable_development.asp www.thenaturalstep.org/en/system/files/Alcan_TNScasestudy.pdf

SUMMARY

Although many ways of strategically planning a venture exist, all have one common element: Each is an extension of the entrepreneur's vision by taking the owner's concept of the business and putting it into action. Entrepreneurs may not use strategic planning for many reasons, among them scarcity of time, lack of knowledge about how to plan, lack of expertise in the planning process and lack of trust in others.

A number of benefits to strategic planning exist. In particular, studies have shown that small firms that use this process tend to have better financial performance than those that do not. Other benefits include more efficient resource allocation, improved competitive position, higher employee morale and more rapid decision making.

A typical life cycle of a venture has five stages: development, start-up, growth, stabilisation and innovation or decline. This chapter focused on ways to maintain an entrepreneurial frame of mind while making the necessary adjustments to deal with the growth phase.

When building the desired adaptive firm, entrepreneurs need to be concerned with three important responsibilities: (1) increasing the perception of opportunity, (2) institutionalising change as the venture's goals and (3) instilling the desire to be innovative.

The balance of entrepreneurial and managerial approaches was reviewed in this chapter. This balance was demonstrated by considering five major factors: strategic orientation, commitment to seize opportunities, commitment of resources, control of resources and management structure. This differentiation of major factors is important for analysing aspects of the venture that need either more administrative or more entrepreneurial emphasis.

The chapter then examined the importance of a venture's growth stage. Underscoring the metamorphosis a venture goes through, four factors were discussed: control, responsibility, tolerance of failure and change. In addition, the challenge of managing paradox and contradiction was presented and the unique managerial concerns of growing ventures were outlined. Doing business globally has rapidly developed into one of the most profitable and popular strategies for many entrepreneurial ventures.

The concept of entrepreneurial leadership was introduced as a way for entrepreneurs to anticipate, envision, maintain flexibility, think strategically and work with others to initiate changes that will create a viable future for the growth-oriented venture.

Finally, the chapter examined strategy from the perspective of sustainability and described several of the emerging tools that an entrepreneurial strategist can use to come to grips with the era of climate change and global warming.

KEY TERMS & CONCEPTS

adaptation to climate change
adaptive firm
backcasting
capex
entrepreneurial actions
entrepreneurial leadership
entrepreneurial strategy matrix
growth stage
growth wall
innovation
lack of expertise/skills
lack of knowledge
lack of trust and openness
life cycle stages
mitigation of climate change
moral failure
morphing
Natural Step Funnel
new-venture development
one-person-band syndrome
perceptions of high cost
personal failure
stabilisation stage
start-up activities
strategic backcasting
strategic planning
strategic positionings
sustainable competitive advantage
SWOT analysis
time scarcity
uncontrollable failure

REVIEW & DISCUSSION QUESTIONS

1. In what way does an entrepreneur's vision affect the company's strategic plan?
2. How is the strategic plan of an engineer/scientist entrepreneur likely to be different from that of an entrepreneur whose primary strength is in the manufacturing area?
3. Give three reasons why many entrepreneurs do not like to formulate strategic plans.
4. Does strategic planning really pay off for small ventures? Why or why not?
5. Describe the entrepreneurial strategy matrix and explain why it is effective for entrepreneurs.
6. Briefly identify and describe the stages of development for a new venture.
7. Firms that fail to innovate will die. What does this statement mean in the context of new ventures?
8. How can entrepreneurs build an adaptive firm?
9. Successful ventures balance entrepreneurial characteristics with managerial style. What does this statement mean?
10. Comparing the entrepreneurial focus with the administrative focus involves five major areas of consideration. What are these areas?
11. Identify and describe the four key factors that need to be considered during the growth stage.
12. What is meant by managing paradox and contraction?
13. Identify five unique managerial concerns of growing businesses.
14. Define the one-person-band syndrome.
15. Explain the concept of entrepreneurial leadership
16. What are three ways of planning for a sustainable business?
17. What is the Natural Step Funnel? Make up examples that backcast from the future.

EXPERIENTIAL EXERCISE: THE TOWS MATRIX

Directions: Using the concept of the SWOT analysis presented in this chapter, the TOWS Matrix allows an analysis of a new venture based on its combined Strengths, Weaknesses, Opportunities, and Threats.

Find a new start-up venture and work with the CEO to establish the combinations of the following: Strengths, in light of Opportunities; Strengths, in light of Threats; Weaknesses, in light of Opportunities; and Weaknesses in light of Threats. This combination of the SWOT Matrix will help you to understand that tactics of a firm should be based on its own recognised strengths and weaknesses within the framework of the external environment.

TOWS MATRIX

	Strengths – S	*Weaknesses – W*
Opportunities – O	SO Strategies • •	WO Strategies • •
Threats – T	ST Strategies • •	WT Strategies • •

EXPERIENTIAL EXERCISE: THE VENTURE LIFE CYCLE

Listed below are the five basic phases or stages of the typical life cycle of a venture, labelled (A) to (E). Rank these from 1 to 5, beginning with the first phase and continuing to the last. Then examine the list of activities (a) to (j) and place a 1 next to those that happen during the first phase of the venture, down to a 5 next to those that occur during the last phase. Answers are provided at the end of the chapter.

A Growth

B Innovation or decline

C Start-up

D Stabilisation

E New-venture development

a Transition from one-person leadership to team management leadership
b New-product development
c Search for capital
d Increased competition
e Venture assessment
f Attempts to acquire other firms
g Consumer indifference to the entrepreneur's goods or services
h Accumulation of resources
i Major changes in entrepreneurial strategy
j Development of an effective entrepreneurial team

EXPERIENTIAL EXERCISE: A COMMUNITY-LEVEL ANALYSIS

A study of community demographics helps entrepreneurs to determine a strategy based upon the composition or make-up of consumers who live within the community. These data typically include such statistics as community size, the residents' purchasing power (disposable income), average educational background and types of occupation, the percentage of residents who are professionals and non-professionals and the extent of entrepreneurial activity in the community.

A few factors may be of special strategic concern in this data analysis. One is the size of the new venture relative to the community itself and to other businesses in the community. Analysis of this factor helps the entrepreneur evaluate the new venture's potential in terms of sales, growth, employment and attraction of customers. Each variable is directly related to the size factor and all variables are interrelated.

For example, a new venture may actually increase the total sales of all competitive firms in the community. A new furniture store located opposite an established furniture store often will serve to increase overall sales for both by drawing more business to the locale. People from other communities will come to comparison shop and will stay to buy. People from the local community will be more likely to purchase their furniture from one of these two stores than to drive to other communities to do so. The major reason is that furniture is a comparison good and most people like to look at the offerings of at least two stores before they buy.

Another important demographic characteristic is the amount of entrepreneurial activity in the community. To assess this factor, it is important to count the number of entrepreneurs in the community, to examine their types of business ventures and to establish their track records with suppliers (within and outside the region), their success with local banks and their customer base. If the community has a lot of entrepreneurial activity, it will be more receptive to new ventures and doors will be more easily opened. For example, local banks will be more accustomed to reviewing entrepreneurial loan applications and will have developed expertise in evaluating such applications and dealing with follow-up business.

Assume you are in the process of opening a small retail hardware store. Choose a site location in your community and then answer the following questions about the community, potential customers, competition and location.

POTENTIAL OF THE TRADING AREA

1 How big is the trading area? .... sq km
2 What is the customer potential within five kilometres? .... customers
3 What is the density of population? .... people per sq km
4 Is transportation adequate for supplies? .... yes .... no
5 What is the income level of the trading area? .... per capita
6 What is the local employment pattern, based on number of people employed? .... % people employed
7 What is the general make-up of the community? .... residential .... old
8 What are the trends in population and income? .... up .... down
9 Are new constructions increasing? .... yes .... no
10 Are school enrolments up? .... yes .... no
11 Are retail sales increasing? .... yes .... no
12 Have average business improvements been made recently? .... yes .... no
13 Does business property have a high vacancy rate? .... yes .... no
14 Have shopping patterns changed drastically in recent years? .... yes .... no
15 Are customers moving to or away from the potential location? .... to .... from
16 What are the present zoning restrictions? ....

CAN CUSTOMERS GET TO THE LOCATION?

1 Is the area served by adequate public transportation? .... yes .... no
2 How broad an area does the transportation service encompass? .... sq km
3 Is the area generally attractive to shoppers? .... yes .... no
4 Can it be easily reached by car? .... yes .... no
5 Is public parking adequate and relatively inexpensive? .... yes .... no
6 How many spaces in the available nearby car park are taken up by all-day parkers? .... many .... few
7 If located on a highway, is the location easily accessible from the main traffic flow? .... yes .... no
8 What are restrictions on signs and store identification? ....
9 If the location is on a limited access road, how close is the nearest interchange? .... kilometres
10 Is the location accessible to delivery trucks? .... yes .... no
11 Is the traffic speed too fast to encourage entrance by car? .... yes .... no
12 Are most customers who drive past the location on their way to work or on shopping trips? .... on way to work .... on shopping trips
13 Will nearby stores help you? Are the other stores in the shopping centre, neighbourhood, or highway location of a nature that will attract customers who also will become patrons of your store? .... yes .... no .... maybe .... likely
14 What are the prospects for changes in traffic flow in the near future? .... slight .... likely
15 Will anticipated changes improve or damage the location? .... improve .... damage
16 Are zoning changes planned that would affect accessibility of the location? .... yes .... no

JUDGING THE COMPETITION

1 How many other businesses of the same kind exist between the prospective location and the most highly populated area? .... stores
2 Is this spot the most convenient store location in the area? .... yes .... no
3 How many other stores of the same kind are in this trading area? .... stores
4 How many of them will compete with you for customers? .... stores
5 Do these other stores have better parking facilities? .... yes .... no
6 Do these other stores offer the same type of merchandise? .... yes .... no
7 Do you consider these other stores more aggressive or less aggressive than your own operation will be? .... more .... less

8 What other competing stores are planned for this trading area in the near future? ....

....

9 Are other potential sites that are closer to the majority of customers likely to be developed in the near future? .... yes .... no
10 Are your major competitors well-known, well-advertised stores? .... yes .... no
11 Does a need for another store of this kind in the area actually exist? .... yes .... no
12 How well is the demand for this product being met in the area? .... very well .... moderately well .... not at all
13 If any empty stores or vacant lots are near the location, is a competitive store planned for them? .... yes .... no

CAN THE LOCATION ATTRACT NEW BUSINESS?

1 Is the location in an attractive district? .... yes .... no
2 Do numerous stores exist that will draw potential customers for you into the area? .... yes .... no
3 Is the location near well-known and well-advertised stores? .... yes .... no
4 Is this location the most attractive one in the area? .... yes .... no
5 Is the location on the side of the street with the busiest customer traffic? .... yes .... no
6 Is the location nearer to the general parking area than locations of competing firms? .... yes .... no
7 Is the location in the centre of or on the fringe of the shopping district? .... centre .... fringe
8 Is it near common meeting places for people, such as public offices? .... yes .... no
9 Are most of the people passing the store prospective customers? .... yes .... no
10 Are the people who pass usually in a hurry, or are they taking time to shop? .... in a hurry .... taking time to shop

COST OF THE LOCATION

1 What will your rent be? .... per month
2 Who will pay the utility costs? .... you .... others
3 Who pays additional costs, such as taxes, public services and costs of improvements? .... you .... others
4 What are the possibilities for eventual expansion? .... good .... poor
5 Are good employees available? .... yes .... no
6 Will your potential income justify your costs? .... yes .... no

FINAL ANALYSIS

Based on your analysis, is this a good community in which to open a retail hardware store? Explain.

CASE 13.1: HENDRICK'S WAY

When Hendrick Harding started his consumer products firm, he was convinced he had a winning product. His small, compact industrial drill was easier to use than any others on the market and cost 30 per cent less than any of the competitors' drills. The orders began to pour in and within six months Hendrick's sales surpassed his first year's estimate. At the end of the first 12 months of operation his firm was grossing more than $50 000 a month and he had a six-week backlog in filling orders.

The rapid growth of the firm continued for two years. Beginning about four months ago, however, Hendrick began to notice a dip in sales. The major reason appeared to be a competitive product that cost 10 per cent less than Hendrick's drill and offered all the same benefits and features. Hendrick believes that with a couple of minor adjustments he can improve his product and continue to dominate the market.

On the other hand, Hendrick is somewhat disturbed by the comments of one of his salespeople, George Simonds. George spends most of his time on the road and gets to talk to a great many customers. Here is what he had to say to Hendrick: 'Your industrial drill has really set the market on its ear. And we should be able to sell a modified version of it for at least another 36 months before making any additional changes. However, you need to start thinking about adding other products to the line. Let's face it; we are a one-product company. That's not good. We have to expand our product line if we are to grow. Otherwise, I can't see much future for us.'

The problem with this advice is that Hendrick does not want to grow larger. He is happy selling just the industrial drill. He believes that if he continues to modify and change the drill, he can maintain a large market share and the company will continue to be profitable. As he explained to George, 'I see the future as more of the past. I really don't think there will be a great many changes in this product. There will be modifications, sure, but nothing other than that. I think this firm can live off the industrial drill for at least the next 25 years. We've got a great thing going. I don't see any reason for change. And I certainly don't want to come out with a second product. There's no need for it.'

Questions

1. What is the danger in Hendrick's thinking?
2. Using Table 13.3. as your point of reference, how would you describe Hendrick's focus?
3. Based on your evaluation, what recommendations would you make to him?

CASE 13.2: KEEPING THINGS GOING

Because of a surge in outsourcing contracts coming in from the US, the Wadhwani Company of Hyderabad has grown 115 per cent in the past year and 600-plus per cent in the past three years. A large portion of this growth is attributable to Sharma Subramonia's philosophy of hiring the best possible computer systems people and giving them the freedom they need to do their jobs.

Most of Sharma's personnel operate as part of work teams that analyse, design and implement computer systems for clients. First, the company will get a call from a potential client indicating that it needs to have a computer system installed or special software written for its operations. Sharma will send over one of his people to talk to the client and analyse the situation. If it turns out that the Wadhwani Company has the expertise and personnel to handle the job, the client will be quoted a price. If this price is acceptable, a Wadhwani work group will be assigned the project.

An example of a typical project is the manufacturing client who called three weeks ago and wanted to purchase five personal computers for his firm's engineering staff. The company wanted these machines hooked up to the main computer and to have a dedicated connection to their Houston, Texas office. Additionally, the firm wanted its computer-aided design software to be modified so the engineers could see their computer-generated drawings in a variety of colours, not just in monochrome. The Wadhwani group installed the entire system and modified the software in 10 working days.

Sharma realises that the growth of his enterprise will be determined by two factors. One is the creativity and ingenuity of his workforce. The other is the ability to attract talented personnel. 'This business is heavily labour intensive', he explained. 'If someone wants a computer system installation, that may take 100 labour hours. If I don't have the people to handle the project, I have to turn it down. My expansion is heavily dependent on hiring and training talented people. Additionally, I need more than just hard workers. I need creative people who can figure out new approaches to handling complex problems. If I can do these two things, I can stay a jump ahead of the competition. Otherwise, I won't be able to survive.'

In dealing with these key factors for success, Sharma has initiated three changes. First, he has instituted a bonus system tied to sales; these bonuses are shared by all of the personnel. Second, he gives quarterly salary increases, with the greatest percentages going to employees who are most active in developing new programs and procedures for handling client problems. Third, every six months the entire staff goes for a long weekend to a mountain area where they spend three days discussing work-related problems and ways of dealing with them. Time is also devoted to social events and to working on developing an esprit de corps among the personnel.

Questions

1. In what phase of the venture life cycle is Sharma's firm currently operating?
2. How are Sharma's actions helping to build an adaptive firm? Give three specific examples.
3. If Sharma's firm continues to grow, what recommendations would you make for future action? What else should Sharma be thinking about doing in order to keep things moving smoothly?
4. Do you have ideas about how Sharma could acquire more of the US outsourcing business?

CASE 13.3:

A TWO-PHASE APPROACH

Since its founding six months ago, Abdul Reezal's electronics repair shop in Kuala Lumpur has been booming. Abdul repairs electronic household appliances, including portable telephones, VCRs, televisions, radios and stereo equipment. Usually it does not take a great deal of time to make the repairs. For example, most portable phones have battery-related problems. All the repairer has to do is replace the battery and recharge the unit. The cost of a battery is around 15 Malaysian ringgit and the service charge is MYT135. So despite the fact the rent is high and the store has to keep a large supply of inventory on hand, profits are well over 40 per cent.

Abdul has been doing so well he has been thinking about opening a second store. However, he realises that if this new venture does not pay off, he could be in financial straits. Before going any further, he has decided to sit down and plan his strategic moves. The plan is going to have two major phases. The first phase will focus on areas such as the direction in which the store currently is heading, projected sales for the next two years, competitive countermoves, responses to these countermoves and overall financial performance. Abdul believes it will not be long before competitors begin to move into his market niche. 'You can't make tremendous return on investment without attracting serious competition', he has told his wife. 'If I want to continue being successful, I have to figure out how to stop these guys from invading my market. I have to have a game plan.' The second phase of the plan will incorporate the new store and will examine the impact of this expansion on overall operations.

Abdul believes this two-phase strategic approach will help him plan for current operations and future expansion. He also feels it will be easier to plan for the expansion if he first lays the groundwork with a basic strategic plan. Abdul's biggest problem right now is that he does not know much about strategic planning for new ventures. He is thinking he might drop by the local university and talk to one of the professors who teaches entrepreneurship or business strategy and get some advice on how to proceed.

Questions

1. If you were advising Abdul, what approach would you recommend he use for putting together his strategic plan? Why?
2. What advantages would your proposed approach have over other approaches? Compare and contrast at least three approaches.
3. How would your approach allow Abdul to incorporate expansion planning into the overall plan?

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Yaowawit School Kapong

Publication date: 1 January 2008
Author(s): Krittinee Nuttavuthisit
Product number: 9-KEL-352

The tsunami of December 2004 caused widespread devastation in the southern part of Thailand. After the tragedy, the Yaowawit School Kapong was founded with the aim of providing education and living support to needy children. This public welfare boarding school has been completely funded by partners and donors from all over the world via the Children's World Academy Foundation. However, a major question looms: For how long can the school continue to rely on charitable help? Because of this challenge, from the beginning the school's projects have been created to offer a practical education for the children and also generate income to cover running costs. One of these projects is the Yaowawit Lodge, which was developed to serve as the essential income-generating unit and to provide children with practical training in the hospitality business, the most promising job opportunity in this part of Thailand. Because of its unique character as a for-profit unit within a non-profit organisation, Yaowawit Lodge must find ways to target niche customers, position itself in the market and deliver marketing strategies accordingly. Additional challenges it faces include the location, which is far from the popular tourist areas; market perceptions concerning the combination of a primary school and a hotel; and the child-labour issue.

Air Deccan (A): Changing the Face of Indian Aviation

Publication date: 12 December 2006
Author(s): Ramasastry Chandrasekhar, Srinivas Sridharan
Product number: 907A01

By November 2005 Air Deccan, India's first low-cost airline, had been in business for two years. During this time, the airline had grown rapidly, adding more planes and increasing its number of passengers at breakneck speed. Using low fares as its central strength, it had caused huge, unconventional changes in the Indian domestic airline industry. Not satisfied, however, the founder and chief executive officer wondered how to adapt to the future and sustain Air Deccan's tremendous initial success.

A Note on Managing the Growing Venture

Publication date: 31 January 2005
Revision date: 23 August 2005
Author(s): Richard G. Hamermesh, James L. Heskett, Michael J. Roberts
Product number: 9-805-092

This case focuses on the strategic and organisational challenges that confront growing enterprises and the entrepreneurs who lead them. It provides an overview of how a new venture needs to change as it passes from the initial start-up to the growth phase. It explores how a venture's leadership, strategy and execution need to evolve to deal with rapid growth.

Innocent Drinks

Publication date: 24 November 2004
Author(s): William A. Sahlman, Dan Heath
Product number: 9-805-031

The three founders of a London-based, start-up smoothie company must decide between three growth options: expansion of the existing product line into Europe, extension of the brand into other product categories, or continued organic growth within the UK.

Start Thinking About Carbon Assets – now

Publication date: 2008
Author(s): Alex Rau and Robert Toker
Product number: F0809C

If you're afraid to involve your company in the carbon-credit market, the prospect of delaying your participation should scare you more. The authors' guide to the basics about carbon assets will assuage your fears by arming you with facts.

Answers to 'The Venture Life Cycle'

A	3	d	4
B	5	e	1
C	2	f	5
D	4	g	4
E	1	h	1
a	3	i	3
b	5	j	2
c	2		

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14 GLOBAL OPPORTUNITIES FOR ENTREPRENEURS

Today, thanks to a thriving world economy, global telecommunications and expanding travel, exchange among Europe, North America and the Pacific Rim is happening at an unparalleled pace. In the urban centres of the developing world signs of the international youth culture are almost everywhere . . . For the companies that sell these new international products, that understand the world as one single market, it is an economic bonanza.

John Naisbitt and Patricia Aburdene, *Megatrends* 2000[1]

chapter objectives

- **01** To introduce the new international developments that have expanded opportunities for the global market
- **02** To examine how entrepreneurs can take advantage of importing opportunities
- **03** To explore the entrepreneurial benefits of exporting
- **04** To discuss the advantages and disadvantages of entrepreneurial joint ventures
- **05** To examine the benefits of direct foreign investment by entrepreneurs
- **06** To explain how licensing arrangements work and to review their advantages and disadvantages
- **07** To set forth the five key steps for entering the international marketplace.

Operating globally today is a hot topic. Whether you are pro-globalisation or anti-globalisation, you confront the global business universe every day in every way. When you make business decisions, you must find answers to perplexing questions. Why not use the cheapest production facility even if there are some questions concerning its labour policies? Should the firm use overseas water or land that is owned by monopolies or oligopolies? How do we fairly pay a worker so as not to distort the competitive economy? How must we deal with labour and environmental regulations? Is there any downstream impact of our activities, such as landfill waste? What are the ethics of locating in an 'export processing zone' that many countries offer, where labour law is slacker than elsewhere?

This chapter has two primary objectives. First, it describes the fascinatingly diverse map of Asia–Pacific countries in terms of their entrepreneurial activity. It's amazing how different they are one from another. Second, the chapter goes on to describe the actual mechanics of how entrepreneurs can and do go overseas with their products and services.

ASIA–PACIFIC ENTREPRENEURSHIP

The following section comes from the excellent reports of the Global Entrepreneurship Monitor (GEM), which each year measures the national level of entrepreneurial activity.[2] GEM is the largest survey-based study of entrepreneurship in the world.[3] GEM measures early-stage entrepreneurial activity and the rate of start-up activity of nascent and new companies less than 42 months of age. GEM then identifies the rate of *established business owners*: entrepreneurs who have paid salaries and wages for more than 42 months and who have survived the most risky stage of the entrepreneurial process. GEM also documents the various motivations that lead people to become entrepreneurs. Business owners are classified as being either necessity-driven (they have no other choice but to start a business) or opportunity-driven (they have spotted a market niche and choose to become entrepreneurs). Beyond this, GEM documents the characteristics of all entrepreneurs with respect to product novelty, intensity of competition, employment and expansion plans and use of technology. Finally, GEM looks at the socioeconomic characteristics of populations, as well as their subjective perceptions and expectations about the entrepreneurial environment. Please note that these figures apply to the period before the economic crisis.[4]

Australia

The last time it was measured (in 2006) Australia's early-stage entrepreneurship rate had declined to 13.4 per cent. Female early-stage entrepreneurial activity also was dropping. The nation's comfortable lifestyle is often said to be an inhibitor to the creation of high-growth businesses. On measures of newness to customers and adoption of new technologies, more than 70 per cent of Australian business owners reported low scores. However, a new government policy on entrepreneurship and innovation through science and technology will doubtless help in the 2010–11 period. The expectation is that the policy will prompt both start-ups and young and established businesses to seek out and adopt new technologies or to create new products and services for customers and markets. Nonetheless, Australia remains below the GEM average on measures of education in entrepreneurship from primary through to higher education. Australian experts believe that entrepreneurial activity could be better supported by measures that drive ambitions and intentions towards the creation of a business environment that thinks and acts as global players on a world stage (see also pages 325–6).

China

Prior to 1978, China had a centrally planned economy where economic activities were controlled by the government through large state-owned enterprises. In 1978, the Communist Party led by Deng Xiaoping began to open the Chinese economy. Small enterprises began to sprout in the countryside. These start-up firms drove China's reform momentum, and are arguably the main source of China's growth.[5] At 24.6 per cent, China had the highest rate of overall entrepreneurial activity among the middle- and low-income countries in GEM, a rate that is accelerating over the course of the research. Male entrepreneurs accounted for 59 per cent of entrepreneurial activity. China had a rate of opportunity-based entrepreneurship of 61.3 per cent and necessity-based entrepreneurship of 38.7 per cent. Entrepreneurship by young adults in China appears to be much higher than among older adults. As well, of the middle- and low-income countries, China clearly stands out as a hotbed of *high-growth expectation* entrepreneurship.

CHINESE ENTREPRENEURS

>>ENTREPRENEURSHIP IN PRACTICE

CHINA'S HOME-GROWN ENTREPRENEURS

Private business [in China] was gradually abolished following the 1949 Communist revolution, so that by the 1950s it had all but disappeared. It was first revived after the Cultural Revolution as a way to respond quickly to the mounting pressures of unemployment and economic stagnation. It was allowed on the fringes of the economy and was initially regarded as a supplement to the state and collective sectors. Private enterprise first took hold in the rural sector, as an outgrowth of the virtual privatisation of agriculture and in small-scale individual enterprises in the urban sector.

During the 1980s, larger private enterprises grew out of these rural and individual enterprises and out of collectives (enterprises with common ownership by the employees, under state supervision) and state-owned enterprises (SOEs). Some were sole proprietorships (*getihu*) that grew and took on more employees. By 1988, when private firms were first officially recognised, China had 500 000 *getihu* that could be called private firms (*siying qiye*). Some larger private enterprises emerged from the leasing of state or collective enterprises to individuals. The private entrepreneur paid the collective a fixed rent and operated the firm as if it were his own – and in many cases accumulated considerable assets. These enabled him to reduce the share of collective ownership and gradually transform the enterprise into a solely owned firm.

Many large private firms disguised their true identities by maintaining the formal status of a collective or SOE, a process known as 'wearing the red hat'. Collective status allowed a degree of local government involvement in the enterprise. This could be helpful in obtaining access to land, bank loans, government contracts and tax breaks. On the other hand, wearing the red hat meant that enterprises could not operate on a fully commercial basis, but had to cooperate, to some degree, with the local government's wishes.

The change in political sentiment following the events of 1989 caused a temporary setback to the growth of private enterprise, but Deng Xiaoping's famous 'Southern Tour' in September 1992, during which he called for continuation of the reform effort, opened the way for renewed growth. During the 1990s, government encouraged the privatisation of smaller, non-strategic SOEs and allowed collectives to transform into private enterprises. As a result, the number of registered private firms (excluding sole proprietorships) rose from 108 000 in 1991 to 960 000 in 1997. In March 1998, the government issued a directive requiring all the red hat firms to 'take off the hat', or show their private ownership, by November 1998. In effect, government was playing catch-up with the reality of how these enterprises were operating. However, because of the advantages of maintaining connections to local government, many privately run enterprises have maintained their collective status.

ONE OUT OF EVERY 30 PEOPLE IN SHANGHAI OWNS A PRIVATE BUSINESS

In China's largest city, Shanghai, there is one private business owner out of every 30 people of employable age, a recent survey among Shanghai's working population has found.

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The survey, conducted by the Shanghai municipal labour and social security department, shows 3.1 per cent of the 25 000 citizens surveyed are operating their private business entities and hold stakes.

Meanwhile, an additional 1.8 per cent of the respondents said they are making concrete preparations for a private business, bringing the actual proportion of private entrepreneurs in the city to 4.9 per cent.

'The percentage is higher than the 3.3 per cent reported in Hong Kong and 4.3 per cent in Taiwan, but lags behind the southern booming city [of] Shenzhen, where 10.5 per cent of the working population are private business owners,' said Sheng Zuhuan, a labour and social security official.

The survey also found an impressive 13.1 per cent of average Shanghai people plan to start up their own businesses in the coming year. The proportion is nearly 23 per cent among the unemployed respondents.

Men are more enthusiastic than women in starting up a business and those between 35 and 44 years old are [the] keenest entrepreneurs, according to Sheng.

Most residents support enterprising endeavours and are tolerant of abortive business attempts, too. About 84 per cent of the parents surveyed said they approve of their children's private business plans and are ready to give a helping hand.

The respondents, aged between 16 and 64, were randomly picked by the labour and social security department to fill out a questionnaire.

Shanghai has been encouraging its unemployed population to start up their own businesses since 1996, with tax exemption policies, easier access to small loans and tailored logistic services for their convenience. About 20.5 per cent of the citizens have benefited from the preferential treatment in the past decade.

Source: Neil Gregory and Stoyan Tenev, 'One Out of Every 30 People in Shanghai Owns a Private Business: Survey', *Xinhua Economic News Service*, 7 November 2005, www.chinabusinessreview.com/public/0101/gregory.html

Hong Kong

Approximately 10 per cent of Hong Kong's population are entrepreneurs, and this rate is rising. Male entrepreneurs outnumber females 2.5:1. Reflecting the population's propensity to hold down more than one job, 42 per cent of the entrepreneurs are involved in the start-up on a part-time basis. About half of the entrepreneurs are new and half are repeat entrepreneurs. The new businesses are largely in consumer services (59 per cent) with transformation industries (manufacturing, logistics, construction, wholesale etc.) accounting for 23 per cent. Hong Kong's new businesses tend to be export-oriented, but many are of the 'me too' variety, entering competitive space alongside similar companies without using the latest or particularly new technologies. Entrepreneurs are clustered in the 25 to 34 years age group, with the highest levels of entrepreneurship (14 per cent) being found among those with some post-graduate education. A new generation of young, educated entrepreneurs appears to be joining the entrepreneurial tradition of Hong Kong. A turnaround in the economy, the successful progress of integration into China, the better availability of informal capital and a renewed consciousness of business venturing may all contribute to this resurgence.

India

Beginning in the late 1970s, successive Indian governments reduced state control of the economy. Progress was slow but steady, and many analysts attributed the stronger growth of the 1980s to those efforts. In 1991, India embarked on a series of economic reforms that has had a great impact on the country's steadily growing economy. A new India that is young, entrepreneurial, skilled and competitive is emerging and foreign investment continues to increase.[6]

Early-stage entrepreneurship in India increased to 11.5 per cent in 2008 from 8.6 per cent in 2007. Established business ownership also increased more than threefold from about 5 per

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cent in 2007 to 17 per cent in 2008. Gender differences exist with male participation representing about three-quarters of the total. Opportunity-based early stage entrepreneurship is about 76 per cent. The increase in early-stage entrepreneurial activity in India is largely accounted for by a transition from a job-oriented to an entrepreneurial economy. Most of these early entrepreneurs are involved in consumer service industries such as retail, trade, hotels and restaurants. The lower participation of women in entrepreneurial activity may be attributed to a societal predisposition towards men who are more risk-taking than women. Entrepreneurial activities in India vary widely across states. West Bengal has the highest early-stage entrepreneurial activities (37.3 per cent) followed by Karnataka (28.4 per cent) while Maharashtra and Goa (excluding Mumbai) have the lowest (3 per cent). Most early-stage entrepreneurs do not focus on technology and innovation. About 98 per cent of businesses offer products or services that are already known by the customers. In order to achieve an average annual GDP growth rate of 9 per cent during its eleventh Five Year Plan (2007–12), the government of India has prioritised the small and medium-sized enterprises (SME) sector. However, establishment of new ventures and Special Economic Zones (SEZs) has been delayed due to strong opposition by activists and some political parties. Higher inflation and interest rates experienced in the Indian economy for the past year has had a dampening effect on SMEs.

Indonesia

Throughout the 1980s and much of the 1990s, Indonesia enjoyed high rates of economic growth, a reduction in poverty and improvements in health and education, but this rapid growth was discontinued in mid-1997 when the currency crisis began to sweep Southeast Asia. The Indonesian rupiah fell dramatically, enormous private sector debts emerged and the banking sector was paralysed. The nation also experienced its worst drought in 50 years, which caused famine. Ranking fourth in the world in 2006 behind Philippines and three Latin American countries, Indonesia has a very high level of early-stage entrepreneurial activity (19.3 per cent) and (behind only the Philippines) established business ownership (17.6 per cent). In the group of middle-income countries, with Malaysia it has one of the highest rates of opportunity-driven entrepreneurship (90 per cent) ever recorded in the GEM surveys.[7]

Japan

Japan has traditionally had a very low rate of entrepreneurial activity, but its rate of 5.4 per cent in 2008 is the highest ever reported for the nation. Male entrepreneurs represented 7.8 per cent of the adult population and female entrepreneurs 3.0 per cent. Opportunity was the main trigger for entrepreneurial activity, while the ageing of Japan's population was the most influential factor in the low rate of such activity. In 2005 the 15- to 64-years-old age bracket accounted for 66.1 per cent of entrepreneurial activity, a figure estimated to drop to 57.6 per cent by 2030.

Korea

Approximately 10 per cent of the adult population in Korea were entrepreneurs in 2008. Male entrepreneurs represented 14.8 per cent of the adult population, while 5 per cent of females started a business. Opportunity was cited as the main trigger for entrepreneurial activity by 58.2 per cent of the entrepreneurs, while necessity was the spur for 40.3 per cent of those starting businesses. After the 1997–1998 Asian financial crisis, Korea entered a period of strong economic growth, which was accompanied by an increase in start-up activity. About 300 business incubators were established by the government to support new entrepreneurial firms. The government initiated programs in the late 1990s to provide strong support to entrepreneurs, such as venture registration that provided favourable access to funding, advice and networks. Industry composition shows an emphasis on the retail sector (33.0 per cent), followed by manufacturing (13.3 per cent) and business services (13.3 per cent). Motivations to start businesses in Korea are negatively impacted by government regulations and fear of failure. In addition, the availability of new technology and skilled labour has been a constraint. While the global financial crisis represents the country's greatest challenge to entrepreneurial activity, stable employment in established firms, with promotions based on seniority, provides little incentive to leave and start a business.

Malaysia

The Malaysian government leads a strong initiative in promoting entrepreneurship, but it nurtures a particular race – ethnic Malays (or Bumiputras) – in order to address the social and economic inequities against Malays resulting from a centuries-old colonial policy that assigned a race to a specific economic activity. Positioning the middle-class Malays as the main agents of economic growth, the government now adopts a variety of supporting mechanisms and policies for the Malay entrepreneurs, including funding, physical infrastructure and business advisory services. Malaysia had a mid-rank of 11.1 per cent early-stage entrepreneurial activity and 7.3 per cent established business ownership in 2006. In the group of middle-income countries it has one of the highest rates of opportunity-driven entrepreneurship (90 per cent) ever recorded in the GEM surveys.

New Zealand

New Zealand has distinguished itself since 2001 as one of the world's most entrepreneurial countries. The last time it was measured (in 2005), New Zealand at 17.6 per cent was surpassed only by Thailand and Venezuela. The indigenous Polynesian population, the New Zealand Māori, is every bit as entrepreneurial as European New Zealanders and has higher rates in some measures. About 25 per cent of Māori versus 13.1 per cent of the general population said they expect to launch a start-up in the next three years. Māori entrepreneurs between 35 and 44 years old have some of the highest total entrepreneurial activity rates ever recorded in the GEM survey. About one in three Māori between 35 and 44 years of age is an entrepreneur. Māori women have the world's third-highest opportunity entrepreneurship rate and only a moderate rate of necessity entrepreneurship. Māori males have much higher rates of necessity entrepreneurship, about five times the rate of the general male population. For New Zealanders, both Māori and non-Māori, wealth creation is not as important as independence. New Zealand is largely a country of lifestyle entrepreneurs with low horizons and ambitions. They would rather exploit existing equilibrium opportunities and optimise supply and demand in established markets than exploit innovative venture opportunities and create new markets at home and abroad. The New Zealand government has largely ignored the needs of entrepreneurs while concentrating on innovation policy. While the number of commercialisable ideas has significantly increased, the supply of high-growth entrepreneurs has not.

Philippines

Generally, Filipinos' attitude towards entrepreneurship is very bullish. Incredibly, 39.2 per cent of adult Filipinos were engaged in business start-ups in 2006, second only to Peru among middle and low income countries and first among benchmarked countries in Asia. Around half of adult Filipinos (46 per cent) are expecting to start a business in the next three years and six out of 10

(57 per cent) see good business opportunities in their locale. This outlook ranked the country the highest in Asia among those perceiving favourable opportunities. Eight out of 10 (83 per cent) adult Filipinos are also considering starting a business as a desirable career choice. Regionally, North Luzon has the highest level (53 per cent) of business participation rates, while Metro Manila has the lowest in the Philippines (30 per cent), which nonetheless is one of the highest rates recorded in the GEM surveys. While most businesses (53 per cent) are skewed towards consumer-oriented industries, a large portion of the country's established businesses (35 per cent) remains extractive, compared with other Asian countries which focus on consumer-transformative industries. Notwithstanding high prevalence rates, many businesses remain small in scale and are motivated by necessity (54 per cent compared to 37 per cent of opportunity motivations). Many businesses also face high competition (75 per cent) and lack novelty (71 per cent), new technology (67 per cent) and high growth potential in terms of employment size (63 per cent are not employing) and export propensity (77 per cent are not exporting). Only 34 per cent of business owners have had any dealings with a bank. Only 17 per cent of Filipinos who receive remittances from overseas family members use them to help finance business. Some experts say the greatest need is to improve formal and informal education and training towards entrepreneurship, while also improving technological infrastructure, research and development. There seem to be no sociodemographic barriers. The younger adults, those aged 18 to 24 years old, are the most bullish in their outlook. Neither is gender a hindrance to entrepreneurship. Professionals and entrepreneurs even cite positive social and cultural norms as contributing to entrepreneurship. They especially recognise gender equality and the role of women in supplementing the family income.

Singapore

A recession that began in 2001 led to a renewed interest in and urgency to encourage entrepreneurship in Singapore. The government developed economic and business strategies in response to increased market competition and the shift of focus away from Southeast Asia to China. The success of creating a strong civil service and an environment to attract multinationals has hampered the entrepreneurial spirit. Young people have limited interest in starting new companies; finding a job in a large corporate entity is the preferred career option. Joining the civil service is also very attractive due to an excellent compensation package. As a result, Singapore has the lowest rate of entrepreneurial activity (4.9 per cent) among the OECD countries of GEM and this was apparent across all demographic groups. Singapore is on par with the rest of the OECD (11.7 per cent) in using the latest technology, but that is actually ahead of countries such as Sweden, Germany and Iceland. Singapore was also high in start-ups or new businesses intending to sell products or services to new markets. Singapore is first in the OECD in terms of export-oriented entrepreneurs. Experts rate Singapore's environment for entrepreneurship as favourable, especially in the areas of availability of capital, research and development (R&D) transfer, university and management education training and business services. Culturally, Singapore has weaknesses. Just 25.4 per cent of adults thought they had the skills to start a business, compared to the OECD average of 41.1 per cent. The proportion of Singaporeans who personally know an entrepreneur is lower than the OECD average, but those with no fear of failure is on par with the OECD average.

Thailand

Thailand's total early-stage entrepreneurial activity significantly increased to 28.4 per cent in 2007 from 15.2 per cent in 2006. This is the highest rate of any country surveyed in 2007. Established business ownership has also increased. The gender gap remains narrow. The rate for male activity increased from 16.3 per cent (2006) to 27.8 per cent (2007) and for female activity from 14.2 per cent to 26 per cent in the some period. Consistent with previous years, opportunity entrepreneurship in Thailand accounts for the majority of entrepreneurial activity. The increase in early-stage entrepreneurial activity is largely accounted for by an increase in new business ownership and female participation. Most businesses are in consumer services such as retailing, restaurants and personal services. This can be partly attributed to a decline in business efficiency of many Thai companies, especially in the manufacturing sector. Furthermore, many manufacturing businesses have faced intense competition from other emerging economies. Over the past three years, a decrease in perception of good business opportunities and political instability has hindered Thai entrepreneurship. Thais have a positive attitude towards entrepreneurship. Experts confirm that social and cultural norms strongly support female participation in entrepreneurial activity and are strongly supported by market openness, affordable communication and access to public utilities. At the same time, research has shown that most Thai people lack the capacity for entrepreneurship. Thai families and the current education systems do not encourage an entrepreneurial mind-set. Most businesses in Thailand do not focus on innovation, regardless of their stage of development. Following the announcement of a national policy on creating a 'knowledge economy', the second SME development plan (2007–11) is focusing on building platforms for encouraging the creation and commercialisation of products and services based on local knowledge and local innovations.

HOW TO GO GLOBAL

Having reviewed the levels of entrepreneurial activity in the various countries of our region, we turn now to concrete measures that an entrepreneurial firm can take to go global.

Research literature has traditionally focused on a particular pattern that firms should go through when they develop exporting strategies. This thinking, described as an **incrementalist approach** to export and expansion, saw firms move through a specific sequence of events, starting out with no export activity, then employing intermediaries and finally setting up subsidiaries or agents.[8] Recent research has changed its attitude towards this process and focuses on the small firm that begins *exporting from start-up*. These are called '**born global**' firms.[9] They are exporters from the beginning. Without international trade they simply would not exist. Chetty and Campbell-Hunt examined New Zealand firms in search of so-called 'born-global' factors such as entering global markets rapidly, capitalising quickly on innovation, focusing on narrow niches and using extensive business networks.[10]. Looking at other small countries, Moen and Servais found – at least among Danish, Norwegian and French SMEs – that the one-third portion that took only two years to shift into export mode were outperforming firms that waited years to go global.[11] Whatever the provenance, there are certain methods that globally oriented entrepreneurial firms use.

The first question the entrepreneur should ask is: Why should I go global in the first place? An entrepreneurial firm should be able to answer 'yes' to many of the following questions.

- **Profit maximisation**: Is the firm driven by a need to maximise profits? Are shareholders or investors expecting quick returns? This might mean adopting an opportunistic strategy in which the company moves from market to market in search of the best possible returns, rather than slowly building a position in any particular market.
- **Market share**: Does the firm want to establish a strong position in an undeveloped market? Is it willing to charge less initially (penetration pricing) in order to get buyers? This may mean spending more on advertising and marketing and having less concern

with short-term profitability. This strategy works best in a market where demand is strong (or can be stimulated with appropriate marketing) and where competition, particularly from local suppliers, is weak.

- **Maximising cash flow**: Another strategy may be simply as a way of maximising cash flow. Firms strapped for cash may go abroad to bring in more revenue. This may be the case, for example, for companies that have large stocks of unsold or discontinued inventory or with idle production capacity.
- **Repositioning the business**: Global market entry may help an entrepreneurial firm reposition a business by developing new product lines and new capabilities. It may make sense to roll out a different product in a new market, where the company is relatively unknown, than attempt to change the company's image in its original market, possibly undermining its existing business in the process.
- **Domestic impact**: Aggressive firms may go overseas in order to acquire new knowledge, skills or technologies for their domestic operations. Such strategies are often pursued by companies in technology-intensive industries or in sectors undergoing rapid change.

The entrepreneur can actively engage in the international market in many ways. These include:

1. importing
2. exporting
3. joint ventures
4. direct foreign investment
5. royalties and licensing
6. franchising
7. mergers and acquisitions
8. greenfield investment.

These are all becoming part of the extended enterprise, but each of these methods involves increasing levels of risk. The final decision whether or not to go global will depend on the organisation's needs and the risk it is willing to take.

Importing and global sourcing

Importing is buying and shipping foreign-produced goods from foreign sources. Entrepreneurs trade because it enables them to acquire goods they cannot produce themselves. Today importing is called **global sourcing**. Entrepreneurs find market niches and fill them. Global sourcing makes it possible to meet an increase in product demand. There also is an issue of quality to consider. Some countries have a reputation of producing high quality products with high reliability that are sought by others. Another issue to consider is the penetration of growth markets. An entrepreneur may get a foothold in a new country by sourcing in that country. Last, but not least, is the issue of cost. Buying abroad is sometimes cheaper than domestic buying. Of course, there are disadvantages as well. There are extra cost factors and time factors, such as travel and communication. A foreign broker's and an agent's fees must be paid. Then there is the cost of distribution, which adds hugely to the unit cost.

One illustration of 'importing talent and production' is called **near-shoring**, which means moving jobs to a nearby foreign country. It is part of the 'X-shoring' constellation of terms that include: off-shoring (sending work to an overseas location), multi-shoring (sending outsourced work to several overseas locations based on the job to be done and the relevant skills available) and two-shoring (using an offshore location and a domestic one). Near-shoring brings many direct material benefits. It allows a firm to upsize or downsize and to spread risk to other parts of the production chain. Wage and costs differentials in near-shore countries make the company more competitive in the home market. Nearby countries may have higher quality workers and multilingual capability. Rather than extend operations to a country around the world, near-shoring can reduce costs and time to market because of the proximity to the home market.

How does an entrepreneur become aware of import opportunities? Knowing where to look is sometimes the hardest part of importing. A starting place is your knowledge of world trends in your industry or existing market, or your intuition about likely new markets. The next stage is to test and confirm this. Some entrepreneurs use a formal market selection process, which considers a wide range of political, geographic, economic and other factors. Others use a less formal process, such as talking with business people and other importers. Another way is to attend trade shows and fairs where firms gather to display their products and services. Some of these shows are international in flavour, with firms from different countries exhibiting their products and services. The trade show gives the prospective customer the opportunity to window-shop. Trade publications are another good source of information as firms often advertise in those publications to make themselves known to potential customers.

Exporting

On the flip side is **exporting**: shipping and selling locally-produced products and services abroad. Every globally active entrepreneurial seller is an exporter of some kind. This is particularly important for countries of the Asia–Pacific.

Exports can be commodities such as wood and meat products, manufactured goods such as electronics or automobiles, knowledge products such as software or video, services sold to foreigners or even education sold to international students. Exporting is important for entrepreneurs because it often means increased market potential. Instead of being limited to a small market, the exporting firm has a broader sales sphere.

Increased export sales volumes will lead to lower unit costs, which will lead to increased margins and profits. As more and more units are exported, the firm becomes more efficient at production of the units, thereby lowering the cost per unit. The lower unit cost thus enables the firm to compete more effectively in the marketplace.

Exporting has been increasing as a method for venture growth and increased profitability among entrepreneurial firms. One study identified four key competitive export strategies small firms can use to gain a competitive edge in their market:

- market differentiation through competitive pricing, through the development of brand identification or through innovation in marketing techniques
- focus strategy involving specialty products for particular customers or new-product development
- achieving technological superiority of certain products
- product-oriented emphasis using the elements of customer service and high quality.[12]

In order to pursue any of these strategies, entrepreneurs need to understand some of the ways to become involved in exporting. Foreign market entry is a complex and sometimes lengthy process. Even if the firm is producing more units efficiently, it will take time to learn the intricacies of global entrepreneurial trade. There are many considerations when launching an entrepreneurial export business – from cultural issues in advertising, currency trading and hedges to tariffs and taxes. Smaller companies can sometimes overcome this by entering into deals with companies abroad. That means shifting some of the risks to overseas firms. It also means relinquishing at least some power over how a transaction is made and its value captured. The bottom line is: Are increased sales in an international market worth the loss of control and profit?

Large and frequent exporters can usually handle the challenges of international trade on their own. For smaller firms of the Asia–Pacific, diverse mechanisms can lead to benefit on both sides of the transaction through various types of alliance and partnering strategies. These can:

1. take care of tricky distribution and delivery issues
2. share risks and costs as well as the reward
3. overcome culture and distance barriers
4. bring the exporter's product or service more closely in line with the needs of the customer.

Some exporters do not actually export products themselves. Indirect exporters simply provide components to other companies who are the exporters. This way, small entrepreneurial firms can get a taste of the rigours of foreign exporting without all of the problems. For example, automobile manufacturers source components from a host of smaller suppliers. Many of the cars they assemble are destined for export. These suppliers – called indirect exporters – need not concern themselves with market entry barriers, logistics or international distribution. Yet they must continually produce their product with foreign customers in mind.

Indirect exporting

Exporting to foreign markets takes two forms. Direct exporting means setting up expensive subsidiaries or establishing contractual relationship with foreign companies. Direct exporting does give greater control over sales channels and intellectual property protection, but the entry costs, time to market and ongoing costs are higher.

The other form is **indirect exporting**, which means selling goods to foreign buyers through third parties such as export agents, export merchants or buying houses. This is an especially good mode of entry for the novice exporter or for a manufacturer who lacks country knowledge.

China is a good example. Many exporters do not have the expertise to enter the Chinese market successfully. However, when they use indirect exporting, they offer their products through intermediaries who take the product directly to the markets. This way time to entry in the Chinese market is shorter and more flexible. Exporters can receive payment earlier and risks are minimised, particularly involving volatile foreign exchange markets and credit risks.

One of the greatest benefits of indirect exporting is the ability to obtain export know-how and personal contacts through the export merchant or agent. The exporter can possibly realise greater sales volumes since the foreign export agent often represents several different related products or product lines and thus can deliver on economies of scale. As well, exporters find it easier to ascertain whether their products will sell well in a foreign market without the effort, financial investment, or risk associated with direct exporting. They do not have to worry about all the complexities; they merely give instructions to the agent about packing, labelling, transportation and so forth.

However, there are quite a few disadvantages. Perhaps the biggest is that the indirect exporter has very little contact with the foreign agents or distributors, let alone with end users and customers. That means it is more difficult for them to acquire the needed experience in entry into the foreign market. Indirect exporters, especially from smaller firms and smaller countries, may find it difficult to get an export trading house to take on their products without a great deal of paid promotion and advertising. Worse still, the exporter may lose control of pricing and marketing, and even of intellectual property. In addition, the exporter may receive a smaller profit margin than through direct exporting.

Here are the four basic channels for indirect exporting:

- *The Export Merchant* buys the local firm's product outright and assumes the risk of being able to resell it profitably abroad. The type of company typically has expertise in a particular product line and/or in a special geographical market.

- *The Export Agent* usually represents several non-competing manufacturers and receives a commission. The agent does not take title of the goods directly, so they do not assume the risk of not being able to sell them abroad. The function of the export agent is to appraise the export potential of the local manufacturer's products, advertise them abroad, look for foreign buyers, obtain export orders, and advise on, or arrange for, the documentation, shipping and insurance once a sale has been made
- *The Export Management Company*, also known as a trading house, is a private firm that serves as an export department for several manufacturers. This company solicits and transacts export business on behalf of its clients in return for a commission, salary, or retainer plus commission. In addition, some export management companies will purchase the product and sell it themselves to foreign customers. Export management companies can facilitate the export process by handling all of the details – from making the shipping arrangements to locating the customers.
- *Foreign Distributors* have similarities with the trading house. The distributor takes title of the goods and has to resell them down the distribution chain. The big difference is that the transaction (transfer of ownership) may take place in the home country of the distributor. What this means is that the producer must do the packaging and delivery. The producer assumes more risk, but is in a better position to capture more value from the transaction.
- *Foreign Agents* require the exporter to retain title until the goods are delivered to the buyer or even to the consumer. The agent merely represents the producer, but never takes ownership of the goods. Motivated agents like to work on a commission basis because they capture an agreed-upon percentage of every transaction – often with an escalator clause based on sales. That gives them the incentive to maximise sales volumes.

Strategic alliances

All of the following methods comprise various forms of the strategic alliance. The term encompasses everything from informal agreements to share information all the way to joint ventures. In short, a **strategic alliance** is any formal relationship, short of a merger or acquisition, between two companies, formed for the purpose of gaining synergies. In the new economy, strategic alliances enable business to gain competitive advantage through access to a partner's resources, including markets, technologies, capital and people.

Teaming up with others adds complementary resources and capabilities, enabling participants to grow and expand more quickly and efficiently. Especially fast-growing companies rely heavily on alliances to extend their technical and operational resources. In the process, they save time and boost productivity by not having to develop from scratch. Thus, they are freed to concentrate on innovation and their core business.[13]

Alliance patterns differ from one industry to the next. Companies in the biotechnology sector tend to seek out alliances for joint R&D. Alliances in the information technology sector tend to favour marketing agreements and those in the materials industry tend to be production-oriented. By using these various forms of alliance, small entrepreneurial firms can compete effectively in the global economy. The linkages formed are restricted primarily by a company's ability to manage its relationships.

Before entering into a strategic alliance, much thought must be given to the structure of the relationship and the details of how it will be managed. Consider the following in your planning process:

- Define expected outcomes from the relationship for all the parties in the strategic alliance.

- Define and document the elements provided by each party and the benefits a successful alliance brings to each.
- Identify the results that will cause the alliance to be most beneficial for your business and define the structure and operating issues that need to be addressed to achieve these results.
- Protect your company's intellectual property rights through legal agreements and restrictions when transferring proprietary information.
- Define the basics of how you will operate.
- Be certain that the company cultures are compatible and the parties can operate with an acceptable level of trust.[14]

Export management company

Another way to get into exporting is through an **export management company**, also known as a trading house. An export management company is a private firm that serves as an export department for several manufacturers. The company solicits and transacts export business on behalf of its clients in return for a commission, salary, or retainer plus commission. In addition, some export management companies will purchase the product and sell it themselves to foreign customers. Export management companies can facilitate the export process by handling all of the details – from making the shipping arrangements to locating the customers.

When approaching an export management company, however, entrepreneurs should exercise caution. Questions to ask include:

- What is the reputation of the firm?
- What expertise does the firm have in the specific product line?
- What is its track record?
- Does it have an adequate number of staff?
- Will it accept a non-exclusive contract?
- Can it handle documentation and shipping requirements?
- Is the company familiar with selling in areas of the world where you want to go?
- Will it accept a performance clause in the contract?

On the positive side, the small entrepreneurial firm does not have to find foreign buyers and deliver the goods. It can also add synergies and broader markets to sales volumes since many trading houses specialise in specific types of goods and can offer larger catalogues of, say, electronic parts, or clothing or food products. The producer would then see the benefits of higher volumes or higher prices. On the minus side, the producer loses control over pricing, positioning, marketing and delivery. This strategy would not be appropriate for a company trying to establish a brand reputation abroad.

One form of export management is the freight forwarder. A freight forwarder is an independent business that handles export shipments in return for compensation. This does not cost as much as the services offered by an export management company. That is because an export management company handles all of the export-related activities, whereas the freight forwarder simply arranges for product shipment.

Foreign distributors

There are quite a few similarities with **foreign distributors** and the trading house. It is also quite like indirect exporting (above). The producer also has to take care of all of the barriers to market entry before the products arrive at the distributor. Of course, this can be arranged differently. Apprehensive exporters can offer their products 'ex works' – in effect selling them at their factory gate. That means all of the formalities fall to the distributor. On the negative side, the distributor relationship means the producing firm can lose control over marketing, sale and delivery. The goods may even be totally repackaged, relabelled, or repositioned to suit the distributor rather than the exporter (unless specific provisions are included in the agreement). This means that a fruitful and productive foreign distributorship can have some characteristics of a strategic alliance or even a partnership.

Foreign agents

An 'agency agreement' with a **foreign agent** is a step forward from these previous forms of market entry. Here the producer retains title until the goods are delivered to the buyer or even to the consumer. A new agent starts out on a low salary and commission. As sales increase, so do commissions. It is generally the exporter's responsibility to pack and ship the goods, clear them through customs and deliver them to the agent. This means that the producer/exporter assumes direct responsibility for most of the steps in the distribution chain. A good agent can also be extremely helpful in dealing with some of the procedures involved and is better placed to understand any duties, taxes or 'tips' owing on the shipment. In rare instances the exporter may deal directly with a foreign customs broker – usually if the goods must be stored for future distribution.

Setting up a local office

Beyond agents, the next route to global market entry is setting up a small office in the overseas country you are targetting. Usually firms send over one or two people with specialist language or cultural expertise to set up a small office, gather local intelligence, set up a contact network, trial-test new opportunities and carry out marketing and public relations. If things go well, then the staff moves from information gathering to deal making and order processing. This could lead to setting up a full-scale subsidiary in the new market. It is important to work with trade delegations from your home country that have offices in the target country. They have experience, specialist expertise and, most importantly, the contact network to help your venture.

Contract manufacturing

Contract manufacturing means that a contractee/manufacturer assembles the product under a contract arrangement. The manufacturer often charges on a per-piece or per-lot basis for the labour required for their services while using components or materials, moulds or detailed manufacturing instructions supplied by the entrepreneur. Sales and marketing of the finished product remain the responsibility of the contractor, not the manufacturer. Firms engage in overseas contract manufacture not to replace domestic production, but as a means of achieving strategic advantages in that country.

Co-production

Under **co-production** agreements, companies agree to manufacture each other's products. Co-manufacturing may be combined with co-promotion or **co-marketing** agreements (see below). Most such agreements do not involve licences or royalties, but some rights to the product may be worked into the agreement.

Joint production

In a **joint production** agreement, companies cooperate to produce goods. These agreements enable firms to optimise the use of their own resources, to share complementary resources and to take advantage of economies of scale. Companies may cooperate to make components or even entire products. Many foreign engineering firms have entered joint production agreements with domestic firms that have manufacturing expertise. In the automobile and telecommunications industries, competing firms often form an alliance to make components that they all need and use.[15]

Retail outlet

Beyond this comes the network of **retail outlets** as volume increases. Some are owned and operated by the parent firm or could be dealerships that have an exclusive relationship to the parent. This gives the parent company direct control over the whole distribution chain from initial production to final sale. One of the huge additional benefits is that the parent company can monitor customer behaviour. On the negative side, though, it means hiring, training and firing sales staff, managing inventory, navigating local laws and operating the outlets.

Co-marketing

Co-marketing, also known as co-promotion, means two or more companies cooperating to market or promote each other's products. This type of alliance can involve **cross-licensing** a shared promotion campaign, or even the formation of a joint venture to market products. For a firm wanting to enter a new market, a co-marketing agreement is an effective way to take advantage of existing distribution networks and an ally's knowledge of local markets. It allows firms whose products complement each other to fill out a product line while avoiding expensive and time-consuming development.

Export consortium

The most common form of an **export consortium** might involve a joint bid by several small firms to bid on a foreign project. For a large-scale project, this is the only way that small firms can reach a threshold of size and credibility to complete the assigned task. Much smaller ventures might also require a diversity of skills. Consortia can be informal, but they work better if there is some common agreement that defines the group's objectives.

Joint venture

A **joint venture** (JV) is an international business collaboration in which two or more parties establish a new business enterprise to which each contributes and in which ownership and control are shared. There are good business and accounting reasons such as distribution, technology, or finance to create a joint venture. One is that the firm would be able to gain an intimate knowledge of the local conditions and government where the facility is located. It provides the opportunity to obtain new capacity and expertise. Another benefit is that each participant would be able to use the resources of the other firms involved in the venture. This allows participating firms a chance to compensate for weaknesses they may possess.

It is important to consider certain factors before forming a joint venture. These include:

- prospective partners should be screened
- joint development of a detailed business plan and a short-list of a set of prospective partners based on their contribution to developing a business plan
- due diligence – checking the credentials of the other party ('trust and verify' – trust the information you receive from the prospective partner, but it's good business practice to verify the facts through interviews with third parties)
- development of an exit strategy and terms of dissolution of the joint venture
- most appropriate structure (for example, most joint ventures involving fast-growing companies are structured as strategic corporate partnerships)
- availability of appreciated or depreciated property being contributed to the joint venture (by misunderstanding the significance of appreciated property, companies can fundamentally weaken the economics of the deal for themselves and their partners)
- special allocations of income, gain, loss or deduction to be made among the partners
- compensation to the members that provide services.[16]

The central characteristic of a joint venture is that it is an equity-based relationship. In a joint venture, two or more 'parent' companies agree to share capital, technology, human resources, risks and rewards in the formation of a new entity under shared control. Each parent owns a part of the joint venture and is represented on its board of directors or other governing body.

If the ownership of the joint venture is split 50–50, it is usually because the partners are about the same size and both want a large say in the company. A different split usually reflects a difference in the resources committed by each parent. Here are three possible joint venture governance arrangements:

- full equality – the parents decide policy and operating matters together
- policy equality – the parents must concur on joint venture policy terms, while one takes the lead in operating matters
- lead parent arrangement – one parent has the lead on policy as well as operating questions.[17]

One of the disadvantages associated with joint ventures is the problem of fragmented control.[18] For example, a carefully planned logistics flow may be hampered if one of the firms

>>ENTREPRENEURSHIP IN PRACTICE

JOINT VENTURE AGREEMENT CHECKLIST

- >> Legal structure of the new business
- >> Scope of business
- >> Governing structure: Percentage ownership; co-operation at the policy and operating level
- >> Investment: Form of investment (know-how, technology, brand equity, equipment, land, cash and so on); total investment and/or capital contribution
- >> Production: Goods and/or services to be produced and/or provided; location of production facilities; required production capacity; required office space; R&D budget; quality management and standards
- >> Management and staffing: The CEO (should come from one of the parents, but be able to win both parents' confidence); board of directors (total number, number of appointees of each parent, frequency of meetings); governance policies (regulatory compliance, board policies); other key positions (who appoints what members of the management team and responsibilities for each position); expatriates (legal, living and working arrangements); delegation of authority; reporting structure
- >> Technology and intellectual property transfer: Technology transfer (patents, copyrights, know-how, trade secrets); specifics on technology to be transferred; training and technical assistance
- >> Marketing: Marketing strategy; office space required and location of sales and branch offices; share or products/services to be sold at the local and international market; marketing budget
- >> International business procedures: Requirements for local or imported raw materials and components; foreign currency requirements; taxes and import duties; regulatory approval process (cost, timing requirements)
- >> Contracted services; Product/service development; marketing support
- >> Revenue sharing: Dividend policy; royalties or transfer fees
- >> Accounting and control methods: Level of detail in cost accounting required; information required for venture control; frequency and level of detail required for accounting reports; choice of auditor.

Source: Ten3 East-West. 'Joint Venture Agreement: Checklist', www.1000ventures.com/doc/legal/agr_jv_checklist_byten3ew.html decides to block the acquisition of new equipment. This type of problem can be avoided or diminished in several ways:

- One party can control more than 50 per cent of the voting rights. This will normally give formal control; however, even a minority opposing view can carry considerable influence. This can be particularly true if the differences of opinion reflect different nationalities.
- Only one of the parties is made responsible for the actual management of the venture. This may be complemented by a buyout clause. In case of a disagreement among the owners, one party can purchase the equity of the other.
- One of the parties can control either the input or the output, exerting significant control over the venture decisions, despite voting and ownership rights.

Direct foreign investment

A **direct foreign investment** is a domestically controlled foreign production facility. This does not mean the firm owns a majority of the operation. In some cases, less than 50 per cent ownership can constitute effective control because the stock ownership is widely dispersed. On the other hand, the entrepreneur may own 100 per cent of the stock and not have 'real' control over the company because the government dictates whom to hire, what pricing structure to use and how to distribute the earnings. This causes some concern about exactly who is in control of the organisation. Because of the difficulty of identifying direct investments, governmental agencies have had to establish arbitrary definitions of the term. A direct foreign investment typically involves ownership of 10 to 25 per cent of the voting stock in a foreign enterprise.

A firm can make a direct foreign investment by several methods. One is to acquire an interest in an ongoing foreign operation. This initially may be a minority interest in the firm, but enough to exert influence on the management of the operation. A second method is to obtain a majority interest in a foreign company. In this case, the company becomes a subsidiary of the acquiring firm. Third, the acquiring firm may simply purchase part of the assets of a foreign concern in order to establish a direct investment. An additional alternative is to build a facility in a foreign country.

An entrepreneur may want to make a direct foreign investment for several reasons. One is the possibility of trade restrictions. Some countries have prohibitions or restrictive trade barriers on imports of certain products. These barriers can make exporting costly or impossible. In addition, foreign governments may grant tax incentives to a firm seeking direct investment in that country. These incentives can be attractive if the anticipated rate of return is estimated to be higher at the foreign location than domestically.

Direct investment can be an exciting venture for small firms making efforts to increase their sales and their competitive positions in the marketplace. However, it is sometimes not practical for a firm to make a direct investment in a foreign location. If the firm has a unique or proprietary product or manufacturing process, it may want to consider the concept of licensing.

Royalties and licensing

A **royalty** is a payment made in return for being permitted to exercise a right owned by another person. Most commonly, it is allied to the payment made by a publisher or record producer to the author of a book or performer of a piece of music, but it can apply equally to a payment made for producing something by a patented process. This method of distribution is usually entered into when the developer of a product or component does not have the capital, time or commitment to manufacture and market the product/component themselves, or there are substantial tariff barriers to imports in the market of interest. You effectively sell your intellectual property to someone else to manufacture on your behalf, or to incorporate into a product they are already manufacturing. You then receive an agreed amount – a royalty – every time they make a sale. This method is often entered into when a small component has been developed that can be used in other processes – for example, a microchip that can be used in computers.[19]

Licensing is a global market-entry tool in which the company enters into an agreement with a licensee in the foreign market, offering the right to use a manufacturing process, trademark, patent, trade secret, or other item of value for a fee or royalty. Licensing can cover inventions, technologies, software, manufacturing systems and processes, products and artistic and literary material. The entrepreneur need not make an extensive capital outlay to participate in the international market. Nor does the licensor have to be concerned with the daily production, marketing, technical, or management requirements; the licensee will handle all of this. Due to the high cost of manufacture and the comparatively small investment of a licensing program, many of the risks that a company would otherwise face in exploiting its intellectual property are transferred to the licensee. Depending on the exclusivity of the licence, there are varying degrees of risk involved for the licensee and licensor; however, an effective licence strategy will minimise risk for both parties.[20]

For developing an international licensing program, three basic types of modalities are available:

- **Patents**: The entrepreneur must file applications in several countries as a defence against competitors. A rule of thumb is that gaining sufficient protection for a patent internationally could cost about $100 000. Filing ten related patents to create a protective 'picket fence' around an invention could cost the entrepreneur $1 million. Self-defence has increased the cost of international patent protection.[21]

  Therefore, the entrepreneur should pursue patents that are broad, commercially significant and offer a strong position. Record all steps or processes in a notebook and have them witnessed so that documentation secures a strong proprietary position. Prepare a detailed patent plan outlining the costs to develop and market the innovation. Analyse the competition and technological similarities to your idea and establish an infringement budget. Patent rights are effective only if potential infringers fear legal damages.[22] Evaluate the patent plan strategically as the typical patent process can take up to three years. This process should then be compared to the actual life cycle of the proposed innovation or technology. While intellectual property may represent a significant share of some firms' market value, only a small percentage of issued patents are commercially valuable. As well, many patents are not put into use and so firms may wish to sell underutilised patents in order to monetise intellectual property assets for other purposes.
- **Trademarks**: Due to the difficulties that can occur in direct translations, it may be advisable for the entrepreneur to have more than one trademark licensed for the same product. The entrepreneur should keep in mind, however, that if the product is not well recognised in the international market, they will not be able to use it as a major incentive in the bargaining phase. Sometimes, licensees want the patent rights, but prefer to use their own trademarks. This is often the case if the foreign firm is well established.
- **Technical know-how**: This type of licensing is often the hardest to enforce since it depends on the security of secrecy agreements. (The licensor should sign an agreement to prevent the licensee from legally revealing trade secrets.) In some localities,

governments have strict regulations governing the use of technical know-how licensing. Frequently, one may protect the technical capabilities for only five years before the licensee is free to use this know-how without paying royalties. However, keep in mind that this may differ from country to country, depending on the particular regulations. Because this is a complex process, the entrepreneur must continue to develop their technical capabilities to ensure an ongoing international need for the company's services.[23]

- **Advantages of licensing**:
  - It can be an extremely attractive way to enter the international arena. It requires a minimal capital outlay and can generate savings in tariffs and transportation costs.
  - It is a more realistic means of expansion than exporting, particularly for the high-tech firm.
  - Access to the market is easier in comparison with equity investments and foreign governments are more likely to give their approval because technology is being brought into the country.
  - A potential exists for the licensees to become partners and contributors in improving the 'learning curve' of technology.
- **Disadvantages of licensing**:
  - It is possible that the licensee will become a competitor after the contract expires.
  - The licensor must get the licensee to meet contractual obligations and to adjust products or services to fit the licensee's market.
  - The licensing entrepreneur must manage the relationship's conditions and circumstances, as well as resolve conflicts or misunderstandings as they occur.
  - The integrity and independence of both the licensor and licensee must be maintained.

To be competitive with larger firms, small businesses have to be on the cutting edge of bringing in new and innovative technology. Moreover, some small firms may not have the financial resources available to participate in the international marketplace by exporting, joint venture, or direct investment. For many of these firms, international licensing is a viable and exciting method of expanding operations.[24]

Before a company considers licensing out its technology, however, it should consider whether other ways of taking advantage of its property, such as joint ventures and strategic alliances with other companies, would better complement its economic position. Once licensing is the chosen direction, the nature of the company, as well as the particular property it wishes to utilise, should be carefully considered before deciding the architecture of the licence.[25]

Franchising

Franchising is a specific form of licensing that involves selling the rights to a complete package of trademarks, processes, technologies, designs and copyrights, as they are all involved in the operation of a specific business. (See the section on 'Franchises' in Chapter 6.) Perhaps the best-known franchises are in the fast-food business, with the world leader probably being McDonald's. Whether it is in North America or Russia, a McDonald's restaurant promises the same food, the same quality and the same level of service to customers. Moreover, its business formula involves service standards (quick service, a standard menu), an approach to employment (hiring younger people), technology (high-tech ovens, foolproof cash registers), marketing (Ronald McDonald, frequent promotions) and a common look that is reinforced by logos and other symbols. In selling its franchise, McDonald's provides an entire process, employee training, monitoring of performance, quality control and marketing support as part of the package.

Generally, with franchising, though terms of the arrangement vary, the purchaser usually pays a lump sum for the franchise and then remits a percentage of all subsequent profits. The sale of a franchise marks the beginning of an ongoing partnership between the franchise owner and the purchaser that apportions responsibilities in both directions. That partnership may include an agreement that the purchaser buy specific products or supplies from the franchise owner on an exclusive basis. The franchise owner will certainly provide ongoing training and marketing support to the purchaser.

Mergers and acquisitions

Mergers and **acquisitions** are another way for companies to position themselves in a new market. They can also be important for companies seeking to develop greater economies of scale or to acquire new capabilities. A merger occurs when two corporations join into one, with one corporation surviving and the other corporation disappearing. An acquisition is one company taking control of another, often through an 'unfriendly' or 'hostile' acquisition. A prospective exporter interested in acquiring a foreign firm would do well to develop a cooperative business

>>ENTREPRENEURSHIP IN PRACTICE

HARDWARE VERSUS 'HEARTWARE' IN SINGAPORE

The lesson learnt is that globalisation and cross-border mergers and acquisitions are not about acquiring the hardware and the infrastructure. It is equally important to acquire the 'heartware' of the local people. Without that, the acquisition will be very costly and it would be doomed to fail.

In the early nineties, a listed and well-known US company acquired a listed Asian company that had built a highly successful electronics distribution business in key markets in Asia. Soon after the acquisition, the US company introduced many drastic changes, including strict internal control compliance procedures and structured financial reporting. While these were good practices, they were not executed with a sound integration strategy, which provided time and buy-in from local management. As a result, there were clashes in management style and the key local managers left.

Soon after their departures, these key managers joined their competitors and started to dismantle the highly successful distribution network that the US company thought it now owned. The consequences were dire. The US company had to write off millions of dollars of bad debts as many distributors defaulted. They had to rebuild their distribution channels from scratch, which was a very costly exercise. The lesson learnt is that buying and owning the hardware does not automatically mean owning the 'heartware'; that is, the loyalty of the local team.

On the other hand, a local contracting company that provided services to major telecommunication companies in the region was successful in acquiring both the hardware and the 'heartware'. Rather than acquiring the local contracting company in each country, a new company was incorporated, with the Singapore side controlling 70 per cent. However, in the shareholders' agreement the local partner was entitled to 50 per cent profit-sharing. Key guiding principles were established, but the local partners were allowed to manage the business.

As the local partners were treated like partners, not employees, their mind-sets and attitudes were different. They worked harder, solved teething problems, secured local working capital financing and made huge profits for the joint venture company. The lesson learnt is that globalisation and cross-border mergers and acquisitions are not about acquiring the hardware and the infrastructure. It is equally important to acquire the 'heartware' of the local people. Without that, the acquisition will be very costly and it would be doomed to fail.

Source: Stone Forest, 'Financing Mergers and Acquisitions: Growth Strategies of Successful Singapore Companies', in International Enterprise Singapore, *Financing Internationalisation: Growth Strategies for Successful Companies*, Singapore: Singapore Information Services, 2004: 129

relationship with it first. This gives both companies a chance to work out an effective relationship, develop trust and assess the real advantages and disadvantages of a merger or acquisition.

The four main reasons for making an acquisition include:

- to acquire complementary products in order to broaden the line
- to acquire new markets or distribution channels
- to acquire additional mass and benefit from economies of scale
- to acquire technology to complement or replace the currently used one.[26]

Greenfield investment

Building everything from the ground up may be the ultimate international market entry strategy. **Greenfield investment** involves building everything the foreign subsidiary might need. In the past, this was a good way to get around protectionist barriers or to acquire an idle production plant cheaply. These days, this strategy is less popular for two reasons: expense and risk. It's also much cheaper to outsource the services needed. Greenfield investment also means tying up scarce capital, which leads to being inflexible and less strategically agile.

FIVE STEPS TO THE INTERNATIONAL MARKETPLACE

Figure 14.1 illustrates the process for an entrepreneur to follow when deciding whether to pursue a global expansion. The following pages summarise the process into five distinct steps. This five-step process begins with research and moves into a feasibility study. From this point, the financial arrangements are secured, the necessary documentation is prepared and, finally, the plan is implemented.

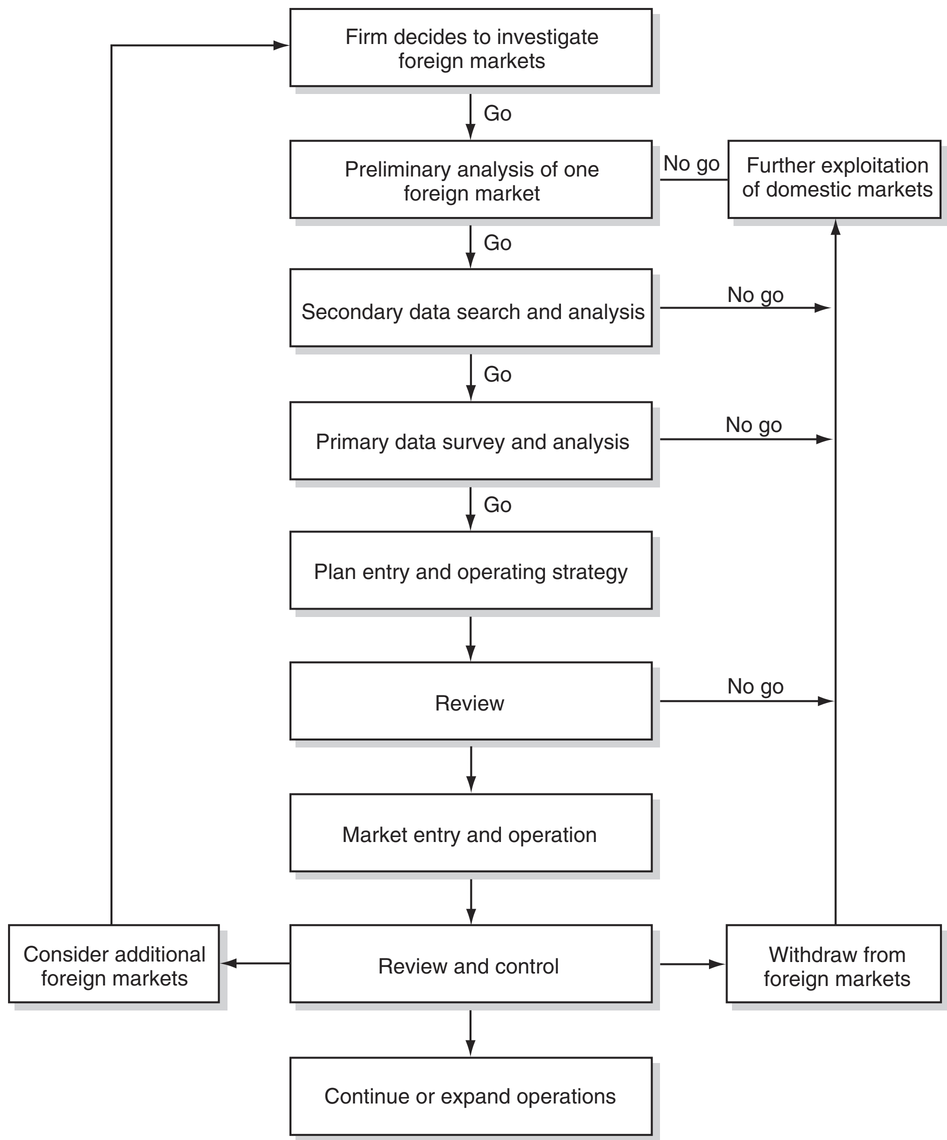
Conduct research

One of the most difficult phases of entering the international arena is that of conducting research on the market. Compounding this problem is the fact that the entrepreneur may be thousands of kilometres away from this market. As a result, the entrepreneur must often turn to methods and techniques other than marketing research to determine the most profitable markets.

Any company seeking to enter foreign markets needs to evaluate the opportunity. In the first instance this means developing a general understanding of the characteristics, pressures, trends and requirements in the target countries being considered. It is important to flag and eliminate unattractive options that do not meet the company's basic objectives, either in performance potential or operating requirements. Beyond that, the researcher helps identify the preliminary priorities and risks associated with the trade opportunity. The Internet is a cornucopia for trade researchers. One can also acquire proprietary research undertaken by survey and market researchers in target countries. Here are key elements that have to be addressed in any foreign market entry plan:

- **Macro-level market attractiveness**:
  - Which markets should be given further attention?
  - Is there a basic need for the company's product/service?
  - Are business conditions suitable for the firm's risk profile and capabilities?
- **Basic fit**:
  - Is the country receptive to imports of products or services such as those provided by the company?
  - Are there reasons why the product would not be right for this market (for example, climate – sending snowsuits to the tropics), involving infrastructure

FIGURE 14.1: ANALYSIS OF GLOBAL EXPANSION DECISIONS



Source: Roger D. Blackwell and Kristina Stephan, 'Growing Profits for Small Business Through Global Expansion', *Small Business Forum*, Winter 1990: 55

(for example, reliability of power for electronic goods) and related products (for example, computer software requires an installed base of computer hardware)?

- **Economic environment (market indicators)**:
  - What is the relative overall market size (gross national product (GNP), population)?
  - How strong/concentrated is the consumer or industrial purchasing power (income distribution, capital expenditures)?

- How rapid is overall growth in the market (GNP **growth rates**, per capita income growth)?

- **Political/legal environment (risk, requirements, regulations)**:
  - How stable/risky is the political situation/level of civil unrest and how would this affect trade?
  - Would government regulations restrict access to certain types of trade, or create excessive burdens for the firm's entry plans (for example, do they require a certain level of local production)?
  - Are there tariffs, entry barriers or non-tariff barriers which would either hamper or help market entry of a product from your country (for example, a special trade arrangement such as a free trade agreement could help market entry to the US)?
  - Are there legal restrictions that would require excessive modification to the product (for example, restrictions on the use or protection of a trademark or brand name, labelling requirements)?
- **Financial environment**:
  - How stable/volatile is the overall economy (for example, inflation, interest rates)?
  - Are there restrictions on exchanging foreign currency (can the firm be paid in a suitable currency)?
  - What is the level of general credit availability and payment reliability?
- **Sociocultural environment**:
  - To what degree is language a factor in the company's ability to do business in foreign markets?
  - To what degree would the social structure affect/alter the way the firm does business?
- **Market potential/industry attractiveness**:
  - Is there sufficient demand in the latter for the firm's product or service?
  - How much adaptation would be needed?
  - Will demand exceed the cost of doing business?
- **Economic/market considerations**:
  - How will economic factors affect the standardisation of the product or the marketing mix (for example, will product sizes need to be reduced or less choice need to be provided at the premium end to accommodate lower purchasing power)?
  - How strong is the current and potential demand for this product (for example, what is the market size and growth trend)?
  - What market segments exist that could create opportunities?
  - What stage of the product life cycle would the firm's export be entering?
- **Sociocultural considerations**:
  - Will cultural factors require the firm to change features of its marketing mix?
  - Will language affect the company's marketing efforts in the target market? Is there more than one language that must be considered?
- **Competitive considerations**:
  - How strong is the current competition (their size and market share, the quality levels of their product, level of after-sales service, intangible advantages – member of a favoured nation)?
  - What is the source of the competitors' products (for example, imported or locally produced?)
- **Political/legal considerations**:
  - Are there specific tariffs, taxes, duties and/or permits which apply to the firm's product?
  - If permits are necessary, would they be difficult or costly to obtain?

- **Infrastructure considerations**:
  - What are the characteristics of the shipping, transportation, warehousing, distribution facilities and the general level of access to the markets?
- **Physical/geographic considerations**:
  - Are there specific characteristics that would affect the marketing mix and require adaptation?
  - What is the internal suitability like? How will it affect the firm's other operations?
  - What form of business should the firm adopt (internal/external exporting, indirect or direct exporting, licensing or franchising, technology transfer)?
  - If the company adopts an external form of exporting (for example, through an agent, distributor, trading house), how does it select the best representative?
  - How will it manage the representative? What relationship will it have with the representative? What are the legal implications of the relationship?
  - If it licenses, franchises or transfers technology, how does it find and select the right partner?
  - What type of payment/credit arrangements would be most suitable?
  - Is there a solid chance for product acceptance to compensate for the cost of entry and ongoing support?

Prepare a going global feasibility study

A feasibility study should be undertaken to determine if the proposed project is capable of being carried out. Figure 14.2 illustrates a format the study can take. The feasibility study is a critical document of the entry procedure in that it helps demonstrate how realistic the project is. Because the first few years in the international markets typically will be non-profitable, it is imperative the entrepreneur have sufficient foresight to look at both the long-term and short-term prospects of the proposal.

Secure adequate financing

Exporters naturally want to get paid as quickly as possible, while importers usually prefer to delay payment until they have received or resold the goods. Because of the intense competition for export markets, being able to offer attractive payment terms that are customary in the trade is often necessary to make a sale.[27]

The following factors are important to consider in making decisions about financing:

- the need for financing to make the sale – in some cases, favourable payment terms make a product more competitive
- the length of time the product is being financed – this determines how long the exporter will have to wait before payment is received and influences the choice of how the transaction is financed
- the cost of different methods of financing – interest rates and fees vary; where an exporter can expect to assume some or all of the financing costs, the effect of costs on price and profit should be well understood before a pro forma invoice is submitted to the buyer
- the risks associated with financing the transaction – the riskier the transaction, the harder and more costly it will be to finance; the political and economic stability of the buyer's country can also be an issue.[28]

>>ENTREPRENEURSHIP IN PRACTICE

WHERE TO FIND GOOD FOREIGN MARKET RESEARCH

Acton Institute, Research Resources	www.acton.org/ppolicy/trade/resources.html
Australian Bureau of Statistics	www.abs.gov.au
California Association for Local Economic Development	www.caled.org
Canada Business, Services for Entrepreneurs	www.canadabusiness.ca/gol/cbec/site.nsf/en/index.html
Federation of International Trade Associations, Web Resources for International Trade	www.fita.org/webindex/index.html
eMarketer	www.idcresearch.com
Government trade agencies	http://dir.yahoo.com/Business_and_Economy/Trade/Government_Agencies
International Data Corporation	www.idcresearch.com
International Economics	http://netec.wustl.edu/WebEc/webecf.html
International trade agencies	http://dir.yahoo.com/Business_and_Economy/Trade/International_Trade_Organizations
International Trade Data Network	www.itdn.net
Jupiter Research	www.jup.com
Lex Mercatoria	www.lexmercatoria.org
List of central banks around the world	www.bis.org/cbanks.htm
Michigan State University, Global Edge	http://globaledge.msu.edu/ibrd/ibrd.asp
National Trade Databank	www.stat-usa.gov/tradtest.nsf
Philadelphia University, Everything International	http://faculty.philau.edu/russowl/russow.html
The Art of Business Web Site Promotion	www.deadlock.com/promote
The United Nations national and international data sources	http://unstats.un.org/unsd/methods/inter-natlinks/sd_natstat.htm
US commercial service about market research	www.export.gov/marketresearch.html
University of Tennessee, international trade links	www.lib.utk.edu/refs/business/international.html
US Census Bureau	www.census.gov
World Bank, Trade and International Integration	www.worldbank.org/research/trade/majoract.htm
Yahoo's Internet Statistics and Demographics Surveys	http://dir.yahoo.com/Computers_and_Internet/internet/statistics_and_demographics/surveys

Global entrepreneurship and sustainability

It is perfectly possible to become more sustainable by exporting one's pollution to other countries. A good example is auto exports. Non-industrial countries such as Burma and New Zealand have become graveyards for ageing emission-spewing Japanese cars. Japan thus sees sustainability gains by exporting its pollution to others. A young Chinese person once asked Thomas Friedman: 'You Americans got to grow dirty for 150 years, isn't it our turn now?' To which he retorted, 'Yes, it's your turn, please grow as dirty as you like. The USA needs only five years to invent all the clean power and energy efficiency tools that you will need to avoid choking on pollution, and then we are going to come over here and sell them all to you.'[29]

FIGURE 14.2: FEASIBILITY STUDY OUTLINE FOR GLOBAL MARKET ENTRY

I Identification of international project
II Statement of feasibility
III Summary and/or conclusion
IV Entry selection (select one method and develop complete program)
  A Methods of entry
    1 Exporting
      a Pros
      b Cons
    2 Joint venturing
      a Pros
      b Cons
    3 Direct investment
      a Pros
      b Cons
    4 Licensing
      a Pros
      b Cons
  B Other considerations
    1 Financial considerations
      a Raw materials
      b Labour
      c Tax incentive and allowance
    2 Governmental considerations
      a Stability
      b Regulations
    3 Distribution
      a Modes of transportation
      b Channels
V Market profile
  A Overview: target market
    1 Population
    2 Major cities
    3 Language
    4 Climate
    5 Geography
    6 Imports
    7 Exports
    8 Exchange rate
    9 Transportation
    10 Communication
    11 Business practices
    12 Business hours
  B Society/culture: Background of society
  C Major demographic factors
    1 Income
    2 Occupation
    3 Education
    4 Religion
  D Political climate: Background
  E Economic climate
  F Outlook for trade
  G Opportunities and restraints
VI Targeted consumer analysis
VII Legal considerations
  A Trade policy
  B Registration of company
  C Ownership of the business entity
  D Governmental policy on foreign investment
  E Industrial property protection
VIII Risk identification and analysis
  A Financial risk and property/business seizure
  B Repatriation of capital
  C Political risk
    1 Foreign relations with the entrepreneur's host country
    2 Governmental stability
IX Financial considerations
  A Type of financing for proposed project
  B Source of financing
    1 Internal
    2 World Bank
    3 Other
  C Break-even analysis
    1 Return on investment
    2 Return on total assets employed
    3 Sales forecast
  D Taxation considerations
  E Policy on repatriation of profits
X Labour and managerial considerations
  A Organised labour
    1 Description
    2 Bargaining tools
  B Work characteristics
    1 Hours worked
    2 Pay rates
  C Recruitment
    1 Local
    2 Expatriate
    3 Third country
  D Management
    1 Local
    2 Expatriate
    3 Compensation
XI Control strategies
  A Difficulty of international control
    1 Distance
    2 Diversity
    3 Degree of certainty
  B Centralised versus decentralised
  C Policy
XII Timetable for implementation

SUMMARY

Doing business globally is a profitable and popular strategy for many entrepreneurial ventures. First we examined the Asia–Pacific from the perspective of comparative growth rates. Throughout the world today, multilateral and bilateral free trade agreements are powerful economic forces creating opportunities for entrepreneurs in the international marketplace.

We first compared and contrasted the entrepreneurial profiles of countries in the Asia–Pacific.

Then we looked at the variety of reasons for going global, each with associated risks and challenges. This chapter discussed several ways the entrepreneur can actively engage in the international market. One way is importing, which involves buying goods from other countries. A second way is exporting, which takes a variety of forms. All global strategies involve some form of strategic alliance. For exporters, the export management company, distributors abroad, foreign agents and setting up a local office are important foreign market entry strategies. The global entrepreneur may become involved in contract manufacturing, co-production, joint production, retail outlets, greenfields investments, or co-marketing.

Another way is using joint ventures. These international arrangements offer many benefits for those looking to establish a presence in the international market. Beyond this is direct foreign investment. Before entrepreneurs take this step, however, it is important they carefully evaluate the associated risks. Royalties and licensing have both advantages and disadvantages. Franchising is an increasingly popular way of gaining a foot in an overseas market. Mergers and acquisitions were discussed for companies seeking to develop greater economies of scale or to acquire new capabilities.

The last part of the chapter examined the steps for entering the international marketplace: conduct research; prepare a feasibility study; and secure adequate financing.

KEY TERMS & CONCEPTS

acquisitions
Asia–Pacific Economic Cooperation (APEC)
co-marketing
contract manufacturing
co-production
direct foreign investment
European Union (EU)
export consortium
export management company
exporting
financial environment
foreign agents
foreign distributors
franchising
free trade agreements (FTAs)
global sourcing
greenfield investments
growth rates
importing
joint production
joint venture
licensing
mergers
multilateral institutions
North American Free Trade Agreement
Organisation for Economic Cooperation and Development (OECD)
retail outlet
royalties
strategic alliance
World Bank
World Trade Organization (WTO)

REVIEW & DISCUSSION QUESTIONS

1 Of the countries described at the beginning of the chapter, which, in your opinion, have the best chances of being successful in the global marketplace?
2 What is a 'born-global' firm? Name three born-global companies that you know.
3 How can an entrepreneur become aware of import opportunities?
4 Which of the 'X-shoring' methods would you use for a call centre?
5 Which for a manufacturer of plastic playgrounds?
6 Which for an IT company?
7 Of what value are an export management company and a freight forwarder to entrepreneurs who are seeking to export goods?
8 Before engaging the services of an export management company, what questions should an entrepreneur ask?

9 What is a foreign sales corporation? Of what value is it to entrepreneurs in the export business?
10 What are five of the most common mistakes potential exporters make?
11 How does a joint venture work? What are the advantages of this arrangement? What are the disadvantages?
12 How can a firm make a direct foreign investment?
13 How does a licensing arrangement work? What are the advantages and disadvantages of such an arrangement?

EXPERIENTIAL EXERCISE: MARKET SELECTION MATRIX

This is useful for making comparisons and allows you to weight questions according to importance for your product/service. The following is a fictitious example of the questions a company might ask at the first stage of the market selection process. The product we are seeking to export is a hair removal cream. We have started by asking some very basic, but relevant, questions, assessing five broad regions. The weightings show which questions you decide are the most important in terms of market selection for our product. A weighting of 10 means the issue is twice as important as a weighting of 5. This table has 38 points total score. You can use any total you want. The key here is in the selection of the questions and the relative weightings.

	FEMALE POPULATION	PER CAPITA GDP	SOPHISTICATION OF RETAIL	TRADE BARRIERS	CULTURAL ATTITUDE TO HAIR REMOVAL	TOTAL
Weighting	5	10	3	10	10	38
North America	4	9	3	8	9	33
Asia	5	2	2	8	4	21
South America	3	3	2	5	9	22
Europe	4	8	3	5	6	26
Australia	3	8	3	10	9	33

From the results of this initial analysis we would identify the US, Canada and Australia as priority markets and commission more detailed research.

Now pick another export product and fill in all the blanks.

	FACTOR 1	FACTOR 2	FACTOR 3	FACTOR 4	FACTOR 5	TOTAL
Weighting						
Country/region 1						
Country/region 2						
Country/region 3						
Country/region 4						
Country/region 5						

EXPERIENTIAL EXERCISE: GOING INTERNATIONAL

When entrepreneurs decide to go international, they must take steps in hiring people to help them out, entering into agreements with overseas partners and putting together a plan for conducting the venture. The following are nine groups or terms with which the entrepreneur should be familiar, labelled (A) to (I). Match each of these groups or terms with its correct definition or description (1) to (9). Answers are provided at the end of the chapter.

- **A** Export management company
- **B** Freight forwarder
- **C** Foreign sales corporation
- **D** Joint venture
- **E** Licensing
- **F** Direct foreign investment
- **G** Patents
- **H** Technical know-how
- **I** Conduct research.

1. The first step taken to go international
2. A business arrangement in which the manufacturer of a product gives permission to some group or individual to manufacture the product in return for specified royalties or other payments
3. Can handle all the details for shipping goods overseas, although the cost can be high
4. Some of its income is exempt from federal taxes
5. Foreign governments sometimes grant tax incentives for this
6. One of the basic types of international licensing programs
7. A company owned by two or more organisations
8. Another of the basic types of international licensing programs
9. Can arrange for shipment of the product to overseas markets.

CASE 14.1: HOME AGAIN

For Jamey Bennett, CEO of reading-lamp company LightWedge, the decision to start manufacturing in China was simple. It came down to money: Factories in the People's Republic could make his products for 30 per cent less than those in the US. Those bargain prices brought other problems, though. One year, two factories, two trading companies and countless headaches later, Bennett, 36, moved his company's production back to the States.

Sitting in his Nantucket, Massachusetts, office, Bennett recalls how his problems began immediately after he picked a trading company in Taiwan and a factory in Guangdong province back in 2002. The reading lamps were simple enough – a thin sheet of transparent acrylic, illuminated by two light-emitting diodes, placed over an open book – but the made-in-China versions never looked quite right; there were problems with the texture and the colour of the acrylic. Each lamp requires two LEDs of the same colour, but because the factory matched them by 'eye-balling', some lamps gave off an odd-coloured light.

Bennett, a serial entrepreneur who'd already founded two companies, BookWire.com and LendingTree.com, considered those the inevitable snags of a new venture. He wasn't thrilled, but he was comfortable enough to ship the $34.95 LightWedge Original to customers (and most didn't notice anything amiss). A few months later, however, when the factory shipped the products late and LightWedge almost missed its first holiday season, Bennett was less forgiving. 'We could have done 40 per cent more in sales for Christmas,' he says. 'We got clobbered.'

For the company's second product, a version designed for paperbacks, Bennett tried a different factory, in Shanghai. Unfortunately, he says, 'it was more of a disaster than the one in Guangdong'. The owners spoke little English and despite an $80 000 investment and months spent tweaking machinery, they never got the product right. The lenses arrived with scratches and a 'weird goopy material' on them, Bennett says. Worse, he had more shipping delays. One company that put LightWedges in its May 2003 catalogue couldn't ship them to customers until September.

Anand Sharma, CEO of TBM Consulting Group in Durham, NC, says, 'China works if you have a long lead time and need things that are very standard'. Bennett declined to say how much the experiment cost him, but LightWedge lost $1.5 million in sales in 2003 because of shipping delays alone. Of course, there were soft costs as well: The documentation and fees became burdensome for his three-person business, the weekly conference calls at 11 p.m. were trying and Bennett – halfway around the world – couldn't stop by to check on things. 'There was no way to stay on top of everything with so much other stuff to do,' he says. 'It just didn't work.' Finally he decided to bring production back home.

Today every LightWedge lamp is made in Newport News, Virginia, at a 1500-person plant run by Canon Virginia. (Yes, it's the US arm of Japanese Canon – welcome to the global marketplace.) Bennett's production outlays are 30 per cent higher than those in China and getting a US factory set up costs three times as much, but he says it's worth it – at present. 'We'd consider going back to China, but I think I made the right decision for now.'

Source: 'Home Again', *Fortune Small Business*, New York, 14(2), March 2004: 60

Questions

1. What were the trade-offs when Jamey was considering a factory in China?
2. What could Jamey have done to prevent the problems?
3. What factors would he have to have in place to consider going back to China?

CASE 14.2: 'I DID IT BECAUSE I DIDN'T KNOW THAT I COULDN'T'

That might sound like the sort of line that could get someone in a good deal of trouble, but in the case of New Zealand vegetable exporters, Lance and Kay Peterson, it was exactly that attitude that got their bottled asparagus out of the warehouse and onto the shelves of every supermarket chain in Australia.

Lance explains, 'We'd had some problems getting the product out into the Australian market, so I went to talk to the category buyers themselves. Within six months every one of them was stocking it. When people asked me how I did it, I told them that it was because I didn't know I couldn't'.

If that makes it sound as if all you need is a gung-ho attitude to crack the export market, Lance will assure you that nothing could be further from the truth. What it does tell you, however, is the importance of doing your homework, making the right contacts and knowing which approach is right in any particular market.

Another story from Lance about doing business in Japan exemplifies the very different approach required there. The Petersons' company, Circle Pacific, is a well-established, very successful Hawkes Bay exporter of asparagus and frozen squash pumpkin – a Japanese diet staple. But cementing a business relationship in Japan can take years. 'You're wasting your time if you think you can rush into the Japanese market and score an overnight hit. My Japanese agent and I spent four years talking to one client before he did any business with us.'

'If there's one piece of advice I would give to new and potential exporters, it's to put the time, money and effort into finding the right agent in that market and work on building that relationship. It can take years, but once you are in, they are extremely loyal to you. I can't emphasise enough how important it is to show them that you are there for the long haul.'

After 30 years working to grow their family business and expand their markets around the world, Kay and Lance have recently handed over the reins to CEO Jeannette Samundsen. Jeannette worked closely with Giles Pearson from PriceWaterhouseCoopers to put a new rigorous accounting and computing system in place, which provides Circle Pacific with the quality of information it needs to do business efficiently and profitably, here and around the world.

'The great thing about Giles is that he is never satisfied', says Jeannette. 'It's brilliant having someone who keeps asking us the hard questions and who keeps setting the hurdles a little higher. Giles

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reviews our results and, in particular our margins, every two to three months to ensure that we are actually making the margin that our costings tell us we should be making. In this business there are so many variables and price fluctuations – especially around foreign exchange – we have to have really robust policies and procedures in place to manage the risks and give us the quality of information we need. This last year has been about working with Giles to get our ducks in a row; this next year we're going to really begin to see the results of that.'

Source: PriceWaterhouseCoopers, 'I Did It Because I Didn't Know that I Couldn't', www.pwcglobal.com

Questions

1 What does 'I didn't know that I couldn't' mean to an entrepreneur?
2 Would Circle Pacific have been able to succeed without the help of PriceWaterhouseCoopers?
3 What cultural problems do you think Circle Pacific had in Japan?

CASE 14.3: A FOREIGN PROPOSAL

Australian Edgar Bruning left his job at a major computer manufacturing firm and started his own business, naming it Bruning Computer. Since then Edgar has secured five patents for computer-related equipment. His latest is a computer chip that can increase the speed of most personal computers by 35 per cent. The cost of one of these computer chips is only $8 and the unit wholesales for $135. As a result, Bruning's profits have mushroomed.

Realising that everything he developed can be copied by foreign competitors, Edgar entered into contractual arrangements with a firm in Australia, one in Singapore and another in Dubai to market his product. Bruning ships 50 per cent of its production output to these three firms, while the rest is sold to companies in Australia and New Zealand. Edgar recently has been thinking about increasing his production facilities. He is certain he could sell 40 per cent more chips if he were able to make them.

Last week Edgar had a visit from the chief executive of a Chinese firm. The company has proposed a joint venture between itself and Bruning. The venture would work this way: Bruning would ship the company as many chips as are currently sent to the three other firms. These chips would be paid for on a 90-day basis. The Chinese firm would act as Bruning's Asia sales representative during this part of the agreement. Then within 90 days the Chinese firm would purchase manufacturing equipment that would allow it to make the chips in China. 'This will save us both labour and shipping costs', the Chinese executive pointed out. 'And all profits will be divided on a 50/50 basis. Your only expenses will be your share of the manufacturing equipment and we will apply your profits against those expenses. So you will have no out-of-pocket expenses.'

The idea sounds very profitable to Edgar, but he is not sure he wants to give someone else the right to produce his product. 'Technological secrecy is important in this business. It's the key to success', he noted to a colleague. On the other hand, Edgar realises that without having someone to sell his product in Asia, he is giving up a large potential market. Over the next 10 days Edgar intends to make a decision about what to do.

Questions

1 What type of arrangement is Edgar using in his business dealings with the firms in Australia, Singapore and Dubai? Be complete in your answer.
2 Is the Chinese business proposal a joint venture? Why or why not? Would you recommend that Edgar accept it? Why or why not?
3 Referring to legal challenges in Chapter 7 that Edgar might face what concerns should Edgar have?
4 If Edgar were looking for an alternative approach to doing business with the Chinese, what would you suggest? Defend your answer.

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RECOMMENDED CASES FROM HARVARD BUSINESS SCHOOL ONLINE

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The Entrepreneur's Path to Global Expansion

Publication date: 1 January 2005
Author(s): Walter Kuemmerle
Product number: 9-SMR-160

Most start-up companies today consider overseas expansion from their inception. Yet, says the author, entrepreneurs and their managers often underestimate the cost of expansion and lack a clear conceptual framework for it. On the basis of studying 50 entrepreneurial ventures in more than 20 countries, the author concludes that such ventures follow a variety of different expansion paths. The most successful are those that best manage the constant tensions between resources and opportunities, each of which run the gamut from purely local to worldwide. This case offers a framework that defines the choices a venture has at its inception and throughout its life and shows how to use the framework to assess and direct a venture and mitigate developing tensions by anticipating a variety of strategic, financial, organisational and regulatory factors. It uses case examples of a software company that took a balanced or 'diagonal' path (the most common), an air-freight delivery service that progressed from pursuing local opportunities with local resources to pursuing cross-border opportunities with local resources, and a consumer-loan provider that began by pursuing a local opportunity with local resources, then added cross-border resources.

Rehabilitation Alliance Hong Kong: Next Step Forward

Publication date: 28 April 2008
Author(s): Terence Tsai, Barbara Li
Product number: 9-908-M26

The case is divided into four parts: (1) the establishment of Rehabilitation Alliance Hong Kong (RAHK), its mission and vision and strength, weakness, opportunities and threats (SWOT) to develop SE; (2) the business model of SE; that is, 7-Eleven franchised stores, with an explanation of difficulties that have arisen from government policy inaction and statutory bodies' practices; (3) the environment of forming a strategic alliance with Dairy Farm, the competitive advantage gained and the predicament for continuation; and (4) the brand building through setting up small enterprises; that is, the Rehab Stationery Store and RA Health First Shop, its strategy and challenges for business sustainability. The case is useful for discussion on: (a) the purpose of developing a SE, (b) various business models facilitating SEs, (c) difficulties of establishing a strategic alliance, (d) government policy to encourage SE, (e) marketing, financial and human resource management problems encountered by NGOs in developing SE, (f) nurturing of social entrepreneurs and (g) the challenge of sustaining SE.

Endeavor

Publication date: 14 February 2008
Author(s): Sean Harrington, Garth Saloner
Product number: 9-E30-8

It was July 2007, and Linda Rottenberg, cofounder and CEO of Endeavor – a non-profit dedicated to transforming the economies of emerging markets by identifying and supporting high-impact entrepreneurs – was preparing for a quarterly meeting with the global board of directors. She leafed through a copy of the 2007 Impact Report, checking over the newly published figures one more time. In its 10-year history, Endeavor had selected 272 promising entrepreneurs in eight countries, after screening 15 500 candidates, and then helped them develop and grow their businesses through ongoing mentorship and guidance. Rottenberg was proud of the organisation's accomplishments, but she also knew there was no time for complacency. With aggressive goals for international expansion, the board would definitely want to hear an update on Rottenberg's growth strategy. The directors had also asked to discuss the recent surge in corporate partnership opportunities and long-term plans for funding Endeavor's main operations in New York.

TCS: An Entrepreneurial Air-Express Company in Pakistan

Publication date: 6 November 2002
Revision date: 22 April 2004
Author(s): Walter Kuemmerle, Zahid Ahmed
Product number: 9-803-027

This case introduces Khalid Awan, co-founder of TCS, an entrepreneurial air-express company in Pakistan. Awan has succeeded in building a sizeable company despite serious obstacles, including pressure from the public postal system, an environment prone to corruption and a non-existent market for venture capital. The firm largely followed an organic financing strategy and made extensive use of leasing contracts. However, in the aftermath of 11 September 2001, Awan is now faced with a number of questions regarding further expansion of the firm. The tragic events of 11 September will most likely put pressure on the firm's revenues and create considerable uncertainty. Awan is also starting to think about diversification of his personal wealth, which is concentrated almost entirely in TCS. Decisions on all these issues will impact upon the firm's future financing policies and growth.

Answers to 'Going International'

1 I
2 E
3 A
4 C
5 F
6 G or H
7 D
8 G or H
9 B

Endnotes

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SEARCH ME!

APEC
co-marketing
contract manufacturing
co-production
direct foreign investment
European Union (EU)
export
franchising
free trade agreements
growth rates
import
joint venture
licensing
mergers
North American Free Trade Agreement
OECD
royalties
strategic alliance
World Bank
WTO

15

ENTREPRENEURIAL FAMILIES, SUCCESSION AND CONTINUITY

Entrepreneurs tend to be control addicts. In a sense they have to be. They started their companies to be their own bosses, and at the start, they are usually in charge of everything. But as the company grows, being in charge of everything becomes increasingly impossible to manage.

Company building is a marathon, not a sprint. To avoid the loneliness of the long-distance runner, an entrepreneur needs to tap the support and experience of others. The entrepreneurial course is not only easier to traverse, but also more enjoyable to run with others cheering one along!

Ray Smilor, *Daring Visionaries*

chapter objectives

• 01
To describe the importance of family businesses in the Asia–Pacific and their unique problems

• 02
To examine the problems as well as the key factors in management succession

• 03
To explain the steps involved in carrying out a succession plan

• 04
To relate the ways to develop a succession strategy

• 05
To examine the harvest strategy for reaping the value of family business.

FAMILY ENTREPRENEURS IN THE ASIA–PACIFIC In Chapter 6, 'Pathways to entrepreneurial ventures', we looked at five pathways that new venturers typically take. A sixth pathway to entrepreneurship is through the family. A large proportion of all businesses are owned and managed by families or groups of relatives. This is particularly true of new and growing businesses (see Table 15.1). There is considerable variation across countries in the proportion of family firms. Reynolds et al. found that the rate of family ownership of start-up enterprises ranged from 86 per cent in Brazil to 52 per cent in Sweden. In the Asia–Pacific, Singapore had a lower than average rate of 65 per cent.[1]

Australia and New Zealand more or less matched the rates of the US, where about three-quarters of start-up ventures were owned primarily by families. In Australia, family businesses are in it for the long haul – 36 per cent of family businesses were established 29 to 58 years ago and another 17 per cent prior to 1950. More than a third has an annual turnover of between \$5–\$15 million with a further 30 per cent over \$15 million. The typical business has 2.5 family members in the management team and about the same number of family members who do not work in the business. Larger businesses tend to have more overall family members; this is not surprising as they generally are multi-generation businesses. They are hard workers: 78 per cent spend 40 to 69 hours per week in the business. Family relationships are not always harmonious; however, the degree of conflict within a family represents a measure of family cohesion.[2]

Because the majority of entrepreneurial firms are family-owned, their overall growth has a huge impact on national economic growth. Name a Japanese corporation and chances are it started as a family firm: Kikkoman, Mitsubishi, Sumitomo, Toyota. Go shopping in Manila and you'll doubtless enter a mall owned by the Sy or Ayala clans. Hundreds of millions of Indians garb themselves daily in cloth made by the Ambanis or Wadias. The downside is that unacceptable practices (expropriation of outside shareholders by controlling shareholders) are pervasive and deeply embedded in Asia's family-business culture.[3]

A huge number of family firms were started between 1945 and 1960. These proprietors are ageing and control is now passing to the second generation. In Australia, for example, one in five proprietors is aged 65 or more, and more than one in 10 is over 70,[4] while a third are over 50 years of age.[5] Strategies for succession will be required as the owners of nearly half a million Australian enterprises are over 50 years of age and their ranks are growing by 10 per cent annually.[6] Sadly, just 17 per cent of family-run operations have a documented succession plan in place.[7]

Of course, there is more to family business in our region than the **Anglo-Saxon** or **Western model**. Here's a quick look at the variety of family businesses in our region.

- In Indonesia, ethnic Chinese form only about 3–4 per cent of the population, but control nearly three-quarters of the country's wealth.[8]
- Hong Kong Chinese, Indonesian and Filipino family businesses face succession problems that are similar to other countries.[9]

TABLE 15.1: FAMILY OWNERSHIP OF START-UP FIRMS

COUNTRY	START-UPS WHERE FAMILY OWNS OVER 50%
United Kingdom	77.5%
Australia	76.6%
New Zealand	74.6%
United States	74.5%
Singapore	64.7%

INDIAN WOMEN AND THEIR DAIRIES IN NEW ZEALAND

>>ENTREPRENEURSHIP IN PRACTICE

One of the icons of New Zealand culture is the dairy, or the corner convenience shop. These are pillars of their neighbourhoods, community notice boards and quick purchase stores. Indian immigrants run a large share of them in New Zealand. However, they eventually move beyond these routine businesses by harvesting their dairy's value and becoming entrepreneurs in the manufacturing and service sectors.

Having a dairy enables women to contribute to the household income without leaving the home, while continuing to do their traditional duties of looking after the children, husband and the in-laws. The stories of women born into or given in marriage to families from the early Indian settlers epitomise the hard-working and careful saving ethic of Indians in New Zealand. They also illustrate the great importance Indian women place on maintaining the Indian family traditions along with breaking the mould and going out into the world of employment.

In the early 1990s in Auckland, for example, 84 per cent of dairies were owned by Indians. These dairies did not form an ethnic enclave economy as their customers were from all ethnicities, and the dairies were geographically located in various parts of the city.

For a number of immigrants who came to New Zealand in the early 1990s, running a dairy was their means of survival as they were unable to gain employment elsewhere. The use of family labour was vital and in many instances the wife played a major role in the running of the business.

Dairy owners say that they hope that their children do not have to be in the same dairy business. Some of the more recent migrants would prefer to go back to India rather than run a dairy, particularly if they are professionally qualified and had experienced blocked employment in New Zealand. Yet, since their children are happy in New Zealand, they stay on. Quite often it is the men who cannot get appropriate jobs, though the women are prepared to take any sort of job, for it serves as a safety net for the family income. In other cases a woman's lack of English language fluency makes finding employment problematic. The dairy gives women a prominent role, in contrast to them being 'only a housewife'. They are proud of their ability to handle both the dairy and the home.

Family members helping out in the business seems to be a trend for ethnic businesses, particularly in the early stages of the business. In New Zealand a number of the traditional Indian dairy shops are diversifying into superettes, florists with greeting cards and sometimes liquor stores. Indians continue to primarily source funds and seek mentors from the family and ethnic community.

Source: Edwina Pio, *Sari: Indian Women at Work in New Zealand*, Wellington: Dunmore, 2008: 42

- Chinese family businesses are headquartered throughout the Asia–Pacific region, but the heart of the network is in Hong Kong, Singapore, Taiwan and the China coast. Ethnic Chinese are the major source of capital in Thailand, Malaysia, Indonesia, Hong Kong, the Philippines, Vietnam and the China mainland.
- Overseas Chinese account for 80 per cent of all investment coming into China itself.[10] They share a common culture of hard work within a network of entrepreneurial relationships. Top positions are filled by family members with the head of family assuming overall command.[11]
- Chinese family businesses in Singapore are economic assets that propel the modern Singaporean economy. But their hierarchical and patriarchal nature puts them at odds with the state's Western attitudes.[12] They have been transforming from **family-ruled and managed** to **professionally managed family-ruled** models as they react to the state and face increasing competition from Western corporations.[13]
- In Thailand, family businesses have driven the industrialisation process. Before the Asian economic crisis in 1997, 220 family business groups produced two-thirds of the gross domestic product (GDP). But globalisation, social and political change

and the financial crisis have seen the influence of Thailand's business families greatly reduced.[14]

- In Korea, several dozen large Korean family-controlled companies, called *chaebols*, have accounted for almost 100 per cent of the South Korean economy since the 1960s. Through aggressive governmental support and finance, some have become well-known international brand names, such as Samsung, Hyundai and LG. Samsung has an annual turnover of $174.2 billion, equivalent to the entire economy of New Zealand.[15]
- Asian family businesses seldom last beyond three generations. As the Chinese saying puts it, 'Wealth does not endure three generations'. Most family enterprises start off with the 'rags' into riches. The second generation, often sons of the founder, turn the riches into fortunes. At the third generation, the family business empire falls apart because of bitter family feuds.[16]
- Women are increasingly taking the reins in Asia's family businesses through their own nous, but many times their accession to power is caused by the accidental death of a husband. The wife accepts the job during a transition period and her decision is taken with the agreement of her grown-up children.[17]
- Overseas Chinese have played important roles in the economies of many Asian economies, especially Malaysia, Indonesia, Philippines, Singapore, Thailand, Hong Kong, Taiwan, Vietnam, the Pacific Island nations of Papua New Guinea and Fiji, down through Australia and New Zealand – even in the US, Canada and the UK. For example, in Malaysia, Chinese constitute 24 per cent of the population and account for a great portion of the GDP and share market capitalisation. These firms are largely family-owned and operated. Close relatives fill key posts and outsiders are rarely admitted to top levels. They have simple organisational structures based around a family patriarch and they rely on internal financing from trusted banks.[18]

>>ENTREPRENEURIAL EDGE

SINGAPORE FAMILY BUSINESS: NO ONIONS, PLEASE

Wangi Industrial Co. would rather be an orange than an onion. And no, the company isn't talking about getting into the food business. It's referring to its internal hierarchy.

'Communication is very important in our organisation', said vice-president of business development Chew Ker Yee. 'We would like to be an orange. We don't want to be like an onion, which has so many layers. An orange only has two layers. You peel off the skin and then you can eat it. At Wangi our hierarchy is so flat that we only have team leaders and team members.'

It's a rare management style, considering Wangi is a family business. A provider of surface finishing and optical thin-film coating solutions, Wangi was founded in 1968 by Mr Chew's father, Chew Yeow Tong. Today, the senior Mr Chew oversees as managing director, while his two sons help run the show with several teams in Singapore.

'We're trying to break away from the traditional family-style management, where the focus tends to be on loyalty and obedience', said the 30-year-old Mr Chew. 'We want to create a very performance-driven company because we need this kind of culture to be able to survive in a global environment.

'We believe that if team Wangi wins, I personally win', said Mr Chew. 'Over there, it's very difficult to have this kind of thinking. All they want is individual gain. It's a different mind-set.' Still, this won't stop the company from expanding further in China. By the end of this month it will open a new factory in Shenzhen with 50 staff initially and 200 by the first quarter of next year.

Source: 'No onions, please', *The Business Times*, 6/9/05, Singapore Press Holdings Ltd. Permission required for reproduction.

CHALLENGES FACING FAMILY BUSINESSES

Family firms face the same economic issues as all businesses, including market and technological changes, shifting consumer tastes, ever-tougher competition and political instability. Nevertheless, they have many aspects that are unique to them:

- they may lack the financial capability of larger, more diversified firms
- they may have less management expertise to cope with these pressures
- like all families, they have their psychological toils and tribulations.

Family businesses are by definition two overlapping systems. Families usually face inwards and decision making is based more on emotions than on sound commercial judgement. On the other side, the business system requires hard analysis and results. While the family system seeks to preserve harmony and minimise change, the business system needs conflict and change if it is to survive and develop. Therefore, where the two systems overlap, personal relationship issues meet management requirements. That means special forms of conflict resolution have to be developed and adopted.

Figure 15.1 looks at how family business conflict can emerge:

- How much should we pay family members? Families typically reward based on need. In the business world people are paid based on their market value.
- How much equity ownership should family members have and should it be given at all to outsiders? In the real world employers provide incentives to key employees by offering them an equity stake in the company's future.

In reality, though, only one-third of family businesses globally succeed in making the leap across generations. Most are sold or wound up after the founder's death. It is said that the first generation establishes it, the second generation develops it and the third one destroys it. Some studies suggest that only 5 per cent of family firms are still creating shareholder value beyond the third generation.[19]

Family-owned companies can succeed and grow in spite of complex challenges.[20] A variety of reasons helps account for this. One is that these businesses have not been encumbered by demanding shareholders who want to dictate operating strategy. A second is that the

FIGURE 15.1: FAMILY–CONFLICT–BUSINESS

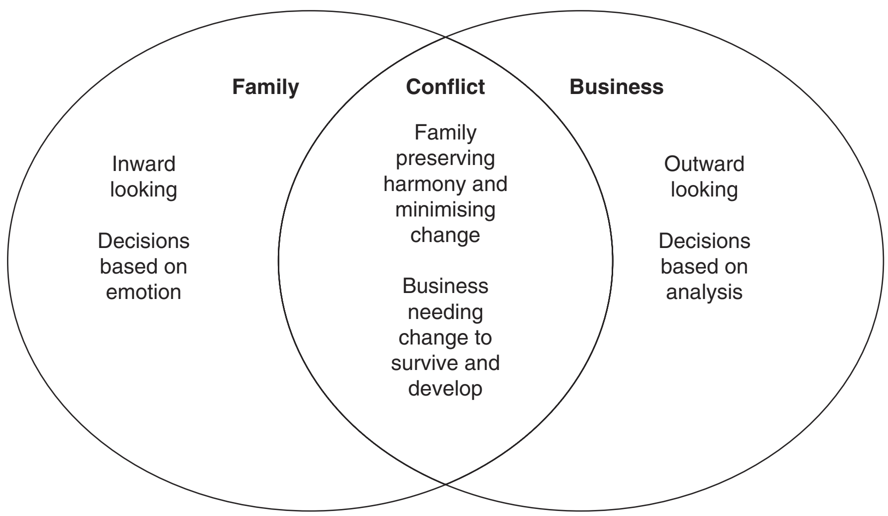

TABLE 15.2: ADVANTAGES AND DISADVANTAGES OF FAMILY-CONTROLLED FIRMS

ADVANTAGES	DISADVANTAGES
Long-term orientation	Less access to capital markets may curtail growth
Greater independence of action	Confusing organisation
Less (or no) pressure from stock market	Messy structure
Less (or no) takeover risk	No clear division of tasks
Family culture as a source of pride	Nepotism
Stability	Tolerance of inept family members as managers
Strong identification/commitment/motivation	Inequitable reward systems
Continuity in leadership	Greater difficulties in attracting professional management
Greater resilience in hard times	Spoiled-kid syndrome
Willing to plough back profits	Internecine strife
Less bureaucratic and impersonal	Family disputes overflow into business
Greater flexibility	Paternalistic/autocratic rule
Quicker decision making	Resistance to change
Financial benefits	Secrecy
Possibility of great success	Attraction of dependent personalities
Knowing the business	Financial strain
Early training for family members	Family members milking the business
	Disequilibrium between contribution and compensation
	Succession dramas

Source: Manfred F.R. Kets de Vries, 'The Dynamics of Family-Controlled Firms: The Good News and the Bad News', *Organisational Dynamics*, Winter 1993: 61

family members are willing to sacrifice short-term profits for long-term gains. Research shows that family members are more productive than other employees.[21] A third is the companies' flexibility, a trait that has allowed family firms to respond to challenges and opportunities in an unrestricted manner. In addition, owners of family firms can convey an image of stability – that the company is in business for the long haul and will provide continuity for customers and employees alike.[22]

Family values and influences can help the operation of a business. According to researchers, three advantages may be forthcoming after start-up:

- preserving the humanity of the workplace – a family business can easily demonstrate higher levels of concern and caring for individuals than are found in the typical corporation
- focusing on the long run – a family business can take the long-run view more easily than corporate managers who are judged on year-to-year results
- emphasising quality – family businesses have long maintained a tradition of providing quality and value to the consumer.[23]

Psychologist Manfred Kets de Vries examined the advantages and disadvantages associated with family businesses.[24] Table 15.2 provides an overview of his particular items. Some of the key advantages already have been touched on (greater flexibility of action, long-term orientation, stability, resilience and less bureaucracy). The disadvantages include family disputes, paternalistic (or maternalistic) rule, confusing organisation (no clear division of tasks), **nepotism** (promoting inept family members) and succession dramas.

HARVESTING THE VENTURE: A FOCUS ON THE FUTURE

Entrepreneurs must realise that the eventual success of their venture will lead them to a decision concerning the future operation and management of the business. A harvest plan defines how and when the

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owners and investors will realise an actual cash return on their investment. Note that 'harvest' does not mean that the challenges and responsibility of the entrepreneur are over. There are challenging decisions to be made. It may be a decision regarding managerial control and succession for successful continued operations as a privately held firm.[25] It may be a desire to initiate a liquidity event through which the venture is able to generate a significant amount of cash for the investors. It may be that the venture has grown to a stage at which the possibility of an initial public offering (IPO), which we discussed in Chapter 8, is a reality. Or it may be that the most realistic opportunity is for the sale of the business. In any of these situations, the entrepreneur is confronted with a myriad of choices and possibilities.

Although it is impossible for this chapter to answer all of the questions that an entrepreneur faces at this point, because each venture presents a unique set of circumstances, it is the goal of this penultimate chapter to review some of the more common challenges that confront entrepreneurs during this stage. Thus, we examine the challenge of a management succession strategy and the two most notable harvest strategies for ventures: the initial public offering and the sale of the venture.

THE MANAGEMENT SUCCESSION ISSUE

Research shows that many family firms go out of existence after 10 years; only three out of 10 survive into a second generation. More significantly, only 16 per cent of all family enterprises make it to a third generation. One important study demonstrated these facts by examining the life expectancy of 200 successful manufacturing firms.[26] The average life expectancy for a family business is 24 years, which is also the average tenure for the founders of a business.[27]

Yet times are changing. According to recent research, almost half of Hong Kong's small business owners intend to pass their businesses on to professional managers instead of their children when they retire. This break from Asian tradition was also evident in the other regions surveyed – India, Malaysia, Singapore and South Korea – where 42 per cent of small business owners planned to pass their businesses on to professional managers and only 28 per cent intended to keep them in the family.[28]

One of the major problems most family businesses have is the lack of preparation for passing managerial control to the next generation. The cruel fact is that one generation succeeds the other with biological inevitability, yet most family businesses never formulate succession plans.

Management succession, which involves the transition of managerial decision making in a firm, is one of the greatest challenges confronting owners and entrepreneurs in family businesses. At first glance succession would not seem to be a major problem. All an owner has to do is designate which heir will inherit the operation or, better yet, train one (or more) of them to take over the business during the founder's lifetime. Unfortunately, this is easier said than done. A number of problems exist.

One of the major ones is the owner. To a large degree, the owner is the business. The individual's personality and talents make the operation what it is. If this person were to be removed from the picture the company might be unable to continue. Additionally, this individual may not want to be removed. So if the owner–manager begins to have health problems or is unable to manage effectively, they may still hang on. The owner often views any family attempt to get them to step aside as greedy efforts to plunder the operation for personal gain. What's more, the owner and family members may feel anxiety over death, since raising the topic of death conjures up a negative image in everyone's mind.

Other barriers to succession include sibling rivalry, family members' fear of losing status, or a complete aversion to death for fear of loss or abandonment.[29] Table 15.3 provides a list of barriers to succession attributed to the owner and to the family.

TABLE 15.3: BARRIERS TO SUCCESSION PLANNING IN FAMILY FIRMS

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

Source: Kets de Vries, 'The Dynamics of Family-Controlled Firms', 68

The basic rule for family-owned businesses is this: The owner should develop a succession plan. Since many people want to keep the business in the family, a decision has to be made regarding an heir. This is often psychologically difficult. Choosing an heir can be like buying a cemetery plot. It is an admission of one's mortality. Owners who refuse to face the succession issue, however, place an unnecessary burden on those whom they leave behind. Family successor problems are not insurmountable. For our consideration of these problems, the best place to begin is with an identification of the key factors in succession.

>>ENTREPRENEURSHIP IN PRACTICE

THE SURVIVAL OF MALAYSIAN FAMILY BUSINESSES

Family businesses that have survived a whole century, albeit few, are the ones that are willing to move with the times; the others simply slip into obscurity without even reaching the second or third generation.

For example, the Royal Selangor International Sdn Bhd, maker of world-renowned pewter, is one of Malaysia's oldest surviving family businesses. Since it was started in 1885 by Yong Koon, the company has been tightly held by the Yong family and is today headed by the third-generation Yong Poh Kon.

Meanwhile, some family enterprises did not even last through the second generation, as in the case of the once-famous saw miller Ong Kian Teck of the 1960s and 70s. The moment the patriarch passed away the family business empire fell apart because of bitter family feuds.

Robert Kuok, dubbed the 'Sugar King of Asia', and richest man in Southeast Asia, is now 85, and has long relinquished his position to his son, Khoon Ean. Similarly, IGB Corporation's Tan Chin Nam has left it to his children to manage his business, while he retires in Melbourne. IOI Group's Lee Shin Cheng has also passed on the baton to his eldest son, Yeow Chor, while two of his sons and four daughters all work in the family business.

In Malaysian family businesses, the typical Asian culture dictates that the son takes over the family business. For example, one of Malaysia's largest housing developers, Mustapha Kamal, is teaching his only son the ropes. However, the eldest son is not always first choice. In casino operator Genting Bhd's case, the baton has been passed from Malaysia's third-richest man, the late Lim Goh Tong, to his son Kok Thay, who is the second-youngest of six siblings.

In these organisations where the power base would have been dealt with before the patriarch leaves the scene, chances of survival are higher.

There are also exceptions to the case where the patriarch himself realises that as the business becomes more complex, professionals have to be engaged, as in the case of Lee Rubber–OCBC Bank Holdings Ltd, which is currently run by professional managers with little influence by the Lee family, although family members still sit on the board.

Source: Adapted from Stephen Ng, 'The Survival of Malaysian Family Businesses', *Malaysian Business*, reproduced in AsiaViews, 47, 5 December 2008, www.asiaview.org

KEY FACTORS IN SUCCESSION

It has been said that the concept of smooth succession in a family firm is a contradiction of terms. This contradiction is because succession is a highly charged emotional issue that requires not only structural changes, but cultural changes as well.[30] Family succession includes the transfer of ethics, values and traditions along with the actual business itself. The family business and the business family are two distinct components that must be dealt with and disentangled if progress towards succession is to be made.[31]

A number of considerations affect the succession issue.[32] One way to examine them is in terms of pressures and interests inside the firm and outside the firm. Another way is to examine **forcing events**. A third way is to examine the sources of succession.

Pressures and interests inside the firm

Two types of succession pressures originate within the family firm. One comes from the family members. The other comes from non-family employees.[33]

Family members

When members of the family are also employees, a number of succession-type problems can arise. One is that the family members may want to keep the business in existence so that they and their families will be able to manage it. Sometimes this results in the members wanting to get, or increase, control over operations. Another common development is pressure on the owner–manager to designate an heir. A third possible development is rivalry among the various branches of the family. For example, each of the owner's children may feel that the owner should put them (or one of their children) in charge of the operation. Given that only one of the family branches can win this fight, the rivalry can lead to the sale or bankruptcy of the business.[34]

Non-family employees

Non-family employees sometimes bring pressure on the owner–manager in an effort to protect their personal interests. For example, long-term employees often think the owner should give them an opportunity to buy a stake in the company, or they believe they should be given a percentage of the business in the owner's will. Such hopes and expectations are often conveyed to the owner and can result in pressure for some form of succession plan. Moreover, to the extent that non-family employees are critical to the enterprise's success, these demands cannot be ignored. The owner must reach some accommodation with these people if the business is to survive.[35]

Pressures and interests outside the firm

Outside the firm, both family members and non-family elements exert pressure on and hold interest in the firm's succession.

Family members

Even when family members do not play an active role in the business, they can apply pressure. Quite often these individuals are interested in ensuring that they inherit part of the operation and they will put pressure on the owner–manager towards achieving that end. In some cases they pressure in order to get involved in the business. Some family members will pressure the owner–manager to hire them. Quite often these appeals are resisted on the grounds of the firm not needing additional personnel or needing someone with specific expertise (sales ability or technical skills) and thus the owner sidesteps the request.

Non-family elements

Another major source of pressure comes from external environmental factors. One of these is competitors who continually change strategy and force the owner–manager to adjust to new market considerations. Other factors include customers, technology and new-product development. These forces continually change and the entrepreneur must respond to them. Tax laws, regulatory agencies and trends in management practices constitute still other elements with which the owner–manager must contend.

Forcing events

Forcing events are those happenings that cause the replacement of the owner–manager. These events require the entrepreneur to step aside and let someone else direct the operation. The following are typical examples:

- death, resulting in the heirs immediately having to find a successor to run the operation
- illness or some other form of non-terminal physical incapacitation
- mental or psychological breakdown, resulting in the individual having to withdraw from the business
- abrupt departure, such as when an entrepreneur decides, with no advance warning, to retire immediately
- legal problems, such as incarceration for violation of the law (if this period of confinement is for more than a few weeks, succession usually becomes necessary if in name only)
- severe business decline, resulting in the owner–manager deciding to leave the helm
- financial difficulties, resulting in lenders demanding the removal of the owner–manager before lending the necessary funds to the enterprise.

These types of events are often unforeseen and the family seldom has a contingency plan for dealing with them. As a result, when they occur they often create major problems for the business.

These considerations influence the environment within which the successor will operate. Unless that individual and the environment fit well, the successor will be less than maximally effective.

Sources of succession

An **entrepreneurial successor** is someone who is high in ingenuity, creativity and drive. This person often provides the critical ideas for new-product development and future ventures. The **managerial successor** is someone who is interested in efficiency, internal control and the effective use of resources. This individual often provides the stability and day-to-day direction needed to keep the enterprise going.

When looking for an inside successor, the entrepreneur usually focuses on a son or daughter or nephew or niece with the intent of gradually giving the person operational responsibilities followed by strategic power and ownership. An important factor in the venture's success is whether the founder and the heir can get along. The entrepreneur must be able to turn from being a leader to being a coach, from being a doer to being an adviser. The heir must respect the founder's attachment to the venture and be sensitive to this person's possessive feelings. At the same time the heir must be able to use their entrepreneurial flair to initiate necessary changes.[36]

When looking ahead towards choosing a successor from inside the organisation, the founder often trains a team of executive managers consisting of both family and non-family members. This enables the individual to build an experienced management team capable of producing a successor. The founder assumes that, in time, a natural leader will emerge from the group.[37]

Two key strategies centre on the entry of the inside younger generation and when the 'power' actually changes hands. Table 15.4 illustrates the advantages and disadvantages of the **early entry strategy** versus the **delayed entry strategy**. The main question is the ability of the successor to gain credibility with the firm's employees. The actual transfer of power is a critical issue in the implementation of any succession plan.[38]

TABLE 15.4: COMPARISON OF YOUNGER GENERATION ENTRY STRATEGIES FOR SUCCESSION IN FAMILY BUSINESS

ADVANTAGES OF EARLY ENTRY STRATEGY	DISADVANTAGES OF DELAYED ENTRY STRATEGY
Intimate familiarity with the nature of the business and employees is acquired	Conflict results when the owner has difficulty with teaching or relinquishing control to the successor
Skills specifically required by the business are developed	Normal mistakes tend to be viewed as incompetence in the successor
Exposure to others in the business facilitates acceptance and the achievement of credibility	Knowledge of the environment is limited and risks of inbreeding are incurred
Strong relationships with constituents are readily established	Specific expertise and understanding of the organisation's key success factors and culture may be lacking
The successor's skills are judged with greater objectivity	Set patterns of outside activity may conflict with those prevailing in the family firm
The development of self-confidence and growth independent of familial influence is achieved	Resentment may result when successors are advanced ahead of long-term employees
Outside success establishes credibility and serves as a basis for accepting the successor as a competent executive	
Perspective of the business environment is broadened	

Source: Jeffrey A. Barach, Joseph Ganitsky, James A. Carson and Benjamin A. Doochin, 'Entry of the Next Generation: Strategic Challenge for Family Firms', *Journal of Small Business Management*, April 1988: 53

Sometimes the founder will look for a non-family outsider to be the successor, perhaps only temporarily. The entrepreneur may not see an immediate successor inside the firm and may decide to hire a professional manager, at least on an interim basis, while waiting for an heir to mature and take over.

Another form of non-family outsider is the specialist who is experienced in getting ventures out of financial difficulty. The founder then usually gives the specialist total control and this person later hands the rejuvenated venture to another leader.

Still another non-family approach is for the founder to find a person with the right talents and to bring this individual into the venture as an assistant, with the understanding that they will eventually become president and owner of the venture. No heirs may exist, or perhaps no eligible family member is interested.

DEVELOPING A SUCCESSION STRATEGY

Developing a succession strategy involves several important steps: (1) understanding the contextual aspects, (2) identifying successor qualities and (3) understanding influencing forces and carrying out the succession plan.[39]

Understanding the contextual aspects

Here are the five key aspects that must be considered for an effective succession.

Time

The earlier the entrepreneur begins to plan for a successor, the better the chances of finding the right person. The biggest problem the owner faces is the prospect of events that force immediate action and result in inadequate time to find the best replacement.

Type of venture

Some entrepreneurs are easy to replace; some cannot be replaced. To a large degree, this is determined by the type of venture. An entrepreneur who is the ideas person in a high-tech operation is going to be difficult to replace. The same is true for an entrepreneur whose personal business contacts throughout the industry are the key factors for the venture's success. On the other hand, a person running an operation that requires a minimum of knowledge or expertise usually can be replaced without much trouble.

Capabilities of managers

The skills, desires and abilities of the replacement will dictate the future potential and direction of the enterprise. As the industry matures, the demands made on the entrepreneur also may change. Industries where high-tech is the name of the game often go through a change in which marketing becomes increasingly important. A technologically skilled entrepreneur with an understanding of marketing, or with the ability to develop an orientation in this direction, will be more valuable to the enterprise than will a technologically skilled entrepreneur with no marketing interest or background.

Entrepreneur's vision

Most entrepreneurs have expectations, hopes and desires for their organisation. A successor, it is hoped, will share this vision, except, of course, in cases where the entrepreneur's plans have contributed to the organisation getting into trouble and a new vision is needed. An example is Apple Computer, where one of the founders, Steven Jobs, was replaced by John Sculley because the board of directors felt that a more managerial, day-to-day entrepreneur was needed to replace the highly conceptual, analytical Jobs.

Environmental factors

Sometimes a successor is needed because the business environment changes and a parallel change is needed at the top. The Sculley–Jobs example is one case in point. Another is that of Edwin Land of Polaroid. Although his technological creativity had made the venture successful, Land eventually had to step aside for someone with more marketing skills. In some cases owners have had to allow financial types to assume control of the venture because internal efficiency was more critical to short-run survival than was market effectiveness.

Identifying successor qualities

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

1. sufficient knowledge of the business or a good position (especially marketing or finance) from which to acquire this knowledge within an acceptable time
2. fundamental honesty and capability
3. good health; energy, alertness and perception; enthusiasm about the enterprise
4. personality compatible with the business; high degree of perseverance
5. stability and maturity
6. reasonable amount of aggressiveness
7. thoroughness and a proper respect for detail
8. problem-solving ability
9. resourcefulness; ability to plan and organise
10. talent to develop people
11. personality of a starter and a finisher
12. appropriate agreement with the owner's philosophy about the business.[40]

A written succession strategy

These elements prepare the entrepreneur to develop a management continuity strategy and policy. A written policy can be established using one of the following strategies.

1 The owner controls the *management continuity strategy* entirely. This is very common, yet legal advice is still needed and recommended.
2 The owner consults with selected family members. Here, the legal advisor helps to establish a liaison between family and owner in constructing the succession mechanism.
3 The owner works with professional advisors. This is an actual board of advisors from various professional disciplines and industries that works with the owner to establish the mechanism for succession (sometimes referred to as a 'quasi-board').[41]
4 The owner works with family involvement. This alternative allows the core family (blood members and spouses) to actively participate in and influence the decisions regarding succession.

If the owner is still reasonably healthy and the firm is in a viable condition, the following additional actions should be considered.

5 The owner formulates **buy/sell agreements** at the very outset of the company, or soon thereafter, and whenever a major change occurs. This is also the time to consider an appropriate insurance policy on key individuals that would provide the cash needed to acquire the equity of the deceased.
6 The owner considers **employee stock ownership plans (ESOPs)**. If the owner has no immediate successor in mind and respects the loyalty and competence of his or her employees, then an appropriate ESOP might be the best solution for passing control of the enterprise. After the owner's death, the employees could decide on the management hierarchy.
7 The owner sells or liquidates the business when losing enthusiasm for it, but is still physically able to continue. This could provide the capital to launch another business. Whatever the owner's plans, the firm would be sold before it fails due to disinterest.
8 The owner sells or liquidates after discovering a terminal illness, but still has time for the orderly transfer of management or ownership.[42]

Legal advice is beneficial for all of these strategies, but of greater benefit is having advisors (legal or otherwise) who understand the succession issues and are able to recommend a course of action.

Entrepreneurial founders of privately held businesses often reject thoughts of succession. However, neither ignorance nor denial will change the inevitable. It is therefore crucial for entrepreneurs to design a plan for succession very carefully. Such plans prevent today's flourishing privately held businesses from becoming a statistic of diminishing family dynasties.

Consider outside help

Promotion from within is a morale-building philosophy. Sometimes, however, it is a mistake. When the top person does a poor job, does promoting the next individual in line solve the problem? The latter may be the owner–manager's clone. Alternatively, consider family-owned businesses that start to outgrow the managerial ability of the top person. Does anyone in the firm really have the requisite skills for managing the operation? The questions that must be answered are: 'How can the business be effectively run?' and 'Who has the ability to do it?' Sometimes answering these questions calls for an outside person. Family businesses also face the ever-present ego factor.[43] Does the owner–manager have the wisdom to step aside and the courage to let someone else make strategic decisions? Or is the desire for control so great that the owner prefers to run the risks associated with personally managing the operation? The lesson is clear to the dispassionate observer; unfortunately, it is one many owners have had to learn the hard way.[44]

THE EXIT STRATEGY: LIQUIDITY EVENTS

It is true that most entrepreneurs are focused on launching and growing their ventures rather than the plan for exiting the venture in years to come. However, an exit strategy is always of prime importance to outside investors. Investors' commitment to capital will always reside on the confidence that they will recover their initial investment with a healthy profit. Entrepreneurs need to be aware that an exit strategy for the venture may mean the entrepreneur's exit from the venture as well.

An **exit strategy** is defined as that component of the business plan where an entrepreneur describes a method by which investors can realise a tangible return on their investment. The questions of 'how much', 'when' and 'how' need to be addressed. Investors always want to convert their share of the investment into a more 'liquid' form, known as a **liquidity event**, which refers to the positioning of the venture for the realisation of a cash return for the owners and the investors. This 'event' is most often achieved through an initial public offering or complete sale of the venture. In either scenario, the entrepreneur must seek professional advice and legal counsel due to the significant regulations and legal parameters involved.

We covered the very important option for family businesses of the Initial Public Offering (IPO) in Chapter 8, 'Sources of finance for entrepreneurial ventures'. Let's now look at the trade sale as another option.

TRADE SALE OF THE VENTURE

After considering the various succession ideas presented in this chapter, many family-business entrepreneurs choose a **harvest strategy**, which means the venture will be sold. If this becomes the proper choice for an entrepreneur (and keep in mind it may be the best decision for an entrepreneur who has no interested family members or key employees), then the owner needs to review some important considerations. The idea of 'selling out' actually should be viewed in the positive sense of 'harvesting the investment'.

Entrepreneurs consider selling their venture for numerous reasons. Based on 1000 business owners surveyed, some of the motivations are: (1) boredom and burnout, (2) lack of operating and growth capital, (3) no heirs to leave the business to, (4) a desire for liquidity, (5) ageing and health problems and (6) a desire to pursue other interests.[45]

Whether due to poor health or retirement, many family entrepreneurs face the sell-out option during their entrepreneurial lifetime. This harvesting strategy needs to be carefully prepared in order to obtain the adequate financial rewards.[46]

Steps for selling a business

There are generally eight steps for the proper preparation, development and realisation of the sale of a venture, as follows.[47]

- **Step 1: Prepare a financial analysis**
  The purpose of such an analysis is to define priorities and forecast the next few years of the business. These fundamental questions must be answered:
  - What will executive and other workforce requirements be and how will we pay for them?
  - If the market potential is so limited that goals cannot be attained, should we plan an acquisition or develop new products to meet targets for sales and profits?
  - Must we raise outside capital for continued growth? How much and when?[48]

- **Step 2: Segregate assets**
  Tax accountants and lawyers may suggest the following steps to reduce taxes:
  - Place real estate in a separate corporation, owned individually or by members of the family.
  - Establish a leasing subsidiary with title to machinery and rolling stock. You can then lease this property to the operating company.
  - Give some or all of the owner's shares to heirs when values are low, but have the owner retain voting rights. Thus, when a sale is made, part or all of the proceeds can go directly to another generation without double taxation.
  - Hold management's salaries and fringe benefits at reasonable levels to maximise profits.[49]
- **Step 3: Value the business**
  Obviously, establishing the valuation of a company constitutes a most important step in its sale.[50]
- **Step 4: Identify the appropriate timing**
  Knowing when to offer a business for sale is a critical factor. Timing can be everything. Here are a few suggestions:
  - Sell when business profits show a strong upward trend.
  - Sell when the management team is complete and experienced.
  - Sell when the business cycle is on the upswing, with potential buyers in the right mood and holding excess capital or credit for acquisitions.
  - Sell when you are convinced that your company's future will be bright.[51]
- **Step 5: Publicise the offer to sell**
  A short prospectus on the company that provides enough information to interest potential investors should be prepared. This prospectus should be circulated through the proper professional channels – bankers, accountants, lawyers, consultants and business brokers.
- **Step 6: Finalise the prospective buyers**
  Inquiries need to be made in the trade concerning the prospective buyers. Characters and managerial reputation should be assessed in order to find the best buyer.
- **Step 7: Remain involved through the closing**
  Meeting with the final potential buyers helps to eliminate areas of misunderstanding and enables you to negotiate the major requirements more effectively. Also, the involvement of professionals such as lawyers and accountants usually precludes any major problems arising at the closing.
- **Step 8: Communicate after the sale**
  Problems between the new owner and the remaining management team need to be resolved in order to build a solid transition. Communication between the seller and the buyer and between the buyer and the current management personnel is a key step.

In addition to these eight steps, an entrepreneur must be aware of the tax implications arising from the sale of a business. For professional advice, a tax accountant specialising in business valuations and sales should be consulted.

The eight steps outlined here will help entrepreneurs harvest their ventures. The steps provide a clear framework within which entrepreneurs can structure a fair negotiation leading to a sale. If the purpose of a valuation is to sell the business, then the entrepreneur must plan ahead and follow through with each step.

>>ENTREPRENEURIAL EDGE

WHAT IS A SUSTAINABLE-SUSTAINABLE FAMILY BUSINESS?

For centuries, a family business could plunder and exploit the planet as long as its family was able to sustain itself indefinitely. Things have changed with the advent of climate change and global warming as very real threats to family businesses. As well, some families are coming to grips with what it means to be a sustainable-sustainable business. In other words, these families seek to preserve themselves while they preserve the planet.

One excellent case is O'Reilly's Rainforest Guesthouse located in the Lamington National Park in Queensland, Australia. It is a family-owned and family-operated business that was established in 1926. Currently, the business is managed by the third generation. This generation is made up of members from two family groups: four offspring of Peter O'Reilly and 10 offspring of Vince O'Reilly. The CEO is the eldest son of Peter O'Reilly.

The family has been pursuing a professionalisation agenda for a number of years, especially under the leadership of its current third-generation CEO, who learned business outside the family business in the hospitality industry both in Australia and overseas. Included among its professional measures are both an active board of directors and regular family retreats. The seven-member board of directors meets monthly and is chaired by a non-family independent director and includes two other independent non-family directors. Additionally, the family has been holding family meetings since the early 1990s. These meetings have now evolved into retreats that are typically held over two days and include all family members plus spouses/partners.[52]

O'Reillys is one of the most successful ecotourism businesses in Australia. The business started in the 1930s and has grown to include a restaurant, a day visitors' area, cultural and natural tours, weekend events and children's activities. The business employs 70 full-time and 25 part-time staff and has a turnover of $10 million per year. The O'Reillys believe that the secret to their success is truly sustainable management, of the planet and of their family and community. The O'Reillys market themselves at tourism conference by providing keynote speeches and providing best practice advice. One family member also chairs the Australian Ecotourism Association.[53]

SUMMARY

This chapter focused on family business and family management succession, which is one of the greatest challenges for entrepreneurs. It is one additional pathway to entrepreneurial ventures as discussed in Chapter 6.

We looked at the status of family business entrepreneurs in the Asia–Pacific region. Their range and diversity is surpassed only by their economic impact.

Family businesses face a number of unique issues, not the least of which are the psychological toils and tribulations of other families.

There is considerable potential for conflict where the family system meets the business system. The sad fact is that only one-third of family businesses make it into the second generation. But there are several factors that give strength and hope to their survival. Their disadvantages are matched by their advantages.

A number of considerations affect succession. Family and non-family members, both within and outside the firm, often bring pressure on the entrepreneur. Some want to be put in charge of the operation; others simply want a stake in the enterprise.

Two types of successors exist. An entrepreneurial successor provides innovative ideas for new-product development whereas a managerial successor provides stability for day-to-day operations. An entrepreneur may search inside or outside the family as well as inside or outside the business. The actual transfer of power is a critical issue and the timing of entry for a successor can be strategic.

Developing a succession plan involves understanding these important contextual aspects – time, type of venture, capabilities of managers, the entrepreneur's vision and environmental factors. Also, forcing events may require the implementation of a succession plan regardless of whether or not the firm is ready to implement one. This is why it is so important to identify successor qualities and carry out the succession plan.

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The chapter continued with a discussion of the entrepreneur's decision to sell. The process was viewed as a method to 'harvest' the investment and eight specific steps were presented for entrepreneurs to follow.

Finally we identified that there actually is something called 'sustainable-sustainable' family business.

KEY TERMS & CONCEPTS

buy/sell agreement
delayed entry strategy
early entry strategy
employee stock ownership plans (ESOPs)
entrepreneurial successor
family-ruled and managed
forcing events
harvest strategy
liquidity event
management succession
managerial successor
nepotism
professionally managed family-ruled

REVIEW & DISCUSSION QUESTIONS

1 Describe the size and impact of family businesses on Asia–Pacific economies.
2 Think of a family firm that you know. Which advantages and which disadvantages does that family firm have?
3 A number of barriers to succession in family firms exist. Using Table 15.3, identify some of the key barriers.
4 What pressures do entrepreneurs sometimes face from inside the family?
5 What pressures do entrepreneurs sometimes face from outside the family?
6 An entrepreneur can make a number of choices regarding a successor. Using Table 15.4 as a guide, discuss each of these choices.
7 What are three of the contextual aspects that must be considered in an effective succession plan?
8 In what way can forcing events cause the replacement of an owner–manager? Cite three examples.
9 What are five qualities or characteristics successors should possess?
10 What are four steps that should be taken in carrying out a succession plan?
11 What do we mean by 'liquidity event'? How can one best maximise it?
12 What eight steps should be followed to harvest a business? Discuss each of these steps.
13 What are the elements of a 'sustainable-sustainable' family business? Can you name one in your community?

EXPERIENTIAL EXERCISE: WHO EMIGRATES FIRST?

The purpose of this group exercise is to understand how migrant families deal with taking their family business overseas. Six is a good number of participants, but numbers can be adjusted by adding roles.

1 (5 minutes). The group starts out with members describing in as much detail as possible a family business she or he owns, has worked for, or simply just knows about. Be sure to include what you know about the number of family members, their ages, etc.
2 (3 minutes). Now one of you should tell the following story. You can embellish it if you want: This is a business family who due to an economic crisis has decided to leave their country. They have a visa to travel to Singapore, but what they really want is refugee status or a business visa in New Zealand. The family runs a successful desserts shop, but relies on the 25-year-old son as their leader. The family has worked for generations in cakes and confection and has a good kitchen, relies on recipes passed down and has a source of innovative talent as well as small business practice. The plan is to send two family members out first and then bring the others over. They need take only the bare minimum with them since they can buy the kitchen equipment and the raw materials overseas. You can add a bit to the story.

3 (5 minutes). Each person now adopts the role of a different family member. The roles assigned will be: (1) an elderly grandmother who is a genius at decorating cakes; (2) an at-home mother who does the financial accounts; (3) a father working three jobs to make ends meet; (4) a 25-year-old son with a certificate in culinary arts, who actually runs the business right now; (5) his 21-year-old sister, who speaks several languages; and (6) his stay-at-home wife. They have no children of their own yet.

4 (5 minutes). Play your role until you have agreed on the family's big plan. Answer the question: Which family member(s) should go first? You should each start the discussion by saying 'I think we should . . .'

5 (5 minutes). After you have talked it out, now talk about your experiences and the lessons you can draw from the exercise.

EXPERIENTIAL EXERCISE: PASSING IT ON

Management succession and continuity are two of the critical concerns of most entrepreneurs. In your library, look through the past-year issues of business magazines. Focus on articles related to the management succession and continuity of specific firms. Then choose the two you find most interesting and informative and for each firm answer the following questions:

1 What business is this company in?
2 What difficulties did the owner have formulating a strategy regarding their succession?
3 What was the entrepreneur's final decision on how to handle the succession?
4 What lessons can be learned from this individual's experience?

Based on what you have learned from these two cases, what recommendations would you give to an entrepreneur who is in the process of developing a succession plan? Be as helpful as possible.

CASE 15.1: JUST AS GOOD AS EVER

When Jason Jones was found in the storage area, no one knew for sure how long he had been unconscious. Within 30 minutes he was in the emergency room of Mercy Hospital and by early evening the doctors had determined that Jason had suffered a mild heart attack.

During the first few days he was in hospital, Jason's family was more concerned with his health than anything else. However, as it became clear Jason would be released within a week and would be allowed back at work within two weeks, family members talked about his stepping aside as president of the operation and allowing someone else to take over the reins.

Jason is president of a successful auto-parts supply house. Gross sales last year were $3.7 million. Working with him in the business are his son, daughter and two nephews. Jason started the business 22 years ago when he was 33. After working for one of the large oil firms for 10 years as a sales representative to auto-parts supply houses, Jason broke away and started his own company. At first, he hired outside help. Over the past five years, however, he has been slowly bringing his family on board. It was Jason's hope that his son would one day take over the business, but he did not see this happening for at least another 10 to 15 years.

Jason's wife, Rebecca, believes that although he should continue to work, he should begin to train his son to run the business. On the day before he left hospital, she broached this subject with him and asked him to think about it. He replied: 'What is there to think about? I'm too young to retire and Herbert does not know the business well enough to take over. It will take at least five more years before he is ready to run the operation. Besides, all I have to do is slow down a bit. I don't have to retire. What's the hurry to run me out of the company? I'm as good as ever.'

Rebecca and Herbert believe that over the next couple of months they must continue working on Jason to slow down and to start training Herbert to take over the reins.

Questions

1 Why is Jason reluctant to turn over the reins to Herbert?
2 Cite and discuss two reasons Jason should begin thinking about succession planning.
3 What would you recommend Rebecca and Herbert do to convince Jason they are right? Offer at least three operative recommendations.

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CASE 15.2: NEEDING SOME HELP ON THIS ONE

When Jack Schultz started his company 10 years ago, he was lucky if he had two cars a day to work on. Today, Jack has 15 people working for him and he usually has a backlog of about five days' work. Some of this work is repairs caused by car accidents; a lot of it is as a result of improper maintenance by the owners.

Jack is 64 years old and feels he will work for about six more years before retiring. The business is very profitable and Jack and his wife do not need to worry about retirement income. However, Jack is concerned about what to do with the business. He has two children who work with him, Bob (31 years old) and Tim (29 years old). Jack has not asked either of them if they would want to take over the operation. He assumes they will. He also has a nephew, Richard (35 years old), working for him. All three of these relatives have been with Jack for nine years.

Jack believes that any one of the three could successfully head the venture. But he is concerned about in-fighting should he favour one over the others. On the other hand, if he turns the business over to all three of them collectively, will they be able to get along with one another? Jack has no reason to believe the three cannot work things out amicably, but he is unsure.

Jack has decided he cannot wait much longer to groom an heir. The major stumbling block is identifying who that person will be. Additionally, Jack really does not know anything about picking a successor. What characteristics should the individual possess? What types of training should the person be given? What other steps should be followed? Jack feels he needs to answer these questions as soon as possible. 'I know how to plan business operations', he told his wife last week. 'However, I don't know how to go about planning for the succession of business operations. It's a whole different idea. I need some help on this one.'

Questions

1. Identify and briefly describe four characteristics you would expect to find in a successful manager of this type of venture.
2. What steps does Jack need to follow to successfully identify and groom a successor? Be complete in your answer.
3. If you were going to advise Jack, what would you recommend he do first? How should he get started with his succession plan? What should he do next? Offer him some general guidance on how to handle this problem.

CASE 15.3: THE COMEBACK CORBANS

The way Corban cousins Alyn and Brian see it, the family is back – with luck and some thoughtful succession planning, maybe for another 100 years. That is certainly the kind of long-term view they take to their enterprise, the Hawke's Bay-based wine company, Ngatarawa.

Ngatarawa is a family business story with a twist. The cousins are descendants of Assid Abraham Corban who left Lebanon in 1891, bringing 300 years of winemaking tradition with him. Assid was followed by his wife Najibie and two oldest sons in 1898, and their other seven children were born in New Zealand. The whole family helped to establish the Corban family grape growing and winemaking enterprise that underpinned much of New Zealand's wine industry last century. However, after almost 70 years the Corbans were forced out of the family winemaking business. In 1975, increased competition and the need to raise more capital to grow the business in the suddenly expanding industry left Rothmans Industries with 78 per cent of the equity in A.A. Corban and Sons. The core winemaking business passed out of family hands.

The Ngatarawa story began 23 years ago when Alwyn met Hawke's Bay pastoral farmer Garry Glazebrook and entered into a 50/50 partnership to establish a small vineyard and winery on a sliver of Glazebrook land that hosted the slowly deteriorating stables of a previously successful racing stud.

In 1988 they turned the partnership into a company with the Corban and the Glazebrook families each holding 50 per cent of the equity. The move introduced Brian Corban, a lawyer and professional director and his commercial and governance skills to the business as a founding director of the new company. A regrafted family business was starting to take root. In 1999, the Corbans bought out the Glazebrooks and the Corban family were back in the winemaking business lock, stock and wine barrels.

The transition to a family business did not, however, end the disciplined approach to governance and management introduced by Brian. A generation older than his cousin, Brian had cut his teeth on the industry as an executive in the original family business. He took over as Ngatarawa chairman and brought both industry knowledge and commercial governance skills, much to the relief of his younger and more production-focused relative. Alwyn could get on with the job of building and managing an outstanding boutique winery, leaving much of the financial planning and strategy development to his chairman cousin. The board was expanded to include Brian's wife Lindsay, a specialist in human resource management and their son Ben, a talented graphic designer with his own successful design business. Ngatarawa's new Silks label design is his creation.

'Once the company became an undiluted Corban family heritage through ownership the message became stronger because it is founded on our 300 years in the business', adds Brian Corban. 'We use the family heritage as a strong element of market differentiation supported by the wine quality and our whole marketing stance', agrees Alwyn.

The Corbans believe their whole approach to directing and managing the business has lifted several notches since they took over full control. The management and leadership style of the controlling cousins is very different. It is also manifest in what each of them identifies as the key drivers of the business. For Alwyn, the drivers are achieving critical mass, margin control in the manufacture of his wines and minimising risk through a spread of markets. Ngatarawa started exporting in 1998, mainly to the US, partly to spread risk and partly to deliver Alwyn his greater critical mass. And, as he points out, there hasn't been much growth in the New Zealand wine-drinking market over the past 10 years. For Ngatarawa to grow it must steal market share from other players.

Brian, on the other hand, is driven by the desire to succeed financially, which means having a long-term view of the business; building strong brands supported by quality and value; and, thirdly, ensuring first-class marketing and distribution. 'It is brands that are critical to success in the consumer industry', he adds.

Now is a critical time for the new family business and for the wine industry, says Alwyn. 'For us it is a period for consolidating what we have, differentiating ourselves strongly and setting the base for the future. Particularly in brand building and distribution', says Brian. 'If you look at the life of this winery, the first seven to 10 years was about putting a stake in the ground and pioneering virgin territory (in the Bridge Pa area of Hawke's Bay) here and succeeding in producing wines from it. The second 10 years was spent driving meaningful growth to get critical mass to ensure the viability of the business. The third 10 years will belong to brand building, marketing and getting the distribution right (domestically and internationally). The fourth 10 years will, I think, relate to increasing capital expenditure to extend the winery and build and own the portfolio of vineyards through various micro-climates in the country.'

But although they are cautious about the future, the Corban cousins are both enthusiastic and optimistic about their new enterprise and the New Zealand wine industry. They are even talking about succession planning for the future by bringing other members of the extended Corban family on board. They are not, however, in the least interested in accepting offers from outside investors. 'We have been approached', says Brian. 'But we really are not interested.'

No question about it. 'The Corbans are back!' exclaims Brian Corban enthusiastically.

Source: Adapted from Reg Birchfield, 'The Come-Back Corbans – the Fall and Rise of New Zealand's Best-Known Winemaking Dynasty', *New Zealand Management*, November 2004, 40ff; and family sources

Questions

1. Was it a problem that the Corban and the Glazebrook families each held 50 per cent of the equity?
2. Based on this case, what is the importance of board composition for a small, growing company?
3. Why aren't the cousins accepting offers from outside investors?

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RECOMMENDED CASES FROM HARVARD BUSINESS SCHOOL ONLINE

Bert Twaalfhoven: The Successes and Failures of a Global Entrepreneur

Publication date: 5 June 2007
Author(s): Daniel J. Isenberg
Product number: 9-807-165

Bert Twaalfhoven (70; HBS '54) is faced with two offers to acquire the manufacturing holding company he had built up over 40 years. Despite the attractive price, which would net Twaalfhoven and his family $70 million, he is reluctant to sell the company because his original vision was to create a family-owned conglomerate which would last for generations. Of his eight children, two are appropriate successors, but neither shows much interest in following in their father's footsteps.

Rong Family: A Chinese Business History

Publication date: 9 November 2007
Revision date: 1 July 2008
Author(s): Elisabeth Koll
Product number: 308066

This case provides the complex historical background to understanding the development of family businesses in China from the late 19th century to the present. Using the example of the Rong family, China's most prominent industrialist family in pre-1949 China, the case analyses the organisational structure and transformation of Chinese family firms in terms of managerial hierarchies, kinship alliances and local networks. The case emphasises the response of the family business to major political crises, demonstrates how they dealt with the transition to a socialist government in 1949 and interprets the success of overseas Chinese family business as well as the revival of family business networks in the wake of China's economic reforms.

Negotiating your Entry into Your Family Business

Publication date: 3 October 2005
Author(s): John A. Davis
Product number: 9-806-062

This case provides guidance to junior generation members of a business family concerning negotiating their entry into their family's business.

Siblings and Succession in the Family Business

Publication date: 1 January 1998
Author(s): Warren D. Miller, Kent Noble, Kelin Gersick, Victor Ney, Joseph A. Wolking
Product number: 98108

How do family businesses handle succession? What happens when siblings compete for the position of CEO? Can non-family board members navigate successfully through conflicts among family members? Should they even try? This fictitious case study examines a host of issues with which family businesses regularly grapple.

DEVELOPING EFFECTIVE MIDDLE MANAGEMENT IN AN ENTREPRENEURIAL FIRM IN CHINA

Publication date: 7 November 2007
Authors: Allen Fu Tze Yu, Yuen-ching Sin Fu
Product number: HKU678-PDF-ENG

Victoria Idea Company Limited was a major network security solution provider based in Zhuhai, China. The company had been facing problems common to many family-owned businesses due to its management style. It was later restructured with the goal of transforming it from a family-run business to a professionally managed one by first removing most family members from the company and then slowly rebuilding a new, solid management structure. In order to instil a sense of responsibility and accountability in its middle managers, the company promoted staff from within instead of recruiting from outside, sponsored management training courses and made several other changes, including giving out shares to management staff. Despite all the efforts made, middle managers were still reluctant to make decisions on their own and would turn to senior management who used to be the sole decision makers before the restructuring. Victoria Idea needed to find a way to develop a sense of trust among its middle managers so that they would feel confident to make decisions on their own without seeking advice or approval from senior management. A proactive and responsible management team was deemed to be crucial if the company wanted to expand. This case illustrates how and why changes to long-established practices and operations or management styles can be difficult to implement.

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16 DEVELOPING ENTREPRENEURSHIP WITHIN ORGANISATIONS

Large institutions can be like elephants. They take time to change directions, but when they do, they bring lots of weight or positive leverage. Then there are those who are like high-flying birds, 'dreamers', who can see the landscape of risk and opportunity in useful ways, but often are disconnected from the day-to-day responsibilities of business. By contrast, there is the giraffe with his head in the clouds to inspire sustainable innovation but with his feet firmly planted on the ground, alongside the elephants. Of course, they can also be like gazelles as well as elephants, like dolphins as well as manatees.

Win Sakdinan, Proctor & Gamble[1]

Here's to the crazy ones. The misfits. The rebels. The troublemakers. The round pegs in the square holes. The ones who see things differently . . . you can praise them, disagree with them, quote them, disbelieve them, glorify or vilify them. About the only thing you can't do is ignore them. Because they change things. They invent. They imagine. They heal. They explore. They create. They inspire. They push the human race forward. While some see them as the crazy ones, we see genius. Because, the people, who are crazy enough to think they can change the world, are the ones who do.[2]

'Here's to the Crazy Ones', The Apple Creed, www.apple.com

chapter objectives

- **01** To understand the entrepreneurial mind-set in organisations
- **02** To define the term 'intrapreneurship' in enterprises such as companies and public institutions in the Asia–Pacific
- **03** To illustrate the need for intrapreneurship and how entrepreneurial management differs from bureaucratic management
- **04** To describe the obstacles preventing innovation in enterprises
- **05** To highlight the considerations involved in re-engineering business thinking
- **06** To identify the relevance of purpose and organisation concepts of an intrapreneurial strategy
- **07** To explore entrepreneurial opportunities in the shift to sustainability.

THE ENTREPRENEURIAL MIND-SET IN ORGANISATIONS In Chapter 2 we discussed the entrepreneurial mind-set within individuals. Entrepreneurial mind-sets are necessary for organisations of all sizes to prosper and flourish in competitive environments.[3] Twenty-first century companies dealing with the effects of climate change and the global economic crisis must have continuous innovation to compete effectively in international markets. In this chapter we look at entrepreneurship and innovation inside large companies, social enterprises, governments and other institutions. Some authors (perhaps tongue in cheek) have suggested that this combination is an oxymoron. How can you possibly have innovation in a large corporation or a government bureaucracy? Entrepreneurship is often viewed as a small-business phenomenon, but increasingly it is being applied in the corporate sector. Research and practice have shown that entrepreneurship in large organisations can indeed lead to innovation, new product development, greater wealth creation and economic development. We call this intrapreneurship.

Intrapreneurship (sometimes called **corporate entrepreneurship**,[4] especially in the US and Europe) is a process that can assist businesses and social enterprises in their constant efforts to innovate and cope effectively with competitive realities. Intrapreneurs are a different breed of entrepreneur. Guy Kawasaki once said, 'Entrepreneurs think intrapreneurs have it made: ample capital, infrastructure, salespeople, support people and an umbrella brand. Intrapreneurs do not have it better. At best, they simply have it different. Indeed, they probably have it worse because they are fighting against ingrained, inbred and inept management'.[5] Table 16.1 compares the characteristics and skills of the intrapreneur with those of the traditional manager and the traditional entrepreneur.[6]

Pinchot defines an intrapreneur as a 'person who focuses on innovation and creativity and who transforms a dream or an idea into a profitable venture, by operating within the organizational environment'.[7] Intrapreneurs are not necessarily the inventors of new products or services, but they are the people who can turn ideas or prototypes into profitable realities. They are the people behind a product or service. They are team builders with a commitment

TABLE 16.1: WHO IS THE INTRAPRENEUR?

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

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

Pinchot called intrapreneurs 'dreamers who do'.[8] They tend to be action-oriented. They can move quickly to get things done. They are goal-oriented, willing to do whatever it takes to achieve their objectives. They are a combination of thinker, doer, planner and worker. They combine vision and action. Dedication to the new idea is paramount. As a result, intrapreneurs often expect the impossible from themselves and consider no setback too great to make their venture successful. They are self-determined goal setters who go beyond the call of duty in achieving their goals.[9]

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

The rise of intrapreneurs

The global economy is creating profound changes for institutions, businesses and industries throughout the world. Firms and enterprises everywhere must re-examine their purposes and strategies carefully to satisfy their multiple stakeholders. In response to rapid, discontinuous and significant changes, many established companies have restructured their operations in fundamental and meaningful ways in order to become more entrepreneurial and responsive to change. In fact, after years of restructuring, some of these companies bear little resemblance to their ancestors in their business scope, culture, or competitive approach.[10]

The new century is seeing large organisations focusing more heavily on innovation. This new emphasis on entrepreneurial thinking developed during the **entrepreneurial economy** of the last two decades.[11] Peter Drucker, the renowned management expert, described four major developments that explained the emergence of this economy. First, the rapid evolution of knowledge and technology promoted the use of high-tech entrepreneurial start-ups. Second, demographic trends such as two-wage-earner families, continuing education of adults, and the ageing population added fuel to the proliferation of newly developing ventures. Third, the venture capital market became an effective funding mechanism for entrepreneurial ventures. Fourth, American industry began to learn how to manage entrepreneurship.[12]

The interest in entrepreneurial thinking in large organisations started to develop in the mid-1980s.[13] Propelled by the changes of the new millennium, entrepreneurship is now a major force in world business and this has led to an increased desire for this type of activity inside large enterprises. Although some researchers have concluded that entrepreneurship and bureaucracies are mutually exclusive and cannot coexist,[14] others have described entrepreneurial ventures within the enterprise framework.[15] Intrapreneurial techniques have been used (with success and with failure) throughout the world. Steven Brandt puts it this way:

> Ideas come from people. Innovation is a capability of the many. That capability is utilised when people give commitment to the mission and life

of the enterprise and have the power to do something with their capabilities. Non-commitment is the price of obsolete managing practices, not the lack of talent or desire.

Commitment is most freely given when the members of an enterprise play a part in defining the purposes and plans of the entity. Commitment carries with it a de facto approval of and support for the management. Managing by consent is a useful managing philosophy if more entrepreneurial behaviour is desired.[16]

>>INTRAPRENEURSHIP IN PRACTICE

HOW TO BE AN INTRAPRENEUR IN ASIA?

What about intrapreneurship in Asia, where companies are notoriously regimental and hierarchical and where decisions are often made by one person? Let me share some of my strategies and the path I took as a somewhat successful intrapreneur in a very Asian company.

As most Asian companies are family owned, decisions are made top-down and often by the Chairman/CEO, a.k.a. the patriarch. As a result it is quite common that no decisions are made or no actions taken until the top man or woman says so. Furthermore such 'decision-making paralysis' makes getting anything done in an Asian company very frustrating. Understanding this is the first path to success in intrapreneurship in an Asian company. This is one of the big reasons why intrapreneurship in an Asian company is so difficult. Simply because nothing is done unless you have the explicit approval or agreement of the person above you.

Furthermore, Asian managers have a tendency of not letting go of responsibility or empowering subordinates. Simply, the sense of responsibility and the fear [of] failure and losing face make many Asian managers 'control freaks', or 'lone rangers' working on projects alone. First you need to determine how much leeway you have in your organisational structure to initiate programs or advice, and if it would be welcomed in the first place. If you can manoeuvre yourself into a position where your recommendations are heeded then intrapreneurship initiatives can be easier.

Trust. So how do you get into a position where your advice is sought or recommendations heeded? You do it by establishing trust. Asian companies, in particular, take a long time to establish trust in an employee. In fact, the more highly qualified or ranked you are, the harder it takes to establish trust. The main reason is that new employees have a tendency to rock the boat to justify their employment, further fuelling distrust. And the sheer enthusiasm of a new employee can rub existing employees the wrong way. The best way is to be patient and take things slow. Work hard, do good work, ensure your responsibilities are taken care of, and finally deliver work on time and as you have promised. Missing the scheduled deadline or milestone is often seen in Asian companies as unreliable or untrustworthy.

Find an internal advocate. However, even then all the trust in the world will come to naught if you do not have an internal advocate. An internal advocate is someone in the higher management that supports your work as well as someone that can help facilitate getting decisions made on your projects. Remember the hierarchy? Having a well-placed, very high-up, internal advocate within the management structure can help you get things done at an amazing speed!

Befriend lateral advocates. An interesting difference between entrepreneurs in an organisation and entrepreneurs on their own is that the former cannot work alone. Many intrapreneurship projects fail because of the resistance of the other departments involved. For example, Finance, Sales and Logistics managers all have the power to kill a project. Thus you need lateral advocates as well. These managers of different departments can make or break an intrapreneurship project. The more of them you have supporting you, the easier it is for you to get your intrapreneurship project up and running.

Know your product or business well. Now we start to get into the nitty gritty of things. To really make an intrapreneurship project successful, it is almost imperative that you know your business or product well. Your initiative has to make sense, your solution obvious and you need to know how to go about doing it. Otherwise you risk your effort becoming just a whining complaint to your manager! Therefore you need to know how it is conceptualised, how it is made, how it is distributed, how it is sold, or how it is used etc.

Be in a position for budget and vendor management. After that you need to move into a position where you can dictate and manage your budgets and the use of vendors. This will be the bread and butter of your intrapreneurship project as you are not going to get any-

>>

thing going if you don't have access to any of this. Companies run on budgets. If you are able to move into a position to control how your budgets are allocated or obtained, you can help ensure the success of your project, as money is the project's life blood. Furthermore the ability to manage the vendor helps you ensure the success of your project. The worst scenario would be to start something and not have the ability to finish it.

Know the internal system. Every company has a system, or a set of rules that people play by. If you don't know it, then you better not play! As an intrapreneur you will need to know the system, and know it well. That's the only way you can make things happen, especially in an Asian context.

Do you have the qualities of a maverick? Basically all rules of an entrepreneur's mind-set will apply; the willpower required, stubbornness and patience to succeed are all minimum ingredients. Frustration over lack of control can be very high. Thus the mental preparation is almost equal to that of an entrepreneur going out on his/her own. In fact, it could be tougher as you would likely still have your day-to-day job responsibilities during this time.

A lot of the strategies and ideas mentioned here could not be effective unless you were at least in a middle- to upper-level management position. If feel you are not quite there yet, you will need to get there by working and acquiring the skills required to be in that position. Also don't join a company to be an intrapreneur; it's just not logical. This is because of the need for a high level of conforming to the system, and it might be too much for a purist entrepreneur. However, being an intrapreneur is a good strategy to further or improve your career once you have been in an organisation for a few years.

Source: Adapted from Brian Ling, 'Intrapreneurship in an Asian context: Possibility or Myth?', *Singapore Entrepreneurs*, 28 December 2006[17]

RE-ENGINEERING ORGANISATIONAL THINKING

To establish an entrepreneurial mind-set, organisations need to provide the freedom and encouragement required for employees to develop their ideas.[18] This is often a problem in enterprises because many top managers do not believe that entrepreneurial ideas can be nurtured and developed in their environment. They also find it difficult to implement policies that encourage freedom and unstructured activity. But managers need to develop policies that will help innovative people reach their full potential. Here are five important steps for establishing this new thinking:

1. **Set explicit innovation goals**. These goals need to be mutually agreed on by the employee and management so that specific steps can be achieved.
2. **Create a system of feedback and positive reinforcement**. This is necessary for potential innovators or creators of ideas to realise that acceptance and reward exist.
3. **Emphasise individual responsibility**. Confidence, trust and accountability are key features in the success of any innovative program.
4. **Provide rewards for innovative ideas**. Reward systems should enhance and encourage others to risk and to achieve.
5. **Do not punish failures**. Real learning takes place when failed projects are examined closely for what can be learned by individuals. In addition, individuals must feel free to experiment without fear of punishment.

To establish an intrapreneurial attitude (whether in the commercial world or in government bureaucracies), the institution needs to provide the freedom and encouragement that intrapreneurs require to develop their ideas.[19] This is often a problem because many top managers do not believe entrepreneurial ideas can be nurtured and developed in their environment. They also find it difficult to implement policies that encourage freedom and unstructured activity.

In 1982, in an article in *The Economist* called 'The coming entrepreneurial revolution', Norman Macrae said that job growth would come either from small firms or from those bigger firms that managed to split themselves into smaller and smaller profit centres, which would need to become more and more entrepreneurial.[20] Macrae was actually popularising the growing work of Gifford Pinchot, whose 1985 book *Intrapreneuring* went on to become a classic in the field. Pinchot's strategy sounds remarkably contemporary:

- Does your company encourage entrepreneurial thinking? Will individuals receive the company's blessing for their self-appointed idea creations? Some companies foolishly try to appoint people to carry out an innovation when, in fact, the ideas must surface on their own.
- Does your company provide ways for innovators to stay with their ideas? When the innovation process involves switching the people working on an idea – that is, handing off a developing business or product from a committed innovator to whoever is next in line – that person often is not as committed as the originator of the project.
- Are people in your company permitted to do the job in their own way, or are they constantly stopping to explain their actions and ask for permission? Some organisations push decisions up through a multilevel approval process so that the doers and the deciders never even meet.
- Has your company evolved quick and informal ways to access the resources to try new ideas? Innovators usually need discretionary resources to explore and develop new ideas. Some companies give employees the freedom to use a percentage of their time on projects of their own choosing and set aside funds to explore new ideas when they occur. Others control resources so tightly that nothing is available for the new and unexpected – the result is nothing new.
- Has your company developed ways to manage many small and experimental innovations? Today's business cultures favour a few well-studied, well-planned attempts to hit a home run. In fact, nobody bats 1000; it is better to make more frequent attempts, with less careful and expensive preparation for each.
- Is your system set up to encourage risk taking and to tolerate mistakes? Innovation cannot be achieved without risk and mistakes. Even successful innovation generally begins with blunders and false starts.
- Are people in your company more concerned with new ideas or with defending their turf? Because new ideas usually cross the boundaries of existing patterns of organisation, a jealous tendency to 'turf protection' blocks innovation.
- How easy is it to form functionally complete, autonomous teams in your business environment? Small teams with full responsibility for developing an innovation solve many of the basic problems, yet some companies resist their formation.[21]

If these questions can be answered positively, they create an environment conducive to, and supportive of, potential intrapreneurs. The result is a philosophy that supports intrapreneurial behaviour.

Many intrapreneurial ventures do fall over. Entering into new business ventures is highly risky, especially if they do not fit with the philosophy, management, habits and traits of the existing organisation. For example, ANZ Bank's move into credit cards in Hong Kong was a dismal failure and Disney's Internet portal, Hasbro Interactive, fell over. But the Australian Oxiana mining house has been developing exciting new venture opportunities, including gold in Laos, copper in South Australia, zinc in Western Australia and other opportunities in China and Thailand.[22]

Another way to create an innovative intrapreneurial atmosphere is to apply rules for innovation. The rules in Table 16.2 can provide hands-on guidelines for developing the necessary innovative philosophy. When these rules are followed, they create an environment conducive to and supportive of potential entrepreneurial thinking. The result is a business philosophy that supports innovative behaviour.

TABLE 16.2: RULES FOR AN INNOVATIVE ENVIRONMENT

1	*Encourage action.*
2	*Use informal meetings whenever possible.*
3	*Tolerate failure, and use it as a learning experience.*
4	*Persist in getting an idea to market.*
5	*Reward innovation for innovation's sake.*
6	*Plan the physical layout of the enterprise to encourage information communication.*
7	*Expect clever bootlegging of idea – secretly working on new ideas on company time as well as on personal time.*
8	*Put people on small teams for future-oriented projects.*
9	*Encourage personnel to circumvent rigid procedures and bureaucratic red tape.*
10	*Reward and promote innovative personnel.*

What can a company do to reengineer its thinking to foster the entrepreneurial process? The organisation needs to examine and revise its management philosophy. Many enterprises have obsolete ideas about cooperative cultures, management techniques and the values of managers and employees. Unfortunately, doing old tasks more efficiently is not the answer to new challenges; a new culture with new values has to be developed.[23] Bureaucrats and controllers must learn to co-exist with – or give way to – designers and innovators.

Unfortunately, this is easier said than done. Organisations can, however, use the following methods to help restructure business thinking and encourage an entrepreneurial environment: (1) early identification of potential innovators, (2) top-management sponsorship of innovative projects, (3) creation of innovation goals in strategic activities, (4) promotion of entrepreneurial thinking through experimentation and (5) development of collaboration between innovators and the organisation at large.[24]

Developing an intrapreneurial philosophy provides a number of advantages. One is that this type of atmosphere often leads to the development of new products and services, and it helps the organisation expand and grow. Second, it creates a workforce that can help the enterprise maintain its competitive posture. A third advantage is that it promotes a climate conducive to high achievers and helps the enterprise motivate and keep its best people.

THE NATURE OF INTRAPRENEURSHIP

In recent years, the subject of intrapreneurship and innovation has become quite popular, though very few people thoroughly understand the concept. Most researchers agree that the term refers to entrepreneurial activities that receive organisational sanction and resource commitments for the purpose of innovative results.[25] The major thrust of innovation is to develop the entrepreneurial spirit within organisational boundaries, thus allowing an atmosphere of innovation to prosper.

Defining the concept

Operational definitions of intrapreneurship have evolved over the last 30 years, particularly in how intrapreneurship firms differ from other types of firms.[26] Zahra observed that intrapreneurship 'may be formal or informal activities aimed at creating new businesses in established companies through product and process innovations and market developments. These activities may take place at the whole-firm, divisional, functional, or project levels, with the unifying objective of improving a company's competitive position and financial performance'.[27] Guth and Ginsberg stressed that intrapreneurship encompasses two major phenomena: new venture creation within existing organisations and the transformation of organisations through **strategic renewal**.[28]

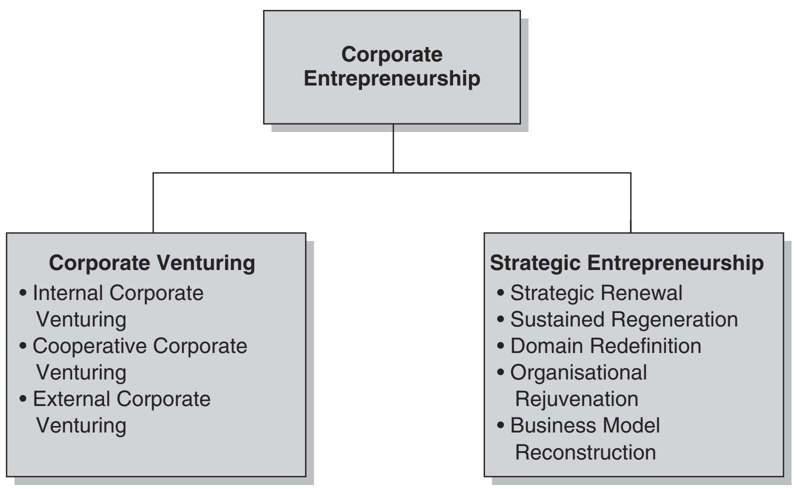
Morris, Kuratko and Covin cited two empirical phenomena as constituting the domain of intrapreneurship – namely, corporate venturing and strategic entrepreneurship. **Corporate venturing** approaches have as their commonality the adding of new businesses (or portions of new businesses via equity investments) to the company. **Strategic entrepreneurship** focuses on large-scale, highly consequential innovations that are adopted in the firm's pursuit of competitive advantage. These innovations may or may not result in new businesses for the company. With strategic entrepreneurship approaches, innovation can be in any of five areas: the firm's strategy, product offerings, served markets, internal organisation (that is, structure, processes and capabilities), or business model.[29] Each of these categories of intrapreneurship is outlined in Figure 16.1.

Recent research defines intrapreneurship as a process whereby an individual (or a group of individuals), in association with an existing organisation, creates a new organisation or instigates renewal or innovation within the organisation. Under this definition, strategic renewal (which is concerned with organisational renewal involving major strategic and/or structural changes), innovation (which is concerned with introducing something new to the marketplace) and corporate venturing (corporate entrepreneurial efforts that lead to the creation of new business organisations within the corporate organisation) are all important and legitimate parts of the intrapreneurial process.[30]

Barriers to intrapreneurship

The obstacles usually reflect the ineffectiveness of traditional management techniques as applied to new-venture development. Although it is unintentional, the adverse impact of a particular traditional management technique can be so destructive that the individuals within an enterprise will tend to avoid intrapreneurial behaviour. Table 16.3 provides a list of traditional management techniques, their adverse effects (when the technique is rigidly enforced) and the recommended actions to change or adjust the practice.

FIGURE 16.1: DEFINING INTRAPRENEURSHIP



Source: Michael H. Morris, Donald F. Kuratko and Jeffrey G. Covin, *Corporate Entrepreneurship & Innovation*, Mason, OH: South-Western/Cengage Learning, 2008: 81

TABLE 16.3: SOURCES OF AND SOLUTIONS TO OBSTACLES IN INTRAPRENEURSHIP

OBSTACLES TO INTRAPRENEURSHIP	ADVERSE EFFECTS	RECOMMENDED ACTIONS
Enforce standard procedures to avoid mistakes	Innovative solutions blocked, funds misspent	Make ground rules specific to each situation
Manage resources for efficiency and ROI	Competitive lead lost, low market penetration	Focus effort on critical issues (e.g. market share)
Control against plan	Facts ignored that should replace assumptions	Change plan to reflect new learning
Plan for the long term	Non-viable goals locked in, high failure costs	Envision a goal, then set interim milestones, reassess after each
Manage functionally	Entrepreneur failure and/or venture failure	Support entrepreneur with managerial and multidiscipline skills
Avoid moves that risk the base business	Missed opportunities	Take small steps, build out from strengths
Protect the base business at all costs	Venturing dumped when base business is threatened	Make venturing mainstream, take affordable risks
Judge new steps from prior experience	Wrong decisions about competition and markets	Use learning strategies, test assumptions
Compensate uniformly	Low motivation and inefficient operations	Balance risk and reward, employ special compensation
Promote compatible individuals	Loss of innovators	Accommodate 'boat rockers' and 'doers'

Source: Reprinted by permission of the publisher from Hollister B. Sykes and Zenas Block, 'Corporate Venturing Obstacles: Sources and Solutions', *Journal of Business Venturing*, Winter 1989: 161. Copyright © 1989 by Elsevier Science Publishing Co., Inc.

Understanding these obstacles is critical to fostering intrapreneuring because they are the foundation points for all other motivational efforts. To gain support and foster excitement for new-venture development, managers must remove the perceived obstacles and seek alternative management actions.[31]

After recognising the obstacles, managers need to adapt to the principles of successful innovative companies. James Brian Quinn, an expert in the innovation field, found the following common factors in large companies that are successful innovators:

- **Atmosphere and vision**: Innovative companies have a clear-cut vision of, and the recognised support for, an innovative atmosphere.
- **Orientation to the market**: Innovative companies tie their visions to the realities of the marketplace.
- **Small, flat organisations**: Most innovative companies keep the total organisation flat and project teams small.
- **Multiple approaches**: Innovative managers encourage several projects to proceed in parallel development.
- **Interactive learning**: Within an innovative environment, learning and investigation of ideas cut across traditional functional lines in the organisation.
- **Gumboot factory**[32] or **skunkworks**: Every highly innovative enterprise uses groups that function outside traditional lines of authority. This eliminates bureaucracy, permits rapid turnaround and instils a high level of group identity and loyalty.[33]

As Pinchot says, creativity and innovation are fuelled by the intelligence of people who have the freedom and right to express their ideas.[34] Intrapreneurship relies less on hierarchy and more on shared vision and less on rules, more on choices and less on command. Teams can be organised around the mission to design ever-better ways to conduct enterprises and create a stream of exchangeable value.[35] Reduction of organisational hierarchy is also important to promote intrapreneurship. It is necessary to eliminate organisational structures that obscure personal responsibility and homogenise individual actions.[36]

NOT FOR BUSINESSES ONLY . . . The need to be entrepreneurial and innovative also applies to institutions such as governments and other public sector organisations. Drucker once observed that public institutions 'need to be entrepreneurial and innovative fully as much as any business does'. Throughout the world, governments and other public institutions have been struggling with how to become more entrepreneurial. This is not easy considering the centuries-long system of entrenched bureaucracies that resist change. Drucker suggested that one of the great social innovations required to realign the modern economy was to abandon 'outworn social policies and obsolete public service institutions'. Entrepreneurship, he believed, was as much a public sector imperative as a private sector one.[37]

Citizens and politicians around the world regularly lament the absence of entrepreneurial behaviour in the public sector. Much of the research on entrepreneurship in the public sector focuses on the torpor of academic institutions,[38] or on the inertia of local and regional government organisations.[39] There has been a great deal of debate on whether the public sector (government bureaucracy in particular) can ever act entrepreneurially, given its historical legacy of entrenched bureaucracies and risk-averse functionaries.[40] Some researchers even suggest that public sector entrepreneurship differs fundamentally from entrepreneurship within private sector firms because it is more civic or social in nature and focuses on social betterment.[41] Boyett observes that a 'new strain of leadership – the public sector entrepreneur – is emerging, to display many of the characteristics of their business counterparts', such as strong persuasive powers, risk-taking ability, creativity and the need for achievement. She even argues that successful public sector entrepreneurs have other forms of profit, namely the guilt level in others and self-satisfaction in oneself.[42] One thing is clear. It has become a political platform for politicians to call for the public sector to be more entrepreneurial.[43]

>>INTRAPRENEURIAL EDGE

NEW ZEALAND COMMERCIALISES GOVERNMENT COMPANIES

During the 1980s, New Zealand government departments with a strong trading function were corporatised or privatised, on the premise that such services could be more efficiently provided by commercially oriented organisations, rather than subject to ministerial control and government interference. This has been a great success and provides an important example of intrapreneurship.

MetService. New Zealand's weather forecasting services began in 1861 as part of the then government's Marine Department. In 1992 responsibility for weather forecasting was transferred to the newly incorporated SOE 'MetService' whose main business activity involved forecasting and communicating weather-related information. MetService's vision was to be a recognised leader in weather and information presentation services, to be profitable and well managed, with enthusiastic and highly skilled staff dedicated to the success of the company and growing worldwide through customer appreciation of its valuable and innovative services. With projects such as turbulence forecasting over the Himalayan Mountains for Qantas Airways, low-cost weather systems for isolated areas using mobile phone technology, heat stress and pasture growth indices for New Zealand's agricultural industry, and energy forecasts for various power stations in the UK, MetService gained recognition as a successful, innovative and entrepreneurial organisation.

New Zealand Post. NZ Post had provided mail services for more than 160 years, but in 1987 the postal side of the business became a commercial, profit-oriented entity. There was an awareness of the decreasing trend in traditional mail, so the decision was made to diversify business around a central theme of connecting people. With projects such as international consultancy to other postal administrations, electronic systems for the archive and retrieval of customer documents, electronic mapping of customer delivery points, and agency services enabling online payment of fees for more than 80 different organisations, NZ Post was increasingly viewed as a successful and proactive organisation. Consistent with this strategy of pursuing entrepreneurial opportunities, NZ Post took the rather bold and controversial step of entering New Zealand's banking industry in 2001 with the establishment of Kiwibank.

Source: Adapted from Belinda Luke and Martie-Louise Verreynne, 'Strategic Entrepreneurship in the Public Sector: Fact or Farce?', *Regional Frontiers of Entrepreneurship Research 2006*, Third AGSE International Entrepreneurship Research Exchange, 8–10 February 2006, Auckland, New Zealand

Only recently has research focused on the differences between public and private sector entrepreneurship.[44] Australian Robert Sadler describes the similarities and differences between **private** and **public sector entrepreneurs**. Both types operate in turbulent environments that hasten the need for entrepreneurial behaviour. Both types use teams for participative decision making. Both in their own ways are more insulated from any organisational authority. However, there are significant differences between public and private:

- There are far fewer entrepreneurs in public sector organisations.
- The public sector is structured hierarchically with relatively rigid pay scales and limited opportunity to use motivating mechanisms to foster innovation.
- Public sector entrepreneurs work in a rigid environment typified by 'red-tape' and regulation.
- Public sector organisations, unlike their private sector counterparts, have inconsistent and unclear objectives.
- Public sector entrepreneurs have less access to resources.
- Public sector entrepreneurial organisations have more **risk aversion** tendencies.
- Political intrusion is a significant barrier to public sector entrepreneurship.[45]

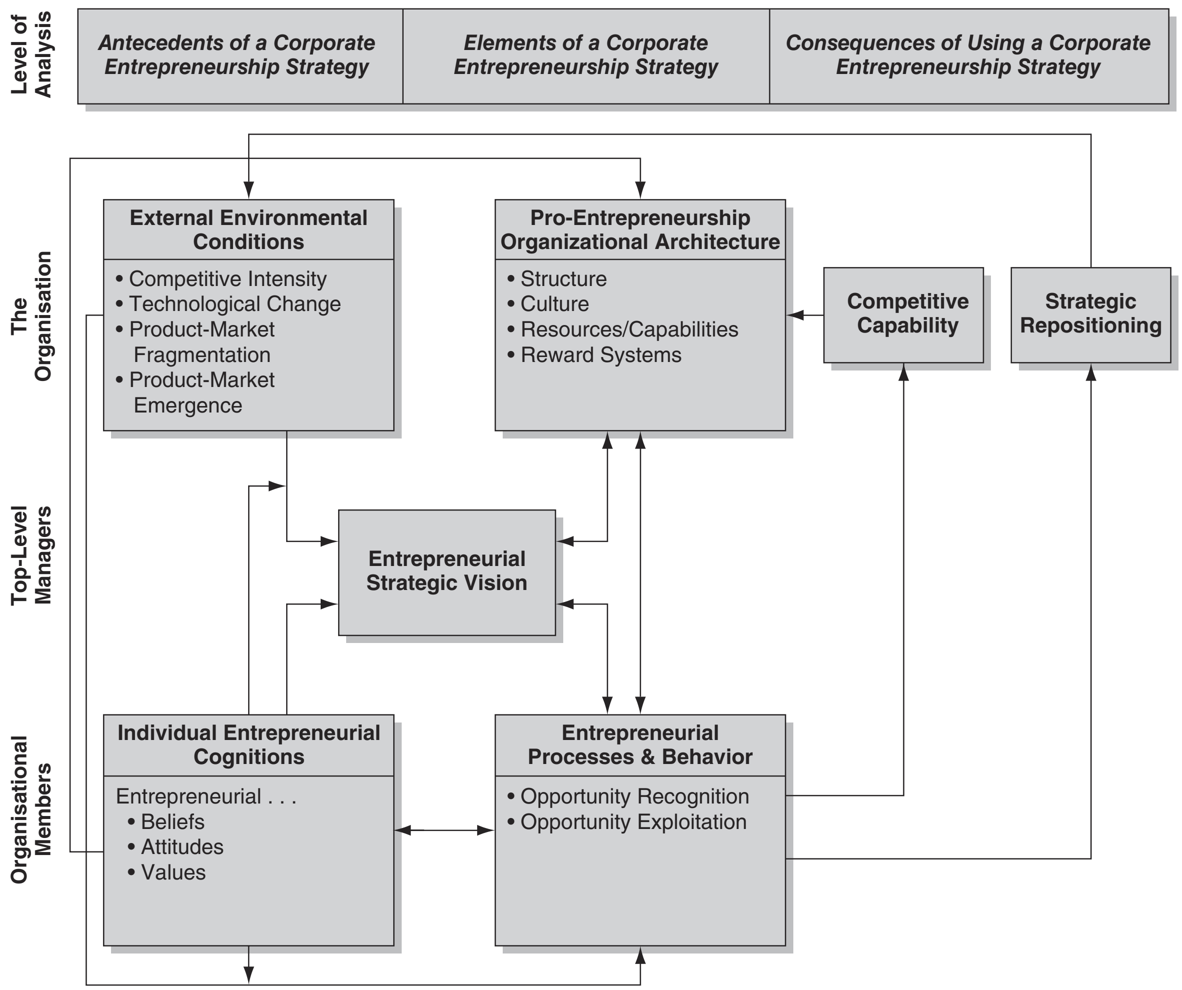
CONCEPTUALISING INTRAPRENEURIAL STRATEGY

As mentioned earlier, we define an intrapreneurial strategy as a vision-directed, organisation-wide reliance on entrepreneurial behaviour that purposefully and continuously rejuvenates the organisation and shapes the scope of its operations through the recognition and exploitation of entrepreneurial opportunity. Intrapreneurial strategy should be thought of in continuous, rather than dichotomous, terms. Stated more directly, intrapreneurial strategies vary in their degree of entrepreneurial intensity.

Figure 16.2 presents a model with three elements: an entrepreneurial strategic vision, a pro-entrepreneurship organisational architecture and entrepreneurial processes and behaviour as exhibited across the organisational hierarchy.[46] This model has several linkages, which include: (1) individual entrepreneurial cognitions of the organisation's members, (2) external environmental conditions that invite entrepreneurial activity, (3) top management's entrepreneurial strategic vision for the firm, (4) organisational architectures that encourage entrepreneurial processes and behaviour, (5) the entrepreneurial processes that are reflected in entrepreneurial behaviour and (6) organisational outcomes that result from entrepreneurial actions.

The model suggests that individual entrepreneurial cognitions and external environmental conditions are the initial impetus for adopting an intrapreneurial strategy, and outcomes are assessed to provide justification for the strategy's continuance, modification, or rejection. The intrapreneurial strategy itself is reflected in the three elements cited previously: an entrepreneurial strategic vision, a pro-entrepreneurship organisational architecture, and entrepreneurial processes and behaviour as exhibited throughout the organisation. An intrapreneurial strategy cannot be consciously chosen and quickly enacted the way some strategies (such as acquisition) can be – it requires more than just a decision, act, or event. It requires the creation of congruence between the entrepreneurial vision of the organisation's leaders and the entrepreneurial actions of those throughout the organisation, as facilitated through the existence of a pro-entrepreneurship organisational architecture. Intrapreneurial strategy is about creating self-renewing organisations through the unleashing and focusing of the entrepreneurial potential that exists throughout those organisations. Firms that engage in intrapreneurial strategies must encourage entrepreneurial behaviour on a continuous basis. Obviously, how extensively firms must engage in entrepreneurial behaviour before the presence of an intrapreneurial strategy can be claimed is a matter of degree. At one end of the

FIGURE 16.2: **AN INTEGRATIVE MODEL OF INTRAPRENEURIAL STRATEGY**



Source: Duane Ireland, Jeffery G. Covin and Donald F. Kuratko, 'Conceptualizing Corporate Entrepreneurship Strategy', *Entrepreneurship Theory and Practice*, 33(1), January, 2009

continuum is stability, or the absence of innovation; at the other end is chaos, or overwhelming innovation.

Thus, for intrapreneurship to operate as a strategy, it must 'run deep' within organisations. 'It is a fundamental orientation toward the pursuit of opportunity and growth that exists when it is embraced throughout the organization and defines the essence of the firm's functioning'.[47] Top managers are increasingly recognising the need to respond to the entrepreneurial imperatives created by their competitive landscapes. Minimal responses to these entrepreneurial imperatives – reflecting superficial commitments to intrapreneurial strategy – are bound to fail. Moreover, although top management can instigate the strategy, top management cannot dictate it. Those at the middle and lower ranks of an organisation have a tremendous effect on and significant roles within entrepreneurial and strategic processes.[48] Without sustained and strong commitment

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from these lower levels of the organisation, entrepreneurial behaviour will never be a defining characteristic of the organisation, as is required by intrapreneurial strategy.

The five critical steps of intrapreneurship strategy are: (1) developing the vision, (2) encouraging innovation, (3) structuring for an entrepreneurial climate, (4) developing individual managers for intrapreneurship and (5) developing venture teams. Each of these is now discussed in greater detail.

>>INTRAPRENEURSHIP IN PRACTICE

THE CUBICLE COMMANDO'S CREDO

Stay true to yourself.
Leverage the power of business for good.
Remember the 'power of AND'.
Subversion is important.
Fight mediocrity.
Ideas and concepts rule.
Tap into your feminine side.
Unleash your passions.
Be a part of the revolution.
Adopt a new mind-set.
Have passion, creativity and the desire to make a difference.
Make meaning from your work.
Be yourself.
Be extraordinary.
Act with integrity.
Live your personal brand.
Be curious about everything.
Find and get behind your cause.
Stand up for yourself.
Get into the action.
Be optimistic.
Engage with like-minded people.
Be a mover and shaker.
Ask why.
Think as big as you can and go for it.
Know what fear smells like, take a deep breath and do it anyway.
Be a dreamer, thinker, doer in one.
Be kind to yourself.
You always have a choice.
Recognise the power of working with others.
Live through your heart and soul.
Create buy-in with involvement.
Convert enemies to allies.
Engage through vision.
Create your intraprise.
Live your dream.
Have big, hairy, audacious goals.
Be open and accepting.
Create suspense and mystery.
Reward yourself and your team.
Be open to all possibilities.
Listen to your intuition.
Don't follow fashion.
Be agile and adaptable.
Create an 'anti-process' process.
Embrace constraints.
Leverage systems.
Pick your battles.
Accept the things you cannot change.
Value and acknowledge yourself.
Know what you want.
Ask for what you want.
Know what success means to you.
Make your own luck.
Stay true to who you are.
Create a vision for your life.
You are an intrapreneur.
You can change the world.
You are not alone.

Source: Lisa Messenger and Zern Liew, *Cubicle Commando*, Australia Square, New South Wales: Messenger Publishing, 2006: 178–9. http://eicolab.com.au/blog.

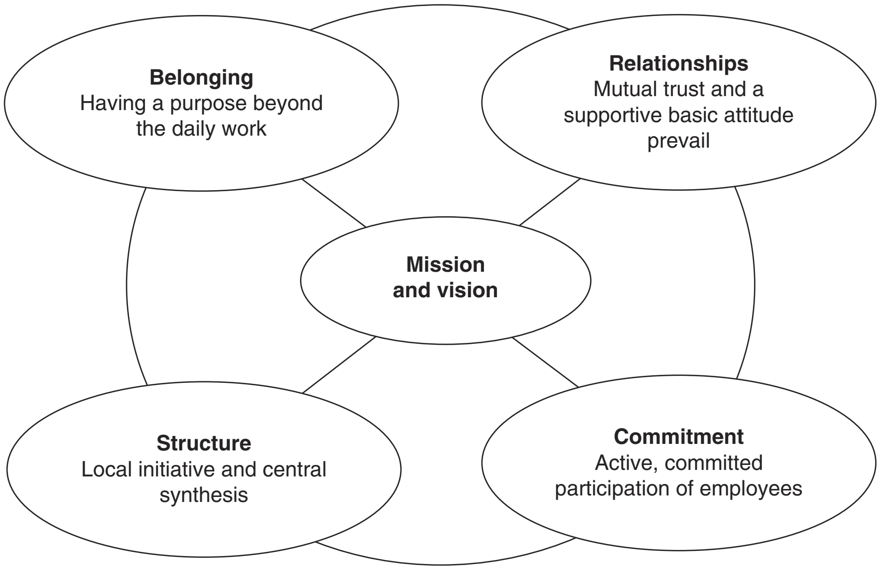
Developing the vision

The first step in planning an intrapreneurial strategy for the enterprise is sharing the vision of innovation that the corporate leaders wish to achieve.[49] The vision must be clearly articulated by the organisation's leaders; however, the specific objectives are then developed by the managers and employees of the organisation. Because it is suggested that intrapreneurship results from the creative talents of people within the organisation, employees need to know about and understand this vision. Shared vision is a critical element for a strategy that seeks high achievement (see Figure 16.3).

Encouraging innovation

Innovation is the specific tool of the entrepreneur (see also Chapter 5). Therefore, corporations must understand and develop innovation as the key element in their strategy. Numerous researchers have examined the importance of innovation within the business environment.[50]

FIGURE 16.3: SHARED VISION



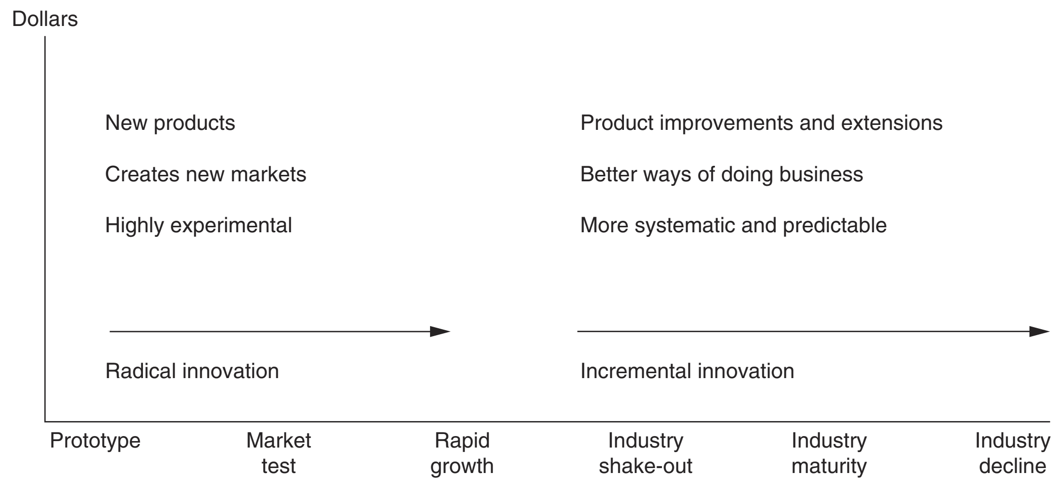
Source: Jon Arild Johannessen, 'A Systematic Approach to the Problem of Rooting a Vision in the Basic Components of an Organization', *Entrepreneurship, Innovation and Change*, March 1994: 47. Reprinted with permission from Plenum Publishing Corporation

Some authors have described innovation as chaotic and unplanned,[51] while other researchers insist it is a systematic discipline.[52] Yet both can be right, depending on the nature of the innovation. One way to understand this concept is to focus on two different types of innovation: radical and incremental.[53]

- **Radical innovation** is the launching of major breakthroughs that radically transform an industry, such as wireless Internet, iPods, videophones, Post-it® notes, disposable nappies, optical fibres, CT scanners, mobile phones, NutraSweet and even overnight mail delivery. They were all radical innovations at the early stages of their diffusion and adoption. They took experimentation and determined vision. They could be 'managed' only with difficulty, but they had to be recognised, nurtured and guided.
- **Incremental innovation** refers to the systematic transformation of an existing product or service into newer or larger markets. These are all products at advanced stages of their product life cycles. Examples include microwave popcorn, packaging beads (to replace Styrofoam®), frozen yoghurt and so forth. Sometimes an incremental innovation will actually take over after a radical innovation introduces a breakthrough (see Figure 16.4). Think of how many incremental versions of Microsoft Windows there have been! The structure, marketing, financing and formal systems of a company can help implement incremental innovation. As Sir Richard Branson said, 'Business opportunities are like buses; there's always another one coming'; Virgin Airlines is like that. It is the airline famous for service innovation. Nothing radical, just incrementally better than the others – constantly.

Amazingly, the history of technology development is littered with good ideas which were not taken up by their creators, like the computer mouse or GUI computer interface. Large corporations failed to commercialise these ideas because they fell 'outside of our core

FIGURE 16.4: RADICAL VERSUS INCREMENTAL INNOVATION



Source: Harry S. Dent, Jr., 'Reinventing Corporate Innovation', *Small Business Reports*, June 1990: 33

competencies'. Other organisations took the ideas and created wealth with them. Recent research shows that large firms fail at developing radical innovations in their core markets because they fear that the new innovations will compete with existing products and services.[54] Fortunately for IBM, in the 1940s they didn't listen to the advice of their president, Thomas J Watson, who reputedly said: 'I think there is a world market for about five computers'.[55]

Both types of innovation require vision and support. This support takes different steps for effective development (see Table 16.4). In addition, they both need a **champion** – the person with a vision and the ability to share it.[56] Both types of innovation require an effort by the top management of the company to develop and educate employees concerning innovation and intrapreneurship, a concept known as **top management support**.[57] Key persons in the organisation are the managers at all levels, but also the mutual interaction processes between colleagues on the

TABLE 16.4: DEVELOPING AND SUPPORTING RADICAL AND INCREMENTAL INNOVATION

RADICAL	INCREMENTAL
Stimulate through challenges and puzzles	Set systematic goals and deadlines
Remove budgetary and deadline constraints when possible	Stimulate through competitive pressures
Encourage technical education and exposure to customers	Encourage technical education and exposure to customers
Allow technical sharing and brainstorming sessions	Hold weekly meetings that include key management and marketing staff
Give personal attention – develop relations of trust	Delegate more responsibility
Encourage praise from outside parties	Set clear financial rewards for meeting goals and deadlines
Have flexible funds for opportunities that arise	
Reward with freedom and capital for new projects and interests	

Source: Adapted from Harry S. Dent Jr, 'Reinventing corporate innovation', *Small Business Reports*, June 1990: 36

individual level. There will not be any intrapreneurship without action, effort and achievement that comes from the individuals themselves.[58]

Encouraging innovation requires a willingness not only to tolerate failure, but also to learn from it. For example, one of the founders of 3M, Francis G. Oakie, had an idea to replace razor blades with sandpaper. He believed men could rub sandpaper on their face rather than use a sharp razor. He was wrong and the idea failed, but his ideas evolved until he developed waterproof sandpaper for the auto industry, a blockbuster success! Thus, 3M's philosophy was born.

3M Company (formerly Minnesota Mining and Manufacturing Company) is an American company with a worldwide presence that produces over 55 000 products, including adhesives, abrasives and laminates, electronic circuits and displays and pharmaceuticals. The company's early innovations included waterproof sandpaper (early 1920s) and masking tape (1925), as well as cellophane tape and sound deadening materials for metal-frame cars in the years that followed. 3M's contributions to modern life include magnetic sound and video recording tape, offset printing plates, Scotchguard fabric protector, translucent dental braces, synthetic ligaments for knee surgery, heavy-duty reflection sheet for construction signs and of course Post-it notes.[59]

Today 3M follows a set of innovative rules that encourage employees to foster ideas. The key rules include the following:

- **Don't kill a project**: If an idea can't find a home in one of 3M's divisions, an employee can devote 15 per cent of their time to prove it is workable. For those who need seed money, as many as 90 Genesis grants of $50 000 are awarded each year.
- **Tolerate failure**: Encouraging plenty of experimentation and risk-taking allows more chances for a new product hit. The goal: Divisions must derive 25 per cent of sales from products introduced in the past five years. The target may be boosted to 30 per cent in some cases.
- **Keep divisions small**: Division managers must know each employee's first name. When a division gets too big, perhaps reaching $250 million to $300 million in sales, it is split up.
- **Motivate the champions**: When a 3M employee has a product idea, they recruit an action team to develop it. Salaries and promotions are tied to the product's progress. The champion has a chance to some day run their own product group or division.
- **Stay close to the customer**: Researchers, marketers and managers visit customers and routinely invite them to help brainstorm product ideas.
- **Share the wealth**: Technology, wherever it is developed, belongs to everyone.[60]

Structuring an intrapreneurial climate

The results of intrapreneurship can result in wide-ranging benefits to the firm. When re-establishing the drive to innovate in today's corporations, the final and possibly most critical step is to invest heavily in *entrepreneurial activities* that allow new ideas to flourish in an innovative environment. This is called the **intrapreneurial climate**. This concept, when coupled with the other elements of an innovation strategy, can enhance the potential for employees to become venture developers. One of the clearest examples of this is displayed by Hewlett-Packard, for which a critical core competence is its capacity to take an idea, build it into a product and get it to market quickly.[61] To develop employees as a source of innovation for corporations, companies need to provide more nurturing and information-sharing activities.[62] In addition, they need to develop an environment that will help innovative-minded people reach their full potential.[63] Employee perception of an innovative environment is critical for stressing the importance of management's commitment not only to the organisation's people, but also to the innovative projects.

Preparing for failure

There have been numerous advocates for the acceptance of failure among innovative projects in organisations. The idea of 'learning from failure' has become an axiom in the corporate entrepreneurial community. Managing the grief process that results from project failure has been studied. The literature seldom recognises the importance of grief in the failure experience. Grief is a negative emotional response to the loss of something important, which triggers behavioural, psychological, and physiological symptoms. Managing grief therefore represents a particularly salient task in the context of corporate entrepreneurship practice, because the amount of commitment essential to a project's success also generates grief when the project fails.

Project failure is a common occurrence, and organisational routines and rituals are likely to influence the grief recovery of those involved in the failed project. To the extent that a social support system could be offered by the organisational environment for individuals' negative emotions, there will likely be greater learning and motivational outcomes. The inevitability of entrepreneurial project failure encourages the adoption of social support mechanisms as means to develop failure-related coping skills among corporate managers. The need in dedicated corporate innovation units for social support mechanisms that enable corporate entrepreneurs to cope with failure-related grief will likely help to build coping self-efficacy in individuals.[64]

Developing individual managers for intrapreneurship

As a way for organisations to develop key environmental factors for entrepreneurial activity, a corporate entrepreneurship/innovation training program often induces the change needed in the work atmosphere. It is not our intent to elaborate completely on the content of a training program here, but a brief summary of an actual program is presented to provide a general understanding of how such a program is designed to introduce an entrepreneurial environment in a company. This award-winning training program is intended to create an awareness of entrepreneurial opportunities in organisations. The Corporate Innovation Training Program consists of six modules, each designed to train participants to support corporate innovations in their own work area.[65] The modules and a brief summary of their contents are as follows:

1. **The entrepreneurial experience**. An enthusiastic overview of the entrepreneurial experience in which participants are introduced to the entrepreneurial revolution that has taken place throughout the world over the last three decades. Participants are challenged to think innovatively and recognise the need for breaking out of the old paradigms in today's organisations.
2. **Innovative thinking**. The process of thinking innovatively is foreign to most traditional organisations. The misconceptions about thinking innovatively are reviewed and a discussion of the most common inhibitors is presented. After completing an innovation inventory, managers engage in several exercises designed to facilitate their own innovative thinking.
3. **Idea acceleration process**. Managers generate a set of specific ideas on which they would like to work. The process includes examining a number of aspects of the corporation, including structural barriers and facilitators. Additionally, managers determine resources needed to accomplish their projects.
4. **Barriers and facilitators to innovative thinking**. The most common barriers to innovative behaviour are reviewed and discussed. Managers complete several exercises that will help them deal with barriers in the workplace. In addition, video case histories are shown that depict actual corporate innovators that have been successful in dealing with corporate barriers.
5. **Sustaining Innovation teams (I-Teams)**. The concept of I-Teams to focus on specific innovations is examined. Managers work together to form teams based on the ideas that

TABLE 16.5: THE INTRAPRENEUR'S COMMANDMENTS

1	*Come to work each day willing to give up your job for the innovation.*
2	*Circumvent any bureaucratic orders aimed at stopping your innovation.*
3	*Ignore your job description–do any job needed to make your innovation work.*
4	*Build a spirited innovation team that has the 'fire' to make it happen.*
5	*Keep your innovation 'underground' until it is prepared for demonstration to the corporate management.*
6	*Find a key upper-level manager who believes in you and your ideas and who will serve as a sponsor to your innovation.*
7	*Permission is rarely granted in organisations; thus, always seek forgiveness for the 'ignorance' of the rules that you will display.*
8	*Always be realistic about the ways to achieve the innovation goals.*
9	*Share the glory of the accomplishments with everyone on the team.*
10	*Convey the innovation's vision through a strong venture plan.*

have been circulating among the entire group. Team dynamics are reviewed for each group to understand.

6 **The innovation action plan**. After managers examine several aspects of facilitators and barriers to behaving innovatively in their organisation, teams are asked to begin the process of completing an action plan. The plan includes setting goals, establishing an I-Team, assessing current conditions, developing a step-by-step timetable for project completion and project evaluation.

Developing 'I-Teams'

Innovation teams (or I-Teams) and the potential they hold for producing innovative results are recognised as a productivity breakthrough for the 21st century. Certainly, no one doubts that their popularity is on the rise. Companies that have committed to an innovation team approach often label the change they have undergone a 'transformation' or 'revolution'. This modern breed of work team is a new strategy for many firms. It is referred to as self-directing, self-managing, or high performing, although in reality an I-Team fits all of those descriptions.[66]

In examining the entrepreneurial development for corporations, Robert Reich found that entrepreneurial thinking is not the sole province of the company's founder or its top managers. Rather, it is diffused throughout the company, where experimentation and development occur all the time as the company searches for new ways to build on the knowledge already accumulated by its workers. Reich defines **collective entrepreneurship** as follows:

> In collective entrepreneurship, individual skills are integrated into a group; this collective capacity to innovate becomes something greater than the sum of its parts. Over time, as group members work through various problems and approaches, they learn about each other's abilities. They learn how they can help one another perform better, what each can contribute to a particular project, how they can best take advantage of one another's experience. Each participant is constantly on the lookout for small adjustments that will speed and smooth the evolution of the whole. The net result of many such small-scale adaptations, effected throughout the organisation, is to propel the enterprise forward.[67]

In keeping with Reich's focus on collective entrepreneurship, venture teams offer companies the opportunity to use the talents of individuals but with a sense of teamwork.

An innovation team, or I-Team, is composed of two or more people who formally create and share the ownership of a new organisation.[68] The unit is semi-autonomous in the sense it has a budget plus a leader who has the freedom to make decisions within broad guidelines. Sometimes the leader is called an innovation champion or an intrapreneur. The unit is often separated from other parts of the firm – in particular, from parts involved with daily activities. This prevents the unit from engaging in procedures that can stifle innovative activities. If the venture proves successful, however, it eventually is treated the same as other outputs the organisation produces. It is then integrated into the larger organisation.[69]

In many ways an I-Team is a small business operating within a large business and its strength is its focus on design (that is, structure and process) issues for innovative activities.

Intrapreneurship and sustainability

Where are the corporate equivalents of social entrepreneurs (see Chapter 4), who are often the greatest agents for social change? Is social or environmental innovation even compatible with large organisations? The answer of course is yes. Social intrapreneurs demonstrate that business and social values can be aligned. A **social intrapreneur** is a person working in a large business or social organisation developing and promoting practical solutions to social or environmental challenges where progress is currently stalled by market failures.[70] A social intrapreneur is an

AUSTRALIA'S EARLY ADOPTERS OF SUSTAINABLE STRATEGIES

>>INTRAPRENEURSHIP IN PRACTICE

In Australia, two notable early adopters of business strategies underpinned by sustainability are Westpac Banking Corporation and Insurance Australia Group (IAG). Both have been able to successfully differentiate themselves from their competitors in their respective markets in ways that deliver both business and social benefits.

Each has evolved Sustainability Business Strategy (SBS) initiatives to create a sustainability attribute in their individual value propositions that is attractive to consumers and difficult for competitors to replicate. Both organisations have become leaders in SBS development and application and have compelled other players in their sectors to reconsider corporate social responsibility in a more strategic context.

Listed below are some ways in which IAG and Westpac have applied SBS to the four fundamental business elements. These activities inherently involve innovation in process, planning, design and technology.

EFFICIENCY

>> IAG: organisational goal for all operations to be carbon neutral within five years, with operational efficiency measures and innovations contributing to reducing greenhouse gas emissions.

>> Westpac: demonstrable performance improvements in greenhouse gas emissions, energy usage, paper usage, recycling and car fleet performance over the past nine years.

RISK

>> IAG: risk-reduction community programs relevant to core business, targeting road and home safety, crime prevention, workplace safety, emergency services and climate change.

>> Westpac: leading the adoption of the Equator Principles with nine other global banks to ensure social and environmental issues are considered in project financing.

RELATIONSHIPS

>> IAG: Australian Business Roundtable on Climate Change multi-stakeholder partnership producing 'The Business Case for Early Action' report.

>> Westpac: Participant in Indigenous Enterprise Partnership in Cape York, building financial independence for communities through programs like Family Income Management and Business Hubs with local indigenous organisations.

Source: Sean Rooney, `The Value of a Truly Sustainable Business Strategy', *Ecos Magazine* 138, pp.27–28, Aug/Sep 2007.

employee of a large organisation who uses entrepreneurial principles to address social and environmental challenges. She or he does so by delivering solutions or products that add value to the company's bottom line as well as to society and the planet. Far-sighted companies are increasingly identifying individuals who look beyond conventional business practices and who can foster economic, environmental and social value.[71] Here are the basic tenets of social intrapreneurship. Social intrapreneurs:

- see businesses as part of the earth ecosystem and needing to add value to society and the environment as well as to the bottom line
- understand business priorities as well as environmental imperatives as they respond to market failures and increased societal expectations of business
- are often more interested in social change than in personal wealth creation as they create new business models and force their firms to look outside traditional models
- share many personality traits with social entrepreneurs, who may actually spurn the business environment
- understand the need to tie into processes and business case elements.[72]

TABLE 16.6: COMMERCIAL POSSIBILITIES FOR SOCIAL INTRAPRENEURS

GAPS BETWEEN THE HAVES AND HAVE NOTS	REALITIES BROUGHT ABOUT THROUGH GLOBALISATION	COMMERCIAL POSSIBILITIES FOR SOCIAL INTRAPRENEURS
Demographic	The world is heading to a population of 9 billion by 2050, with 95% of growth expected in developing countries.	To meet the needs of billions of people affected by market failures in both developing and developed countries.
Financial	40% of the world's wealth is owned by 1% of the population, while the poorest 50% can claim just 1% of the wealth.	Help the have-nots become bankable, insurable and entrepreneurial.
Nutritional	The world now produces enough food for everyone, but over 850 million people still face chronic hunger every day.	Address the needs of those with too little food – and too much.
Resources	60% of ecosystem services, such as fresh water and climate regulation, are being degraded or used unsustainably.	Enable development that uses the earth's resources in a sustainable way.
Environmental	The loss of biodiversity, droughts and the destruction of coral reefs are just some of the challenges facing the globe.	Create markets that protect and enhance the environment.
Health	Some 39.5 million people live with HIV/AIDS in the world, now the fourth-largest killer disease.	Create markets that encourage healthy lifestyles and enable equal access to healthcare.
Gender	Two-thirds of the world's 1 billion illiterate people are women.	Enable and empower women to participate equally and fairly in society and the economy.
Educational	About 100 million children within emerging economies are not enrolled in primary education.	Provide the mechanisms to transfer and share knowledge and learning that empowers all levels of societies.
Digital	Internet users worldwide topped 1.1 billion in 2007, but only 4% of Africans and 11% of Asians have Internet access.	Develop inclusive technology that enables all levels of society to tackle each of these divides more effectively.
Security	Between 1994 and 2003, the majority of the 13 million deaths caused by intra-state conflict took place in sub-Saharan Africa and western and southern Asia – regions that are home to 75% of the world's 37 million refugees and displaced people.	Work to promote security and reduce conflict based on inequity and exclusion.

SustainAbility, *The Social Intrapreneur*, 22

TABLE 16.7: SOURCES OF INFORMATION ON SOCIAL INTRAPRENEURSHIP

American Chamber of Commerce	www.amcham.com.au
Australian Business Limited	www.australianbusiness.com.au
Australian Businesswomen's Network	www.abn.org.au
Australian Human Resources Institute	www.ahri.com.au
Australian Institute of Company Directors	www.companydirectors.com.au
Australian Institute of Management	www.aim.com.au
Australian Institute of Office Professionals	www.aiop.com.au
Australian Marketing Institute	www.ami.org.au
Business Enterprise Centres	www.beca.org.au
Business Network International	www.bni.com.au
Business Referral Group	www.businessreferralgroup.com.au
Climate Help	www.climatehelp.com.au
Connect Marketing Professionals	www.connectnetwork.com.au
Cubicle Commando Events	www.cubiciecommando.com.au
Dow Jones Sustainability Indexes	www.sustainability-index.com/
Entrepreneur's Network	www.networxevents.com.au
Environmental & Social Responsibility Observatory	www.unepfi.org/tools/observatory/index.html
Females in Information Technology and Telecommunications	www.fitt.org.au
First Wednesday Club	www.abacusrecruit.com.au
FTSE4Good Index	www.ftse4good.com
Institute of Management Consultants	www.ime.org.au
Insurance Australia Group	http://iag.com.au/sustainable/index.shtml
Last Thursday Club	www.lastthursdayclub.net
Meetings Industry Association of Australia	www.miaanet.com.au
National Speakers Association of Australia	www.nationalspeakers.asn.au
Networking to Win	www.networkingtowin.com.au
Professions Australia	www.professions.com.au
Recruitment Consulting Services Association	www.rcsa.com.au
ResponsibleChina.com	http://responsiblechina.com/
Rural Women's Network	www.agric.nsw.gov.au
Social Enterprise Network	www.social-e.org.au
Sydney Talks	www.sydneytalks.com.au
The CEO Institute	www.ceo.com.au
The Help House	www.helphouse.com.au/
The Innovation Council	www.innovation.govau
Thought Leaders	www.thoughtleaders.com.au
United Nations Environment Programme Finance Initiative	www.unepfi.org/
Volunteering Australia	www.volunteeringaustralia.org
Women Chiefs of Enterprise	www.weei.com.au
Women in Finance	www.wifnsw.com.au
Women's Network Australia	www.womensnetwork.com.au
Youth 2 Youth	www.youth2youth.com.au

SUMMARY

Around the world, more and more entrepreneurs are starting up businesses for their employers. Intrapreneurship is the process of profitably creating innovation within (sometimes very large) organisational settings. An intrapreneurial organisation is willing to initiate actions, pursue opportunities and emphasise new, innovative products or services. Most companies are realising the need for intrapreneurship. This need has arisen as a response to: (a) the rapidly growing number of new, sophisticated competitors, (b) a sense of distrust in the traditional methods of management and (c) an exodus of some of the best and brightest people from companies to become small-business entrepreneurs.

Intrapreneurship can lead to innovation, new product development, greater wealth creation and economic development for companies that want to compete effectively in international markets. The term ‘intrapreneurship’ means both new-venture creation within existing organisations (be they profit-making, non-profit, public, or non-governmental) and their transformation through strategic renewal. It shows how to harness the entrepreneurial spirit inside a large organisation, be it government, a social enterprise, even the church.

When developing in-house entrepreneurship companies must develop four characteristics: (1) explicit goals, (2) a system of feedback and positive reinforcement, (3) an emphasis on individual responsibility and (4) rewards based on results. Organisations create intrapreneuring in a variety of ways. The first step is to understand the obstacles to intrapreneurship. These are usually based on the adverse impact of traditional management techniques. The next step is to adopt innovative principles that include atmosphere and vision, multiple approaches, interactive learning and skunkworks.

Intrapreneurship is not just for companies; it is also for government bureaucracies and other large institutions. While public and private sector entrepreneurs have a lot in common, there are some significant differences. Public sector organisations have fewer entrepreneurs, are hierarchically structured and are rigid environments. They often have unclear objectives, less resources available for change, significant risk aversion and often political intrusion.

Specific strategies for intrapreneurship entail the development of a vision as well as the development of innovation. Two types of innovation exist: radical and incremental. To facilitate the development of innovation, companies need to focus on the key factors of top management support, time, resources and rewards. Thus, commitment to and support of intrapreneurial activity are critical.

Innovation teams (I-Teams) are the semi-autonomous units that have the collective capacity to develop new ideas. Sometimes referred to as self-managing or high-performance teams, venture teams are emerging as the new breed of work teams formed to strengthen innovative developments.

Intrapreneurs and entrepreneurs share similar characteristics and traits. Among these traits are a generalist point of view, an action orientation, an optimistic approach, self-determination, ambitious goal setting, dedication to new ideas and a willingness to accept mistakes and learn from them. Inventors sometimes acquire intrapreneurial skills, but often the inventors must team up with intrapreneurs to take the invention successfully into the marketplace.

At the end of the chapter, we discussed the new breed of social intrapreneur. These are people working in large organisations who are focused both on shareholder value and on benefit to the planet. They have many of the same personality characteristics of other entrepreneurs.

KEY TERMS & CONCEPTS

champion
collective entrepreneurship
corporate entrepreneurship
corporate revolution
corporate venturing
entrepreneurial economy
gumboot factory or skunkworks
incremental innovation
innovation team (I-Team)
innovation venturing
interactive learning
intracapital
intrapreneurial climate
intrapreneurship
intraprise
private sector entrepreneurs
public sector entrepreneurs
radical innovation
risk aversion
social intrapreneurship
strategic entrepreneurship
strategic renewal
top management support
venture team

REVIEW & DISCUSSION QUESTIONS

1. In your own words, what is the difference between a business intrapreneur and a social intrapreneur?
2. What are two reasons that such a strong desire to develop intrapreneurs has arisen in recent years?
3. How does an entrepreneur differ from an intrapreneur? Compare and contrast the two.
4. Are intrapreneurs in the Asia–Pacific different from intrapreneurs in other parts of the world? Justify your answer.
5. What are some of the obstacles that must be overcome to establish an intrapreneurial environment?
6. What are some of the innovative principles identified by James Brian Quinn (page 575) that companies need to establish?
7. Companies today are working to re-engineer their thinking and encourage an intrapreneurial environment. What types of steps would you recommend? Offer at least three and explain each.
8. What are five useful rules for innovation?
9. What are three advantages of developing an intrapreneurial philosophy?
10. Identify the four key elements on which managers should concentrate to develop an intrapreneurial strategy.
11. Why do we say that intrapreneurship is not for businesses only?
12. Explain the differences between radical and incremental innovation.
13. Identify the five specific entrepreneurial factors that organisations need to address in structuring their environment.
14. Why are innovation teams emerging as part of a new strategy for many companies?
15. What is a social intrapreneur? Can you make a list of characteristics that differentiate this type of person from a regular business entrepreneur?
16. Why do companies need sustainable intrapreneurs? Why do governments?

EXPERIENTIAL EXERCISE: DEVELOPING INTRAPRENEURSHIP

Many ways of developing intrapreneurship exist. Some of these are presented in the following list. Write yes next to those that would help develop intrapreneurship and no next to those that would not help develop intrapreneurship.

1 .... **Create an innovative climate.**
2 .... **Set implicit goals.**
3 .... **Provide feedback on performance.**
4 .... **Provide positive reinforcement.**
5 .... **Encourage structured activity.**
6 .... **Develop a well-defined hierarchical structure, and stick to it.**
7 .... **Tolerate failure.**
8 .... **Encourage a bias for action.**
9 .... **Make extensive use of formal meetings.**
10 .... **Allow bootlegging of ideas.**
11 .... **Reward successful personnel.**
12 .... **Sack those who make mistakes as a way of creating a good example for others.**
13 .... **Make extensive use of informal meetings.**
14 .... **Encourage communication throughout the organisation.**
15 .... **Discourage joint projects and ventures among different departments.**
16 .... **Encourage brainstorming.**
17 .... **Encourage moderate risk taking.**
18 .... **Encourage networking with others in the enterprise.**
19 .... **Encourage personnel not to fear failing.**
20 .... **Encourage personnel to be willing to succeed even if it means doing unethical things.**

Answers: 1: Y; 2: N; 3: Y; 4: Y; 5: N; 6: N; 7: Y; 8: Y; 9: N; 10: Y; 11: Y; 12: N; 13: Y; 14: Y; 15: N; 16: Y; 17: N; 18: Y; 19: Y; 20: N.

EXPERIENTIAL EXERCISE: SPOT THE SOCIAL INTRAPRENEUR

What are the key differences between intrapreneurs and entrepreneurs? There are a fair number, but one of the most important is that – unlike individual entrepreneurs – intrapreneurs potentially leverage the resources of their large host organisations. This is a checklist for spotting social intrapreneurs. This list draws upon a multitude of sources for social entrepreneurial characteristics. Put a tick in the box that applies.

		SOCIAL ENTREPRENEUR	SOCIAL INTRAPRENEUR
1	*Shrug off constraints of ideology or discipline*		
2	*Identify and apply practical solutions to social or environmental problems*		
3	*Innovate by finding a new product, service or approach to a social challenge*		
4	*Focus — first and foremost — on societal value creation*		
5	*Successfully navigate corporate culture, strategy and process*		
6	*Communicate social entrepreneurship in compelling business terms*		
7	*Build and inspire teams across a multiplicity of corporate divisions*		
8	*Jump in before they are fully resourced*		
9	*Have a dogged determination that pushes them to take risks*		
10	*Combine their passion for change with measurement and monitoring of impact*		
11	*Have a healthy impatience — they don't like bureaucracy*		
12	*Run their organisations*		

Source: SustainAbility, *The Social Intrapreneur: A Field Guide for Corporate Changemaker*, p. 27: http://www.sustainability.com/downloads_public/TheSocialIntrapreneur.pdf

Answers: 1: E, I; 2: E, I; 3: E, I; 4: E, I; 5: I, 6: I.; 7: I; 8: E, I; 9: E, I; 10: E, I; 11: E, I; 12: I.

CASE 3.1: IT'S ALL ABOUT GROWING ENTREPRENEURS IN-HOUSE

Sir C.K. Chow is now domiciled in Sydney as the chief executive of the new Brambles after its A$17 billion merger with British engineering giant GKN late last year. Brambles is an Australian-based global provider of support services, operating in almost 50 countries across six continents and employing approximately 28 000 people.

Chow brings an entrepreneurial style of corporate leadership to the local marketplace. It is a style that made GKN a frontrunner in Britain and won him a knighthood before his 50th birthday.

Chow was headhunted to become chief executive of GKN in 1996. He set himself and the company the ambitious task of boosting revenue growth by 40 per cent over five years. In a sector such as automotive components, GKN's main business, this seemed a tough call. The British pound, GKN's reporting currency, was so strong that it was threatening to sink other icons of British manufacturing such as Rover and BTR.

That Chow and GKN managed to achieve, even exceed, the goal are now on public record. At GKN, the company managed to achieve Chow's target not only through strategic moves in helicopter and armoured car manufacturing, but also through his championing of corporate entrepreneurship within the organisation in a program called 'The Way Forward'.

'There was a good reason to promote entrepreneurship at GKN', says Chow. 'It is a very structured and disciplined company and most of its executives are engineers with very high work ethics. In order to encourage growth, we needed to support this strength and combine it with entrepreneurship.'

The cornerstone of the Way Forward program was the formation of what Chow calls 'real working teams' starting from the executive committee of the company through to every business unit. 'They work together on real business issues, often recharting their strategies and redefining their culture.'

Along with the practice of seconding people from their home plants to other parts of the company for long periods, the Way Forward program helped break down competition and suspicion between the plants and created an open atmosphere that encouraged people to feel they were at a disadvantage if they did not share their ideas. Previously impeded by cross-cultural rivalries, this was a major breakthrough in organisational behaviour for GKN that took five years to achieve.

'No successful entrepreneur achieves his success by merely copying what others do; they do something new, different and better', says Chow. 'They are resourceful and often leverage other people's resources to succeed. They also do not take risks blindly. They understand risks very well and take actions to mitigate them as they understand that their survival depends on it.

'Two things that I emphasise in the new Brambles, is firstly that we are a business-to-business solutions provider for outsourcing support services and secondly the key to doing that successfully is through the development of people and promoting an enterprising spirit', Chow says.

'An enterprising spirit is about innovation, overcoming barriers and it is about resourcefulness. And that's what we would encourage our people to do.'

Innovation in support services is best to come from interfacing with your customers, says Chow. 'It is about ideas that start with somebody saying, "Hey let me do this for you" and then it begins; it may start in a relatively small way, but it can grow very quickly.'

Source: Adapted from Lachlan Colquhoun, 'It's all about growing entrepreneurs in-house', *AGSM Magazine* (Sydney: Australian School of Management), 30 March 2002: 11–12

Questions

1. How did GKN achieve Sir C.K. Chow's target of 40 per cent revenue increase over five years?
2. What is the importance of having the executive committee spearhead an intrapreneurial initiative? What are the potential problems with that approach?
3. How would you characterise the enterprising spirit at GKN?

RECOMMENDED CASES FROM HARVARD BUSINESS SCHOOL ONLINE

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Corporate Entrepreneurship for Dummies

Publication date: 1 January 2001
Author(s): Sam Perkins, Neil E. Thornberry
Product number: BAB114

As the new millennium dawned, many old economy companies faced the challenge of transitioning into the Internet era, making 'Go Web or go dead' the common mandate. For John Kilcullen, CEO and publisher of IDG Books, the Internet offered an opportunity to fashion a new business model based on recurring revenues rather than one-time transactions. Instead of just selling books, Kilcullen envisioned the IDG website as the locus of continuing education and information. This case chronicles the evolution of the 'Dummies' series of books within the structure of the huge IDG organisation, offering insights and discussion on what it takes to foster a successful corporate entrepreneurial climate.

Four Models of Corporate Entrepreneurship

Publication date: 1 October 2007
Author(s): Robert C. Wolcott, Michael J. Lippitz
Product number: SMR266

How can established organisations build successful new businesses on an ongoing basis? In their study of nearly 30 corporations as diverse as Google, DuPont and Cargill, the authors identified two dimensions under the direct control of management that consistently differentiated how companies approach corporate entrepreneurship. The first is organisational ownership: Will the primary ownership for the creation of new businesses be focused in a designated group, or will it be diffused across the organisation? The second is resource authority: Will projects be funded from a dedicated corporate pool of money or in an ad hoc manner, perhaps through business-unit budgets? Together the two dimensions generate a matrix with four basic models of corporate entrepreneurship: the opportunist, the enabler, the advocate and the producer. In the opportunist model (example: Zimmer Holdings), the company has no deliberate approach to corporate entrepreneurship, and new businesses are built mainly from the grassroots efforts of a few 'project champions'. Enabler companies (example: Google), provide funding and senior executive attention to prospective projects. In the advocate model (example: DuPont), the company strongly evangelises for corporate entrepreneurship, but business units provide the primary funding. Lastly, producer companies (example: Cargill), establish and support a full-service group with a mandate for corporate entrepreneurship. Each of the four models has a different objective, function and set of challenges. Whichever model is chosen, the crucial thing to remember is that corporate entrepreneurship needs to be nurtured and managed as a strategic, deliberate act.

Business Team at Rubbermaid Inc

Publication date: 10 March 1997
Author(s): Teresa M. Amabile, Dean Whitney
Product number: 897165

Rubbermaid, a consumer-products company widely praised for its innovation, has instituted a company-wide experiment to stimulate innovation even further. The experiment consists of creating small cross-functional business teams within each division, with each team being responsible for the creation, management and profitability of a particular product line.

E-Government Entrepreneurial Mind-set Tool – A Self-Assessment for E-Government Leaders

Publication date: 1 March 2002
Author(s): Lynda M. Applegate and Susan Saltrick
Product number: 9-802-176

This case enables students to assess their personal (or organisation's) propensity to think and act like an entrepreneur.

ENDNOTES

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ENTREPRENEURIAL CASE ANALYSIS

INDIGENOUS TOURISM ON AN AUSTRALIAN ISLE

PART 4

Professor Dennis Foley, University of Newcastle, Australia

This is a case study that is based on several real participants. Their stories have been rolled into one and the facts generalised to some extent to ensure that their identity and privacy is protected. It is based on an island off the coast of New South Wales.

John and Robyn moved from a regional city to start a new life together. Their kids were off their hands and they wanted to move back close to wider family and the traditional homeland of their people. After long negotiation with family and community members they moved to a potentially idyllic site on a headland some 15 years ago. At the time, it was a rubbish dump but on a picturesque location – a rugged rocky outcrop flanked by beautiful beaches on both sides. They could envisage the potential of tourism as supplementary income and perhaps their sole income one day.

After months of backbreaking work and modest beginnings, they started renting out a caravan, locating it on a site under overhanging trees that faced a small beach. Within a short time, by word of mouth and a modest sign on their fence, they had a steady flow of visitors in summer enjoying their hospitality and renting out their on-site van.

By bootstrapping cash flow, within a year they purchased another second-hand van and placed it in a neighbouring position that gave elevated views over the headland and nearby beach. Demand grew such that they had to create several non-serviced campsites, each nestled into natural bushland ensuring privacy and sweeping views over the bay or beach. With increased patronage came demands for better services, which saw them use their savings as well as drawing on available credit cards to build a kitchen and provide an ablution block.

Winter came with reduced patronage and cash flow. Problems began to arise as all their money was tied up in the new facilities; there were no cash reserves for essential maintenance. John was forced to find a construction job at low wages to supplement their current situation.

TROUBLES ARISE AT THE BANK Winter brought severe storms, their bootstrapping ensured that maintenance on the vans was not kept up to date and both suffered severe water damage. There were no funds to repair the damage at the start of the new season and they knew they were in trouble when they had to refer clients to other businesses.

They went to the bank, which was located nearly three hours' drive away. They confronted their first hurdle in their business expansion plans: The bank was less than friendly to them. Was this racism as they are both Indigenous, or was it because all their capital was already tied up in existing infrastructure? Or was it because the fledgling tourism venture was on tribal land that did not have a clear title so it could not be mortgaged to the bank as security? Or was it their lack of sustainable cash flow and additional assets that could be used as collateral? Perhaps it was a combination of all of these issues.

John was frustrated and was short-tempered with the banker in no uncertain terms as he and Robyn could definitely see the potential of the business if given a small loan. He simply could not understand the banker's negativity. Why could he not understand their situation and be compassionate? Another downside was that this was the only bank in town.

So they struggled through that summer, first fixing one van then the other to ensure occupancy could be maintained at a suitable rate.

A BRILLIANT NEW IDEA They received a visit at Christmas from a cousin who told them of his neighbour around the coast who had recently extended his house to provide bed and breakfast-style accommodation with a strong Indigenous cultural flavour. At the time this was unique and the neighbour also had built a small bunkhouse for backpackers that was a growing industry. John thought, 'Hey, we have the basic infrastructure on site, so how much would we need in capital to do something similar?' He visited the operator around the coast who also happened to be Indigenous and was

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the operator that John and Robyn had referred their bookings to when their vans were out of operation.

After working out the capital expenditure required and how it would interrupt with his existing modest household, John realised a B&B was too expensive to set up and he did not have the capital. He still wanted guests to be able to cook their own meals and the existing facilities he had built could cope with increased patronage and expansion.

However, the backpacker bunkhouse was a good idea. Soon he calculated the cost of building a modest bunkhouse onto the existing kitchen that would provide a high level of facilities. Working two jobs (one at nights), together with loans from his family and the help of the other operator from around the coast, he built the bunkhouse, extending it up into a large and very old tree. It gave a mystical impression in the arbour with its rustic appearance and was built mostly from recycled timbers. Construction was undertaken over the winter months with the help of family and other operators keen to learn more.

On the advice of his cousin's neighbour, John and Robyn joined an international backpacker organisation, connected to the Web, got another cousin to help design a webpage to help with bookings and were ready to start operating. However, due to their isolation, limited technological skills and slow computer hardware, it took forever to send and receive emails. There had to be a better way.

SETTING UP AN INDIGENOUS TOURISM ASSOCIATION John organised a luncheon of local seafood, invited all the Indigenous business owners within a 100 kilometre radius, and allowed them to discuss their problems. It was soon realised that the networking ability of the Indigenous operators brought more business collectively within the group than did referrals from outside non-Indigenous tourist operators.

From that day on they began networking more closely, marketing each others' attributes to ensure competition and strengthening diversity. They also helped each other in knowledge of alternative energy, wind and solar power adaptation, how to access and purify local spring water for their businesses and how to build self-composting toilets to limit pollution and human waste. Each carried a stock of the other's brochures to ensure that tourists would experience more than just one operator in the journey through their lands.

SPOTTING NEW MARKET NICHES When they met with the other Indigenous operators, John could see the need for not only a reliable bus service but also a reliable courier service. He traded in his old truck for a 22-seater Toyota bus, took out half of the seats, had a cargo mesh wall installed and then began a daily service picking up guests, transferring them and picking up and delivering essential cargo. In a short time, he also was awarded a mail contract which ensured the viability of the service. In summer he had to put on an additional bus, which he hired at inexpensive rates from a cousin. This developed into short cultural tours where guests stayed at two or three Indigenous backpacker resorts experiencing a unique cultural exposure in remote locations without the trappings of the tourist industry.

John was already known as a legendary fisherman in his region, having been given the knowledge of the reefs and the sea trenches from his ancestors. A well-respected man within Indigenous circles, John owned a small boat and would occasionally take a tourist fishing when the sea was calm. One of his passengers turned out to be an 'angel investor'. He convinced John that if he only had a suitable vessel, he could take groups of international fishermen out to the reefs and they would pay handsomely for the experience. So began his fishing operation, with the investor supplying the funds to purchase a purpose-built vessel which could be launched from the beach and was able to withstand some of the roughest ocean waves.

When the boat arrived, a webpage was constructed and the business launched. Accommodation bookings doubled for certain periods and it seemed that the business was destined for success. The bunkhouse was completed and cash flow was positive. Small loans from family were quickly repaid and property maintenance now ensured the attraction was a showcase. They even built additional private upmarket 'motel'-style accommodation overlooking the beach and rocky headlands.

SUSTAINABILITY AND CULTURE OF THE REEFS AND FISHES The new Indigenous tourism association discussed the creation of game parks and sea parks. John had already stopped fishing and taking crayfish and shellfish from the small bay in front of his resort. Within a few years it developed markedly, enjoyed a rich biodiversity and now tourists could snorkel and see crayfish and many species of fish close to shore. Other

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operators soon followed suit, creating interesting dive sites near their businesses, which further diversified their operations.

Then a dilemma arose for the fishing business. John knew the reefs, knew the coastline and knew that other operators were on the verge of exhausting the fishing stocks around the Island. As an elder in his clan, he understood that it was critical to sustain the reefs, which would sustain his clan as well as the business that he set up. The only solution was to maintain strict catch limits to ensure the reef stocks and ensure that guests understood the cultural implications of sustainability.

Most of his clients warmed to the experience because their introduction to this new fishing practice became a cultural lesson in respect for the sea, the local Indigenous clan and the wider clans that had lived in this country for many generations. Tourists were thrilled to gain exposure to such cultural practices, which for most was a unique experience. Those that didn't like the environmental and cultural rules were advised of other operators who fished other species and did not follow sustainable practices.

WHAT TO DO NOW WITH THE FAMILY BUSINESS? Fifteen years later, the boat, tractor and the bus are all paid for. There is no outstanding debt. Although money is tight, John and Robyn enjoy a good lifestyle. Although their businesses are susceptible to seasonal fluctuations, low visitor numbers in winter allow the operators to catch up on their cultural and family obligations.

Now John and Robyn are getting tired and are thinking of retiring. But they have all their savings and resources tied up in backpacking, camping, renting on-site vans and motel-type lodges on a site that is tribal land. Their fishing business cannot be sold due to the sustainable knowledge that is based on Indigenous lore. To safeguard traditions, only the boat and tractor can be sold, and they are showing wear and tear. The transport/bus business is successful based only on Indigenous networking, so there is a limited market of buyers.

DISCUSSION QUESTIONS

Remember that you are three hours from the nearest major town and suffering limited access to technology and no electricity grid access, town water or sewerage.

1. Have these entrepreneurs created businesses that cannot be on-sold?
2. What steps should John and Robyn have taken in the initial planning of their business and what should they do in retirement?
3. Is bootstrapping a successful way to finance a business?
4. When the Indigenous operators first got together, what were the positives and negatives of this interaction?
5. How sustainable can entrepreneurs be?
6. What would you have done to better diversify this small husband-and-wife tourism operation?